Smith & Williamson

A guide to enterprise investment schemes

Are you eligible?

Enterprise investment schemes (EIS) were introduced in 1994 to help provide unquoted companies with capital to aid their development. Unlike venture capital trusts, EISs are unquoted investments and offer a variety of tax reliefs to compensate for the higher level of risk taken by the investor.

Who are the schemes appropriate for?

Those who:

- are prepared to accept a high level of risk
- are prepared to accept the risks of crystallising a capital loss
- are happy to tie up capital for at least three years or often longer
- have significant income tax liability (at least a 40% tax payer)
- have capital gains to defer
- have significant income together with a potential inheritance tax (IHT) liability
- have already used more mainstream tax efficient investments, such as pensions and NISAs
- are unable to make any further pension contributions.

In order to qualify for EIS relief an investee company must undertake a qualifying trade. There are a number of trades excluded such as property, financial services, commodities and, more recently, all energy generation activities.

There are strict limits on the size of investee companies, with gross assets limited to £15m immediately prior to the EIS investment and £16m immediately afterwards. The company must also have fewer than 250 employees at the time of the EIS investment and have raised no more than £5m aggregate from SEIS, EIS and VCTs in the preceding 12-month period ending on the date of the investment.

Following changes to legislation in Autumn 2015, there is now a £12m lifetime cap on the total venture capital investment a company can receive (a £20m cap applies to knowledge intensive companies). In addition the number of employees permitted is increased to less than 500 for knowledge intensive companies.

Tax relief

EIS investments attract income tax, capital gains tax (CGT) and IHT relief.

Income tax

- Income tax relief – Individuals will receive a credit against their income tax liability in the tax year of subscription equal to 30% of the amount invested. There is an annual maximum of £1m on which relief can be claimed, but with scope to have shares treated as if acquired in the previous tax year up to the unused limit for that year. This relief is contingent upon a minimum holding period of three years, or if later, three years from the commencement of a trade. This limit will increase to £2m provided that any amount above £1m is invested in knowledge intensive companies.
- Income tax loss relief – If, upon eventual realisation of the EIS shares a capital loss has been incurred, a claim for income tax relief can be made against the net cost of the original investment taking account of the income tax relief received at that time. Any loss is deducted from taxable income and relief will be at the investor's marginal rate of income tax.

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Capital gains tax

- Capital gains tax (CGT) deferral – Individuals are able to defer a capital gain that crystallised between three years before and one year after the EIS investment. The relief is not dependent upon the individual claiming the EIS income tax relief and the gain will be brought into charge on disposal or earlier cessation of EIS qualification.
- CGT exemption – Any capital gain realised by the sale of shares in an EIS company is not liable to CGT if the shares have been held for at least three years, or if later, for three years from the commencement of a trade, and the EIS income tax relief has been claimed and not withdrawn on those shares.
- CGT losses – Any losses realised by the sale of shares in an EIS company are allowable against CGT (or claimed as a deduction against taxable income – see above).

Inheritance tax

- Most EIS qualifying investments also meet the requirements for business property relief and an EIS investment would usually fall out of an individual's estate for inheritance tax purposes once held for a period of two years.

Realisation of investment

As these investments are unquoted, it will often be very difficult to sell shares prior to the eventual exit from the EIS. The minimum period of investment is three years. The exit route will obviously depend upon the EIS manager and the underlying company but could include a trade sale or potential listing. As dividends are not paid tax free, it is unlikely these will be received during the period of investment.

Claiming tax relief

Tax relief should be claimed via the self-assessment tax return but this can only be done, subject to the company meeting certain filing requirements, once you are in possession of EIS 3 Certificates.

An EIS 3 Certificate can be applied for from HMRC once the investee company has been trading for a period of four months. If certificates are not received in good time, any income or CGT due at that point will have to be paid and a subsequent submission made to HMRC for a credit against the next payment on account or refund once the certificates have been received.

The investor can claim EIS relief no later than the fifth anniversary of the self-assessment filing date for the tax year in which the shares are issued, or treated as being issued if a carry back claim is made.

Risks

Investors should be aware of the following risk factors.

- EIS are high-risk investments and you could lose a substantial proportion, or all, of your investment.
- EIS investments are in unquoted companies where the risk of failure is high in the early years. You could lose a substantial proportion, or all, of your investment.
- The minimum holding period to continue to benefit from the associated tax relief is three years, but investors should be prepared to tie capital up for a period of at least this, and generally, potentially much longer.
- As these investments are unquoted, they are illiquid and are unlikely to be easily realisable.
- HMRC are entitled to raise an enquiry or challenge the EIS status of this investment and thus there is the potential to lose the associated taxation benefit these investments seek to provide.
- If EIS 3 Certificates are not received in good time, any tax due will have to be paid by the investor, and subsequently repaid.

For more information please contact us
or your usual Smith & Williamson adviser.

Andrew Cunnington, Director
t 020 7131 4448
e andrew.cunnington@smithandwilliamson.com

Nick James, Director
t 0117 376 2101
e nick.james@smithandwilliamson.com

Important information

Tax legislation is that prevailing at the time, is subject to change without notice and depends on individual circumstances. Clients should always seek appropriate tax advice from their financial adviser before making financial decisions.

Capital at risk. The value of investments and the income from them can fall as well as rise and the investor may not receive back the original amount invested.

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