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WHAT IS EIS?



FOREWORD



Over the years, the Enterprise Investment Scheme has been able to help over 33,000 businesses raise over £24 billion.

The Enterprise Investment Scheme's (EIS) centrality in the equity funding market for Small and Medium Enterprises (SMEs) is demonstrated by the fact that it has survived famously volatile governments throughout that time, but it's also a testament to the scheme's importance in helping UK companies grow.

With the Chancellor recently stating that SMEs, "are the champions of small enterprises and the entrepreneur," more and more people slowly realise what the EIS industry has understood for years: SMEs and entrepreneurs are the core of the UK economy.

EIS fills a gap that allows needed capital to reach some of the least developed and most unexplored areas. The good news for investors is that there's an endless supply of high-quality businesses to support. More than ever before, an increased number of small businesses have the desire to scale up and grow quickly.

This guide aims to empower you with the knowledge you'll need to confidently and professionally invest in EIS eligible companies. We hope you find this guide both helpful and informative.



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OVERVIEW OF EIS

EIS is a long-running government scheme that aims to encourage investment in smaller businesses by offering valuable tax incentives to investors who subscribe to qualifying shares in EIS companies.

EIS promotes early-stage investment in smaller and younger UK businesses that show high promise and growth potential by using investor funds to help finance expansion and development.

The UK government provides investors with various significant tax reliefs in exchange for providing capital. This helps investors mitigate investment risks and increase the returns that may be achieved by investing in developing UK businesses.

With numerous tax “loopholes” being closed by the government, it's essential to remember that EIS is a non-aggressive scheme that Government continues to support. Investors benefit both small businesses and the economy by investing into EIS.

The EIS figures for funds raised are estimates based on a National Statistics publication produced by HM Revenue and Customs (HMRC) released on May 27, 2021, which shows that since the Enterprise Investment Scheme (EIS) was launched in 1994, 32,965 companies have received investment and around £24 billion of funds have been raised.



WHY THERE ARE 3 IMPORTANT REASONS WITH EIS



1 The Investor

By investing in EIS and helping small UK businesses, it's only fair that the investor should benefit from their investment.

Investors can benefit in several ways, including:

- Investing in small promising companies can provide large potential investment returns.
- Unlike many traditional investments, EIS investors benefit from a closer relationship with the company they invest in.
- There are numerous valuable tax reliefs available to investors. These can lower the risk of investing in a small business while increasing total earnings.

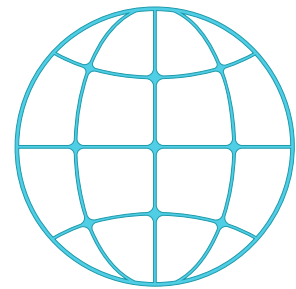


2 The Company

Small businesses have found it increasingly challenging to obtain traditional financing in recent years. Stricter lending standards, less support from banks, and broader limits on other kinds of finance mean that raising cash, no matter how good the company, can be challenging at times.

EIS offers British businesses a different way to fund their businesses. The funds raised can help with most aspects of development, such as creating new businesses, product launches, and entry into new markets.

EIS has contributed to the success of numerous businesses, both small and well-known.



3 The Country

The benefits EIS provides the UK economy and the country is why the government offers the tax benefits. Surprisingly, many people are unaware of these advantages.

Among the advantages are:

- Raising Income Tax and National Insurance from EIS company employees.
- EIS companies contribute to the Treasury through Corporation Tax, VAT, and other duties.
- Helping the economy grow.
- Helping create new British businesses and job opportunities.

TAX SUMMARY

Although the tax reliefs granted to investors by EIS are very generous, as the EIS is a government scheme, it's not considered an aggressive tax planning strategy. Current legislation provides tax incentives to encourage investment.

The following are the tax benefits offered to investors in companies that qualify for EIS:



Income Tax Relief

An individual's income tax can be reduced by up to 30% of the amount invested in qualifying EIS shares.

To avoid Income Tax relief being withdrawn, a qualifying investment must be held for at least 3 years from the date of issue (EIS), or for 3 years from the beginning of trade if later (EIS).

There is no minimum subscription per company, and an investor's maximum investment for which they can obtain Income Tax relief in any tax year is £1 million.

"Carry Back" - Individuals may elect for their share subscriptions (up to their maximum annual allowance) to be treated as if they were made in the previous tax year, effectively carrying Income Tax relief back one year. With EIS, up to £2 million can be invested, of which £1 million can be applied to the previous tax year.

Income Tax relief is restricted to the amount that reduces the individual's taxable income for the year to 'zero'.

CGT Exemption

No Capital Gains Tax is payable on the disposal of shares after 3 years, or 3 years after commencement of trade provided the initial Income Tax relief was given and not withdrawn on those shares.

The shares can be kept for much longer, allowing any CGT-free gain to accumulate over a longer period of time.

TAX SUMMARY

CGT Deferral

When an investor disposes of an asset that generates a capital gain, the capital gains realised can be deferred for as long as the EIS qualified shares are held.

The disposal of the asset that generated the deferred gain must have occurred within 36 months of the EIS investment's share issue date or before the 12 months of the EIS investment's share issue date. It and can be claimed by investors whose interest in the company is more than 30%.

Inheritance Tax Relief

After two years of holding the investment, shares qualify for Inheritance Tax relief up to 100%. This means that any Inheritance Tax liability for such shares is reduced or eliminated.



INCOME TAX RELIEF EXAMPLE

Example - Investing £10,000 in an EIS

Gross Total Initial Investment	£10,000
Less Income Tax Relief @ 30%	(£3,000)
Net Cost of Investment	£7,000

An individual who holds no more than a 30% interest in the company can reduce their Income Tax liability by up to 30% of the amount invested, provided they hold an EIS qualifying investment for at least 3 years from the date of issue of the shares, or 3 years from the date of commencement of trade (if later). There is no minimum subscription, and the maximum investment in EIS qualifying shares that qualify for EIS Income Tax relief in the current tax year is £1million.

Subscriptions may be treated as if they were made in the previous tax year provided their total claim, including any amounts already subscribed for in the last tax year, doesn't exceed the annual limits for the tax year in question.

For instance, an investor who has made no EIS investments in a tax year can make EIS subscriptions of up to £2 million in the next tax year and elect to carry back £1 million to the previous tax year to obtain Income Tax relief.

Individuals (including spouses and civil partners separately) are eligible for income tax relief for the total amount subscribed for eligible qualifying company shares. This relief is normally passed on to the investor in a tax rebate or via an adjustment in their PAYE code. The relief may only be claimed once the company has sent the investor Form EIS 3.



CGT (CAPITAL GAINS TAX) EXEMPTION EXAMPLE

Example - Investing £10,000 in an EIS

Gross Total Initial Investment	£10,000
Less Income Tax Relief @ 30%	(£3,000)
Net Cost of Investment	£7,000
Hypothetical Value of Investment after 3 years	£30,000
Tax Free Gain	£6,000
Total Tax Free Return to Investor	£9,000

The hypothetical values provided are for demonstration purposes only.

There is no CGT payable on gains in respect of investments made in an EIS Company (on which EIS Income Tax Relief has been obtained and not withdrawn) where the investments have been for a minimum 3 years from the date of the subscription (EIS), or from the date of commencement of the company's trade. Income Tax relief must be granted on shares to qualify for CGT Relief on disposal. If full Income Tax Relief isn't retained, partial CGT Relief on disposal may be available.

Worked Example

A higher rate taxpayer has a £100,000 capital gain on the disposal of their second home. The investor has already used their full annual CGT allowance. They invest £100,000 in EIS. The amount of the gain that can be deferred has no limit and is restricted only by the amount subscribed for EIS qualifying company eligible shares.

Gains may be deferred until the EIS qualifying shares are disposed of or when other events trigger withdrawal of the deferral relief if earlier. Once the EIS Company shares have been sold, the deferred gain will be subject to CGT in the year of disposal.

CGT DEFERRAL & REINVESTMENT RELIEF EXAMPLE

Example - CGT Deferral Relief & Reinvestment Relief

Gross Total Initial Investment	£10,000
Less Income Tax Relief @ 30%	(£3,000)
Net Cost of Investment	£7,000
Hypothetical Value of Investment after 3 years	£30,000
Tax Free Gain	£6,000
Total Tax Free Return to Investor	£9,000

With EIS, CGT on gains realised on different assets can be deferred if investors invest their gain into EIS qualifying shares.

To qualify for CGT, the investor must subscribe for EIS shares one year before or three years after selling or disposing of their assets that generated the gain being deferred.

It's unnecessary to claim EIS Income Tax relief to obtain deferral relief. A deferral relief is unlimited and can also be claimed by investors (individuals or trustees) whose interest in the company doesn't fail the 30% tests.

If the shares against which the gains are deferred are held until death, the deferred gain is never chargeable, so the deferral is definite.

There are several circumstances in which a chargeable event may occur relating to deferred gain resulting in the gains, becoming chargeable. Individuals and trustees should seek advice concerning events that could result in the withdrawal of relief.



CGT DEFERRAL & REINVESTMENT RELIEF EXAMPLE

Example - CGT Deferral Relief & Reinvestment Relief

Initial Investment	£100,000 Capital Gain Investment Through EIS
Income Tax Relief @ 30%	(£30,000)
Capital Gains Deferral (CGT 20%)	(£20,000)
Net Cost to Investor	£50,000

Shares Sold - Hypothetical Value

Hypothetical Return (2x on investment)	£200,000
Capital Gain	£100,000
Chargeable Capital Gain (if held 3yrs+)	£0,000

Deferred Gain Becomes Chargeable

Tax Payable on Deferred gain at 20%	£20,000
Net Profit on the Net Cost to Investor	£20,000



LOSS RELIEF EXAMPLE

Example - CGT Investment Deferral

Gross Total Initial Investment	£100,000
Less Income Tax Relief @ 30%	(£30,000)
Net Cash Outlay for Investment	£70,000
Net Loss if Investment fell to £0	£70,000
Loss Relief against income at 45%	£31,500
Net Loss	£38,500
Percentage of original outlay	38.5%

EIS shares that are sold at a loss (after taking into account Income Tax relief which is retained) are eligible for Loss Relief. The loss can be set against an investor's capital gains, income in the year of disposal or the previous tax year.

Depending on the investor's marginal income tax rate and if the shares become entirely useless, the net effect is to limit the investment exposure to as much as 38.5% in the £1 for EIS for losses offset against income.

Worked Example

An investor loses money on an EIS investment, the investments are worth nothing. The loss can be offset against Income Tax for the same year or the prior tax year. Alternatively, it can be offset against capital gains for the same year or carried forward to be offset against future gains, subject to the normal treatment of CGT losses.

Loss relief can reduce the investor's exposure to 38.5% or 27.5% of the original investment if the investor selects to off set the loss against Income Tax due for the current year, and assuming the investor pays Income Tax at a marginal rate of 45% and has sufficient income to offset the loss. It's assumed that Reinvestment Relief isn't claimed.



LOSS RELIEF EXAMPLE

Example - Loss Relief against Capital Gains Tax

Suppose the loss is offset against Capital Gains tax and assuming that the investor has enough gains to offset the loss. The loss can be claimed against capital gains for the current year or carried over and relieved against future capital gains. Capital Gains Tax is currently set at 20% (or 28% for UK residential property) for higher-rate taxpayers.

Gross Total Initial Investment	£100,000
Less Income Tax Relief @ 30%	(£30,000)
Net Cash Outlay for Investment	£70,000
If Investment fell to £0 net loss (relief at 28%)	(£19,600)
Net Loss	(£50,400)
Percentage of original outlay	50.4%

Thus, an individual with income subject to higher income tax rates will choose to balance the loss against income rather than capital gains if possible.



INHERITANCE TAX RELIEF EXAMPLE

Example -Inheritance Tax Relief

For Inheritance Tax purposes, shares in an EIS qualifying company usually qualify for Inheritance Relief. After 2 years of holding such an investment, relief can be up to 100%, indicating that any liability to Inheritance Tax is reduced or eliminated in respect of such shares. Example: An investor who has already used their full Inheritance Tax nil rate band invests £100,000 in cash EIS investments.

The example shows an EIS investment of £100,000, a cash holding of £100,000. It assumes that the investor is a higher rate taxpayer, that the investor's Inheritance Tax nil rate band is already fully used and that all other allowances have been used.

If the shares have been held for at least 2 years before death, the investment may be eligible for Inheritance Tax Relief up to 100%. With the other benefits of the EIS, the investment's effective cost may be considerably reduced

Initial Investment	Holding of Cash	EIS Investment
Total gross Initial Investment	(£100,000)	(£100,000)
Less income Tax Relief @ 30%		£30,000
Net Cash Outlay for Investment	£100,000	£70,000
Hypothetical Value of Cash and Cash from the EIS Tax Relief	£100,000	£30,000
Hypothetical Value of EIS Investment		£100,000
Less IHT on Cash Balance	(£40,000)	(£12,000)
Total Value left to Estate	£60,000	£118,000

*The hypothetical values are solely for illustration purposes only.

Because this example is about tax benefits, for simplicity, zero growth has been assumed on the EIS, and the cash. There is no clawback of the income tax relief or deferral relief on death. Thus, the total value passes to beneficiaries free of inheritance tax in this scenario. The estate is also augmented by income tax and the deceased's capital gains tax saved (there is no CGT on death).



TAX RELIEF and the INVESTMENT PROCESS

Tax Relief and the Investment Process

A typical timeline for an EIS investor in a single company is outlined below. The timeline shows the various stages involved and the order in which they occur.

The process for a fund or portfolio is the same. The main difference is that the investor would usually subscribe to the fund, and the manager would invest in the EIS companies. The manager would then issue EIS 3 certificates to the investor for each EIS company the fund invests in.



How to claim EIS Relief

An investor must fill out Form EIS 3 and send it to HMRC to obtain tax relief. Investors can use the tax relief in a variety of ways, such as:

- An adjustment to their PAYE code
- A tax repayment
- Agreeing to offset the relief against any outstanding tax liabilities

There are additional rules for Capital Gains tax. Investors should seek expert advice on the most effective strategy to obtain tax relief in their specific circumstances.



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