ENTERPRISE INVESTMENT SCHEME

The Enterprise Investment Scheme (EIS) provides a means for small companies to raise capital funds from private investors. Those investors are provided with certain tax incentives for investing in what are traditionally more risky businesses.

COMPANY

What sort of company can use the Scheme?

The company must be unquoted at the time the shares are issued. Unquoted means it cannot be listed on the London Stock Exchange or any other recognised stock exchange (the Alternative Investment Market (AIM) is not considered to be a recognised stock exchange).

In addition, the company must meet the following conditions:

- It must not control another company without that company being a ‘qualifying subsidiary’ (i.e. the company must have more than 50% of the ordinary share capital of the subsidiary).
- The company must not be controlled by another company and there must not be any arrangements in existence at the time EIS shares are issued that could result in this occurring.
- The gross assets of the company cannot exceed £15 million immediately before any share issue and £16 million immediately after that issue.
- It must have fewer than 250 full-time employees at the time of issue.
- It can be either a company carrying on the qualifying trade or the parent of a trading group.

There is no requirement that the company is resident in the UK, but for shares issued on or after 6 April 2011, the company must have a ‘permanent establishment’ in the UK:

- It has a fixed place of business in the UK through which the company’s business is wholly or partly carried on; or
- An agent acting on or behalf of the company has and habitually exercises their authority to enter into contracts on behalf of the company.

Companies which benefit from DECC Renewable Obligations Certificates or Renewable Heat Incentive subsidies are prevented from also benefiting from investment via EIS.

How much can the company look to raise?

Companies are not allowed to raise more than £5 million in total in any 12 month period.

- This applies to all funds raised under venture capital schemes, including EIS, the Seed Enterprise Investment Scheme and Venture Capital Trusts).
- If any share issue breaks the limit, none of the investors in that issue will be able to claim tax relief.

What can the funds be used for?

The money raised by the share issue can be used either for the purpose of an existing qualifying trade or for the purpose of preparing to carry on such a trade, including research and development (R&D) intended to lead to such a ‘qualifying trade’ being carried on.

- Funds must be used for the trade or R&D within two years of the shares being issued (or within two years of the trade commencing if that is later).
- If these requirements are not met then investors will not be eligible for relief on the cost of their shares and any relief given will be withdrawn.

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What is a qualifying trade?

The trade must be conducted on a commercial basis with a view to the realisation of profits. Most trades will therefore qualify. Those that do not are termed 'excluded activities' and include:

- Dealing in land, commodities or futures.
- Dealing in goods, other than in an ordinary trade of retail or wholesale distribution.
- Providing legal or accountancy services.
- Farming or market gardening.
- Shipbuilding.
- Coal production.
- Providing services to another person whose trade is substantially an excluded activity and who also controls the company providing the service.
- Financial activities such as banking and insurance.
- Leasing or letting assets on hire, except in the case of certain ship-chartering activities.
- Property development.
- Holding, managing or occupying woodlands.
- Operating or managing hotels and nursing homes.
- Steel production.
- Generating or exporting electricity which will attract a 'Feed-in Tariff' (subject to certain exceptions).

Note. The company can carry on some excluded activities but these must not be a 'substantial' part of the company's trade (HMRC take substantial to mean more than 20%).

HM Revenue & Customs approval

The Small Company Enterprise Centre (SCEC) administers the Scheme and decide if a company and a share issue qualifies.

- SCEC operates an advance assurance scheme whereby companies can submit details of their plans and the SCEC will advise on whether these are likely to qualify.
- Once shares are issued (irrespective of whether advance assurance has been given) the company must complete a form EIS1 and submit this to SCEC.
    - Forms cannot be accepted unless the company has been trading for at least four months.
    - The also cannot be accepted if submitted later than two years after the end of the year of assessment in which the shares were issued.
- If the SCEC approves this, it will issue a form EIS2 and supply sufficient forms EIS3 for the company to send to its investors so they can claim tax relief.
- The process is repeated each time the company issues shares it wishes to attract EIS relief for.

INVESTOR

The investment

All shares must be fully paid up in cash when they are issued:

- Shares must be full-risk ordinary shares and may not be redeemable or carry preferential rights in the event of a winding-up.
- There must be no arrangements at the time of the investment for the shares to be sold at the end of the relevant period.
- The shares may not be acquired using a loan made available on terms which would not have applied other than in connection with the acquisition of the shares in question.
- The shares must not be issued under any reciprocal arrangements, where company owners agree to invest in each other's company in order to obtain tax relief.

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What tax reliefs are available?

Income Tax Relief	• Relief is at 30% of the cost of the shares to be set against the Income Tax liability for the tax year in which the investment is made. • A maximum of £1 million can be invested. • All or part of the cost of the shares can be carried back to the preceding year for relief to be given in that year (subject to overriding limits). • The shares must generally be held for three years from the date of issue to avoid relief being withdrawn. • The investor cannot be connected with the company.
Capital Gains Tax exemption	• Gains on disposal are free from Capital Gains Tax (CGT) if Income Tax has been received on the cost of the shares (and not subsequently withdrawn) and the shares have been held for the required three years.
Loss Relief	• If shares are disposed of at a loss, you can elect for the amount of the loss (less any Income Tax relief given) to be set against income in the year of the disposal or income of the previous year.
Capital Gains Tax deferral relief	• Gains arising on the disposal of any kind of asset can be deferred when it is invested in shares of an EIS qualifying company. • The investment must be made within the period of one year before or three years after the gain arose. • There are no minimum or maximum amounts for deferral. • No minimum period for which the EIS shares must be held, but the deferred gain is brought back into charge on disposal of the EIS shares. • It does not matter whether the investor is connected with the company.

Connection with the company

You are not eligible for Income Tax relief if you are connected with the company.

Connected by financial interest	You are connected with the company if, in the period beginning two years before and ending three years after the issue, you: • Control the company; or • Hold more than 30% of the share capital or voting rights; or • Are entitled to more than 30% of the assets in the event of a winding up.
Connection by employment	You are connected if you are a partner, director or employee of the company (during the same period noted above).

There are limited circumstances where directors who are ‘business angels’ may qualify for Income Tax relief. This may be where the only connection with the company is as a director who receives no remuneration (and is not entitled to any) and they were not previously involved in the trade.

Summary of tax reliefs

Item	Unconnected	Connected
Income Tax relief on subscriptions	Yes	No
Capital Gains exemption on disposal of shares eligible for Income Tax Relief	Yes	No
Loss Relief on disposal of shares at a loss	Yes	In some cases
Capital Gains Deferral (unlimited)	Yes	Yes

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How to claim tax relief?

You cannot claim relief until the company sends you a form EIS3.

- Claim relief via the Tax Return for the year in which the shares were issued.
- If the shares were issued in a previous year and/or the claim is for CGT deferral relief, the claim part of the form EIS3 must be completed and sent to your tax office.
- Claims to relief can be made up to five years after the first 31 January following the tax year in which the investment was made.

When is relief reduced or withdrawn?

Tax relief will be withdrawn or reduced if during the three years from the date of issue:

- You or an associate become connected with the company.
- The company loses its qualifying status.
- Any of the shares are disposed of (unless to a spouse or civil partner).
- You or an associate 'receive value' from the company or someone connected with it. This might include receiving a loan or benefit from the company or the company selling an asset to you at less than market value (or conversely you selling it an asset at more than market value).

It is worth noting that if a company ceases trading as a result of going into liquidation, and the liquidation is for genuine commercial purposes, any Income Tax relief is not withdrawn.

EIS funds

Instead of investing directly in a company, you can also invest through an EIS fund.

- The fund will invest on your behalf in a number of qualifying companies.
- You remain the owner of the shares and the process for claiming relief is unchanged.