



Enterprise investment scheme (EIS)

The EIS is a government scheme that allows certain tax reliefs for investors who subscribe for qualifying shares in qualifying industries.

What benefits does the Enterprise Investment Scheme provide the investor and companies wishing to raise new finance?

The investor

The investor can expect:

- Income tax relief at the 20% rate of tax on the amount invested in qualifying investments of up to £500,000 per annum. The EIS relief may be withdrawn if certain events occur within three years, e.g. shares sold
- Any gain arising on a disposal of the shares after three years to be free from capital gains tax
- Deferral of capital gains (no limit) on any other assets, by reinvesting all or part of the gain into an EIS company within one year before, or three years after, the gain accrued. The deferred gain becomes chargeable to capital gains tax if certain events occur later
- Relief for any losses made on the disposal of EIS shares against capital gains tax or, in some circumstances, income tax
- The opportunity to participate in the running of the business and to receive reasonable remuneration for doing so

As a result of the above, an individual could have a total tax saving and deferral of 60% of his investment.

The qualifying company

- The company can enjoy the opportunity to raise finance, either for initial start-up or for expansion

For shares issued after 6 April 2006 and where shares were subscribed to after 22 March 2006, the main condition is that the scheme be limited to companies with gross assets of less than £7 million before, and no more than £8 million after, the investment. For shares issued after 18 July 2007, the company must have fewer than 50 full time equivalent staff. Please contact us for shares that fall outside of these criteria.

Outline of the scheme rules

Throughout its relevant three-year qualifying period, the company must:

- Be an unquoted company
- Have only fully-paid issued shares
- Be a trading company, carrying on a qualifying trade, wholly or mainly in the UK
- Exist for genuine commercial purposes, and not be part of a scheme for the avoidance of tax
- Not be a 51% subsidiary of another company, or otherwise be under the control of another company

In addition:

- An investor cannot be 'connected' with the EIS company, i.e. he or she cannot own more than 30% of the shares, directly or indirectly
- Individuals who are paid directors or employees of the EIS company at the time of the issue of shares are normally disqualified from claiming EIS relief. Otherwise, qualifying investors can in certain circumstances be paid for their work, provided the total remuneration package is 'normal and reasonable'
- The money raised by the EIS share issue must be wholly used for the qualifying business activity
- Schemes that involve guarantees or exit arrangements will not attract tax relief

Qualifying trades

The definition of qualifying trades is quite extensive, but certain activities (such as most dealing operations, banking, leasing, legal, and accounting services) are specifically excluded, as are those considered to be 'asset backed' (farming, forestry, property development, hotels, and nursing homes). From 2008 excluded activities also include shipbuilding and steel or coal production.

Spreading your risk

Investors who do not want to put all their eggs into one basket could consider an EIS approved investment fund or a Venture Capital Trust (VCT).

Approved investment funds are collective investment vehicles employing a fund manager to invest subscribers' money in qualifying companies. The fund manager brings together the total investment of a number of investors over a number of companies.



Conclusion

The scheme is becoming more and more popular, and currently there appear to be more potential investors than there are opportunities. As may be expected, the tax breaks have been introduced by the Government to encourage would-be investors in what, given the nature of the investment companies concerned, must be inherently risky ventures. However, readers with an entrepreneurial spirit, surplus cash, and the appetite for a healthy payback, may be interested to learn more.

For further information contact the Employment Taxes team on 01223 728222 or email EmploymentTax@pem.co.uk