

Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) is designed to assist small and medium trading companies to raise finance by offering a range of tax reliefs to investors subscribing for shares in such companies. The rules are designed such that both the investee company and the investor must qualify before relief can be given.

Investment Limits

- The first £500,000 invested by an individual in any one tax year (£400,000 for the 2006/07 and 2007/08 years and £200,000 prior to that) will qualify for income tax relief and capital gains tax (CGT) exemption. Several subscriptions can be combined to meet these limits.
- Where shares are issued before 6 October it may be possible to treat half of the investment as having been made in the previous tax year. The total amount which can be carried back is however limited to £50,000.
- A minimum of £500 in any one company in any one tax year must be subscribed to qualify for the relief.

Who Qualifies

- Any individual who is not 'connected' with the company.
- Connection can be:
 - Employment
 - Partnership
 - Directors (although there are special rules for Business Angels).
 - Associate of one of the above (e.g. spouse, child or parent)
 - Owns/entitled to acquire > 30% of issued ordinary share capital, loan capital or voting power of the company
- Must be qualifying individual for two years prior to issue & three years after issue.

Eligible Shares

- New ordinary shares issued by a company for bona fide commercial reasons.
- Carry no preferential rights to dividends or assets on liquidation of the company.
- The shares must be fully paid up at the time of issue and they cannot be redeemable.

Qualifying Companies

- The funds raised must be used by the issuing company or by a qualifying 90% subsidiary in carrying out qualifying activities.
- The issuing company must be unquoted when EIS shares are issued (companies listed on AIM or the PLUS-quoted market are treated as unquoted for this purpose).
- The gross assets of a single company, or aggregate gross assets of a group, must not exceed £7m prior to investment nor £8m post investment (for shares issued before 6 April 2006 the limited were £15m & £16m respectively).
- Must have fewer than 50 employees.
- The company must be independent, it is not considered to be controlled by another company.

Business Activity

- Can raise a maximum £2 million from Venture Capital Trusts, the EIS or the Corporate Venturing Scheme in any 12 month period. However shares issued to Venture Capital Trusts on or before 5 April 2007 and EIS/CVS shares issued prior to 19 July 2007 are ignored for these purposes.
- A qualifying trade wholly or mainly in the UK during the three years from when the shares are issued.
- Research and development undertaken with the intention of starting a trade is also treated as a qualifying business activity.
- There are various excluded trades including dealing in land, financial activities, legal/accountancy services, leasing and certain property backed activities.

Tax Benefits

- 20% income tax relief - a credit against an individual's tax liability.
 - 20% of the sum invested subject to there being sufficient tax liability to absorb the relief. Maximum tax credit available to an individual is £100,000 in each tax year.
- No capital gains tax on disposal.
 - If a qualifying individual holds eligible shares for more than three years from the date of issue, then any capital gain on the disposal of the EIS shares after that period will be tax free.
 - If a loss arises on the disposal of EIS shares, that loss will be available to the investor. This relief can either be claimed as a capital loss or as a loss for income tax purposes.

Deferral of CGT

- CGT on a gain from the disposal of any asset can be deferred against an EIS share subscription.
- The tax on any gain rolled over in this way becomes due on disposal of the EIS shares or if the individual ceases to be UK resident within 3 years of issue of the shares.
- To qualify for deferral relief the investment must be made during the period one year before the realisation of the gain to three years after.
- The rules on connected individuals are disapplied for this purpose, and there is no upper limit on subscription.
- Deferral relief can be claimed by trustees as well as individual taxpayers

Other Points of Note

- EIS monies raised must be wholly applied in qualifying business activities.
- At least 80% of the funds must be applied within 12 months of the share issue, or where it is a new trade, within 12 months of the start date. Any remaining funds must be invested in the following 12 months.
- A disposal of EIS shares within three years of issue could:
 - Restrict or deny the EIS reliefs previously given.
 - Result in loss of CGT exemption.

Conditions for Retaining Relief

- The company must qualify for the whole three year period.
- Shares must be fully paid up when issued.
- If the individual investor becomes connected with the company during the relevant period, relief is withdrawn however;
 - investors can become directors of companies into which they have invested as long as they become directors after the issue of the shares. Such a position may be executive in nature and the individual may be remunerated accordingly.

The Operation of EIS

EIS is administered by HM Revenue & Customs. It is possible to obtain provisional advance assurance with regard to EIS qualification of a company from HMRC. This can be useful to show to potential investors.

Once shares have been issued – irrespective of whether advance assurance has been obtained, the company has to make a submission to HMRC for EIS clearance. This needs to be done within two years of the end of the year of assessment in which the shares were issued. Once the submission has been approved, certificates signifying this approval will be sent to the company for distribution to investors. Having received the certificate, the investor can claim EIS relief on his or her own tax return.

Summary

The rules and regulations covering EIS are complex and as a result this paper can only give general guidance to the EIS investment process. We recommend you take specific advice.

How we can help

We will be more than happy to provide you with assistance or any additional information required.

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For further information about James Cowper and how we may be able to assist you, visit www.jamescowper.co.uk