Enterprise Investment Scheme (EIS)

The enterprise investment scheme (EIS) is a government initiative designed to encourage growth in new companies by rewarding investors in such companies through a variety of tax reliefs, such as tax free capital growth, income tax relief, loss relief and CGT deferral relief.

What is an EIS eligible company?

- It is an unquoted (at the time shares are issued) trading company and has a UK permanent establishment
- It carries on a qualifying business activity: there are prohibited trades which include farming, market gardening, property development and financial trades
- The company assets must not exceed £15m before the share issue and £16m after
- The number of full time equivalent employees must not exceed 250 (499 for knowledge-intensive companies)
- The money raised from the share issue must be used for the purpose of the qualifying business activity within two years from the issue of the shares or commencement of the qualifying activity (if later)
- It must not be in financial difficulty
- The company must be less than seven years old (ten for knowledge-intensive companies) for shares issued on or after 18 November 2015 (although, there are exceptions if further conditions are met)
- Within the period 12 months before and three years after the subscription for the EIS shares, it must not be under the control of another company and must only have qualifying subsidiaries (broadly, more than 50% of shares owned by the parent and not controlled by another company)
- The maximum EIS subscription for any 12 month period is £5m per company (and its subsidiaries). However, from 6 April 2018 this limit will be increased to £10m for knowledge-intensive companies.
- There is a lifetime limit on the total amount of relevant investments a company may receive. The limit is £12m for most companies and £20m for knowledge-intensive companies.

Income tax relief

If eligible, an individual may be entitled to income tax relief on subscription for EIS shares. This is available as a tax reduction for the tax year of subscription. Although the relief can only reduce the tax liability for the year to nil, it can be carried back to the previous tax year.

The tax reduction is 30% of the lower of the initial subscription or £1m. From 6 April 2018 this limit will increase to £2m provided any amount over £1m is invested in one or more knowledge-intensive companies. Therefore a subscription of £1,000 would effectively only cost £700 after the income tax relief.

The shares must be owned for three or more years (from the later of the date of subscription or date the qualifying trade commenced) otherwise the relief is withdrawn. Any clawback is assessable in the tax year of relief. The relief withdrawn is the original income tax reducer, or, if the shares are sold at a loss, the clawback is 30% of the sale proceeds.

An individual is eligible for relief if:

- The shares are subscriber shares and are issued before 6 April 2025
- The individual is not connected to the issuing company within the period two years before and three years after the issue of the shares.

Broadly, connection means that the individual (including any associates) is not an employee/director and does not hold more than 30% of the share capital.

- An investor (or an associate) does not receive a loan that is linked to the subscription within the period two years before and three years after the issue of the shares.
- The individual must not hold any other shares in the company or its qualifying subsidiaries unless they are 'founder shares' (shares issued on incorporation) or 'risk finance investments'.
- The subscription must not be made as part of a tax-avoidance scheme

Associates for these purposes are spouses, civil partners, children, grandchildren and parents. Brothers, sisters, nephews, nieces, uncles, aunts, cousins, stepchildren and other relatives acquired by marriage or civil partnership are not associates.

In particular circumstances, directors can still be eligible for relief even if they are 'connected' to the issuing company if they are unpaid and are not involved in the day to day running of the business. Directors in this situation are commonly known as 'business angels'.

Capital gains tax deferral

If an individual has subscribed for qualifying EIS shares, he or she can defer the gain on the sale of any asset so long as the individual is resident in the UK and the gain arose in the 12 months before and three years after the subscription for the EIS shares.

The claim must be made no later than five years from 31 January after the end of the tax year the shares were issued.

Unlike the income tax relief, CGT deferral relief is not withdrawn where the individual is 'connected' with the issuing company.

The deferral amount is the lower of:

- The gain
- The investment in the EIS shares
- Any other amount specified, i.e. to utilise annual exemptions and losses.

The gain becomes chargeable on the earlier of:

- Sale of the EIS shares
- The year EIS shares cease to be eligible, and
- The year the taxpayer becomes non-UK resident, but only if this is within three years of the EIS share issue.

If only a proportion of the EIS shares are sold, only a proportion of the deferred gain will come back into charge at that time.

Sale of the EIS shares

Any gain on the EIS shares themselves is exempt from CGT provided they are held for the full qualifying period, and income tax relief was obtained on subscription. This allows tax free capital growth so long as the shares have been owned for three or more years.

If a loss is made, the loss will be allowable regardless of the ownership period, although it will be restricted by any income tax reduction that has been given.

A claim can be made for any loss on the sale of the EIS shares to be set against income of the current or previous year.

EIS and business property relief

If the shares are held for more than two years and are still held at date of death, they should be eligible for 100% business property relief (BPR), meaning that inheritance tax is not payable on the value of the shares in your estate.

EIS investment platform

There are specialist firms that invest in EIS companies, which aim to control risk through diversification. The companies they invest in are formed around realistic business models and target steady levels of growth. Liquidity of these investments is dependent on the underlying business model adopted by each provider and investors should be aware that the exact timing of sale and the ultimate value of their investments cannot be guaranteed.

Risks

Please note that EIS investments do place your capital at risk and you may not get back the full amount that you invest. EIS shares may also be difficult to sell. The tax treatment depends on individual circumstances and may change in the future, and tax reliefs depend on the EIS company maintaining its qualifying status. The EIS scheme is directed at raising investment in smaller companies, which is considered a high risk investment because they have a higher failure rate than more established businesses. If you sell your EIS shares before the end of the three year minimum holding period, you will have to repay any income tax relief you have claimed. EIS products may not be suitable for everyone and it is important that you fully understand the risks involved. We recommend investors talk to an independent financial adviser before making any investment decisions.

How can we help?

The EIS legislation is complicated and this factsheet only provides a broad overview of the relief, therefore care should be taken with regard to eligibility and the application of the rules. Please speak to your usual PKF Francis Clark adviser, who will be more than happy to provide you with any assistance or additional information you may require.

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