



# The Enterprise Investment Scheme (EIS)



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# The Enterprise Investment Scheme (EIS)

Start-up and early stage enterprises will often find that bank funding is not available to them. For these companies business angel investors can be a very useful source of funds. There are generous tax breaks available to investors under the Enterprise Investment Scheme ('EIS'). This Fact Sheet gives information on EIS. The purpose of EIS is to encourage investment in small higher-risk unquoted trading companies. It does so by providing Income Tax and Capital Gains Tax ('CGT') reliefs for investors who hold qualifying shares in these companies.

## 1. The Reliefs Available Income Tax Relief ('ITR')

ITR is only available to investors who subscribe for shares in a 'Qualifying Company' (see below):

- There is a minimum investment of shares worth £500 in any one company in any tax year;
- Relief is 30% of the cost of the shares, to be set against investor's Income Tax liability for the tax year in which investment made;
- There is a maximum relief of £500,000 (£1,000,000 from April 2012) invested in such shares, giving a maximum tax reduction per year of £150,000;
- The tax relief is withdrawn if shares are not held for three years from the date they were issued, or if the qualifying trade started after the shares were issued, the period is three years from the date trade started ('the Period'); and
- ITR may only be claimed by individuals who are not 'Connected' (see below).

## Capital Gains Tax exemption

- Gains made on the cost of the EIS shares at disposal are exempt from CGT (as long as ITR has not been withdrawn);
- Relief is also given for any allowable losses on the disposal of EIS shares, (less any Income Tax relief already claimed on those shares) against either income or chargeable gains.

## Capital Gains Tax Deferral Relief ('CGTDR')

This is available to individuals and some trustees. Payment of tax on a capital gain can be deferred where the

gain is invested in shares of an EIS Qualifying Company.

- The gain may arise from disposal of any kind of asset;
- Investment must be made within the period 1 year before, or 3 years after a gain arose;
- There is no minimum or maximum amount for deferral;
- The investor may be connected to the company;
- Unconnected investors may claim both ITR and CGTDR; and
- There is no minimum period in which shares must be held, deferred capital gain is brought back into charge whenever the shares are disposed of, or are deemed to have disposed of under EIS legislation.

## 2. Qualifying Company

The company must satisfy HMRC that it is a Qualifying Company:

- It must be unquoted at time of issue;
- It must not be controlled by another company, except where the controlling company in question is a new holding company, (as long as all shares in the old company are exchanged for shares of the same kind in the new holding company);
- The Company may have subsidiaries, but they must be qualifying subsidiaries (i.e. the Company has more than 50% of the ordinary share capital of the subsidiary, and it is not controlled (by other means) by another company;
- The Company must be a 'small company' (where gross assets of the company/group must not exceed £7 million immediately before any share issue and £8 million immediately after issue). Additionally, it must have less than 50 full-time employees at the time the shares were issued.

From April 2012, the restriction on the number of employees will increase to 250 and the value of gross assets before investment will rise to £15 million (subject to state approval).

The company must be carrying on a 'Qualifying Trade', (or the parent company of a trading group does). A trade will not qualify if excluded activities amount to a large proportion of the trade. Some of the excluded

activities include: property development, leasing or letting assets on hire, financial activities and managing nursing homes.

## 3. Who is able to claim EIS Relief?

Investors are not eligible for Income Tax relief on the cost of shares if they are 'Connected' with the company. They could be connected in either of two ways:

### (i) Connection by financial interest

- The investor is Connected if he controls the company, or holds more than 30% of the share capital/voting rights; and
- These conditions apply throughout the period beginning two years before the issue of shares and ending three years after the issue (or three years after commencement of trade, if that followed the share issue). Therefore, if an investor takes a 10% stake and is given Income Tax relief then a year later takes a further 25% stake he has become connected and the relief will be withdrawn.

### (ii) Connection by employment

- If the investor is a partner, director or an employee of the company then they are connected, neither are they eligible for relief if their associate is connected, (however, see below with regard to the Business Angel exception);
- This restriction applies not only at the time the shares were issued but to the two year period before shares were issued and the three years after the issue (or three years after commencement of trade if that followed share issue).

### (iii) Business Angels

Relief is available for Business Angels, to be classified as a Business Angel:

- The investor's only connection with the company at the time of the investment is as a director who receives no remuneration (and is not entitled to such remuneration); and
- The investor must not have been previously involved in carrying on the trade which the company is carrying on at the time the shares are issued.

EIS relief is not withdrawn if the investor subsequently becomes a paid director,

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providing that remuneration is reasonable.

The investor may claim Income Tax relief on investments made after becoming a paid director, provided shares are issued during the Period.

A key point to highlight is that relief is not available where an investor's debt is converted into shares.

For further information see Everyman Legal's Business Angel pack.

#### 4. Relief reduced / withdrawn

##### (i) Tax relief will be withdrawn if during the Period:

The investor or an associate becomes connected with the company; and/or  
The company loses its qualifying status.

##### (ii) Tax relief will be reduced or withdrawn if during the Period:

Any of the shares are disposed of;  
The investor receives value from the company e.g. receiving a loan or benefit from the company; and  
The company repays or repurchases its own share capital from any shareholder.

#### 5. When to use money?

Any money raised can be used for the purpose of an existing Qualifying Trade

or for the purpose of preparing to carry on such a trade;

- If preparing to trade, must start within 2 years of the shares being issued;
- Alternatively could be used for Research and Development intended to lead to a Qualifying Trade. Again however, this must be used within 2 years of the shares being issued (or 2 years of trade commencing if later).

#### 6. The Process

Initially the company (or it's Solicitor) completes Form EIS1 (available at: <http://www.hmrc.gov.uk/forms/eis1.pdf>) ; this is then sent to the Company's specific Small Company Enterprise Centre (HMRC).

If this is successful HMRC will then issue a Form EIS2 to the Company. This authorises the Company to issue an EIS3 Certificate. This certificate confirms the investor is entitled to the relief. The investor should complete the claim form (attached to the certificate) and then send it to his HMRC office. They will either adjust the investor's PAYE code, agree to offset the relief against any tax liabilities or make a tax repayment.

#### 7. Matters to be certified

The form EIS1 requires the investor to

declare the following:

- The trade of the company (or its R&D) has been carried on for 4 months;
- The shares issued were wholly for cash and were fully paid up at time of issue;
- The shares are ordinary and at no time since being issued have carried any preferential rights;
- The shares were issued for genuine commercial purposes (not merely for tax avoidance)
- For shares issued on or after 22 April 2009, the money raised by the issue of the shares has or will be employed within the period;
- From the date of issuing the shares, the company was unquoted

These reliefs can be valuable; however, they do require careful planning as over time the legislation has become increasingly complex. Tax advice should be taken from your accountant or other tax advisor.

It is not possible to highlight all of the relevant rules of the scheme here. If, however, you are interested in EIS, please do contact us for further information.

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