Enterprise Investment Scheme (EIS)

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What is the objective of the EIS scheme?
The Enterprise Investment Scheme is designed to help smaller higher-risk trading companies to raise finance by offering investors who subscribe for new shares in those companies a range of tax reliefs.

How does a company qualify as an EIS company?
To qualify for EIS investment, a company must meet the following conditions:

- The company must be unquoted and have a UK permanent establishment;
- The company (or its group) must carry on a qualifying trade (see below);
- The gross assets of the company must not exceed £15 million before the investment and £16 million after the investment;
- The number of full-time employees of the company must not exceed 250 or 500 for "knowledge-intensive" companies;
- The company must not be a 51% subsidiary of another company; and
- The company must not be in financial difficulty.

The maximum annual amount that can be invested in a company through schemes such as EIS is £5 million, and the maximum total amount that can be invested in a company through schemes such as EIS is £12 million, or £20 million for "knowledge intensive companies".

A "knowledge-intensive" company is one that is particularly focused on research and development or innovation and there are detailed conditions that need to be met for the higher limits to be available.

How does the investment need to be made?
An EIS investment must be in new ordinary shares which are not redeemable and which do not carry any preferential rights to assets on a winding up. A preferential right to dividends can be included but this right cannot be variable and it cannot give a right to a cumulative dividend.

Shares need to be subscribed for wholly in cash, and fully paid up at the time they are issued. A company must therefore have a bank account at the time the shares are issued to be able to receive the subscription money.

Time limits
A company must normally raise its first EIS investment within seven years of its first commercial sale, although there are some exceptions to this, and the time limit is extended to ten years for "knowledge-intensive" companies.

Can the company carry on any trade?
No – certain activities are "excluded" and for EIS relief to be available excluded activities cannot account for more than 20% of the company's trade. The following activities are "excluded" for EIS purposes:

- Dealing in land, commodities or certain futures;
- Dealing in goods, other than in an ordinary trade of retail or wholesale distribution;
- Financial activities, such as banking, insurance, money-lending, debt-factoring, or hire-purchase financing;
- Leasing;
- Receiving royalties or license fees;
- Providing legal or accountancy services;
- Property development;
- Farming or market gardening;
- Holding, managing or occupying woodlands, any other forestry activities or timber production;
- Shipbuilding;
- Coal or steal production;
- Operating or managing hotels or similar establishments;
- Operating or managing nursing homes or residential care homes;
- The subsidised generation or export of electricity, or the subsidised generation of heat, gas or fuel (to be extended from 6 April 2016);
- Making available reserve electricity generating capacity (to be extended from 6 April 2016); and
- Providing services to certain associated persons whose trade consists substantially of excluded activities.

Is there a requirement as to how the money is used in the EIS company?
The money raised through EIS investments must raised for the purpose of business growth and development and it must be used in the qualifying trade within two years.

Can anyone invest in an EIS company?
Except for the purposes of Capital Gains Tax Deferral Relief, the investor must not be "connected" with the company.

An investor will be "connected" with the company if he or she, either on his/her own or with associates, possesses or is entitled to acquire more than 30% of the issued share capital, voting power, or assets available on a winding up.

An investor will also be "connected" if he or she or any associates, is an employee or director of the company (with certain limited exceptions for directors).

In addition, if the investor already holds shares in the company, any new investment will only qualify for EIS if those shares are either shares that qualified for EIS or a similar scheme, or if the shares were original subscriber shares.

How does the Income Tax relief work?
A qualifying EIS investment will give rise to a reduction in the investor's income tax liability for the year of 30% of the amount invested, up to the annual investment limit.

The annual investment limit is currently £1,000,000, meaning the maximum income tax saving per year is £300,000.
EIS relief can only reduce the investor's income tax liability to nil, although an individual can elect for EIS investment in one tax year to be treated as if it had been made in the previous tax year.

Income Tax relief can be clawed back if the company fails to meet certain qualifying conditions throughout the three years from the later of the investment or the date the company starts to trade. It may also be clawed back if the investor becomes "connected" with the company, if the investor receives value from the company, or if the shares are sold, within the same three year period.

How does the Capital Gains Tax Deferral Relief work?
A capital gain on the disposal of any assets can be deferred if the amount of the gain is invested in qualifying EIS shares in the period from one year before the disposal to three years after the disposal.

A deferred gain will usually come back into charge when the EIS shares are disposed of and if the gain would have qualified for Entrepreneurs' Relief at the time of the original disposal it will also qualify when it comes back into charge.

Will there be a capital gain when I subsequently sell my EIS shares?
Where an investor received EIS Income Tax Relief on the subscription for shares, the subsequent disposal of those shares will be exempt from capital gains tax if two conditions are met:

- The shares have been retained for the three year qualifying period; and
- The EIS Income Tax relief has not been withdrawn.

What is the inheritance tax position in respect of the EIS shares?
Once a two year ownership period has been satisfied, shares will normally attract Business Property Relief at the rate of 100% and should therefore escape inheritance tax.

What if the company fails?
EIS investments are likely to be in more risky ventures and it is inevitable that some will fail. A loss made on EIS shares, after the deduction of any EIS Income Tax relief given and not clawed back, will be allowable either against capital gains or alternatively against taxable income.

As an example, an investment of £10,000 made in the 2015/16 tax year that fails (with no funds being repaid) in the 2016/17 tax year would give rise to the following tax consequences:

	£
Amount of investment	**10,000**
Income tax relief at 30% - not clawed back as no proceeds received on disposal	3,000
Capital loss	10,000
Less income tax relief not clawed back	(3,000)
Capital loss relievable against income or gains	7,000
Income tax saved on capital loss at 45%	3,150
Total relief	6,150
Net loss on investment on investment of £10,000	**3,850**

How can Kingston Smith assist me?
Kingston Smith offers a comprehensive service with the right advice at the right time to make sure that an investment is properly structured to attract EIS relief.

We can review your company and the nature of your trade and apply for advance EIS assurance that the company is a qualifying company conducting a qualifying trade.

Note that EIS relief is subject to withdrawal if either the company or the investor ceases to meet the eligibility requirements. We can help the company and investors make sure that these eligibility requirements do not cease to apply.

The above provides a brief summary of EIS relief and should not be relied upon without taking further advice. Please get in touch with our team if you would like to discuss aspects of EIS relief in greater depth or other related topics.

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