Enterprise Investment Scheme

The purpose of the Enterprise Investment Scheme (EIS) is to help certain types of small higher-risk unquoted trading companies to raise capital. It does so by providing income tax (IT) relief and capital gains tax (CGT) exemptions or deferrals to investors in these qualifying companies.

There are two separate schemes within EIS, which an investor can apply for:

- A scheme giving IT relief on the investment and a CGT exemption on gains made when the shares are disposed of and/or;
- A scheme aimed at providing CGT deferral.

Reliefs, exemptions and deferrals

For IT, Investors receive relief at 30% on their investments of up to £1,000,000 a year. However, the relief is withdrawn if the shares are disposed of within three years.

In relation to CGT, gains on the disposal of EIS shares are exempt unless IT relief is withdrawn. Similarly, CGT exemption will be restricted if an investor did not get full IT relief on the subscription for EIS shares. On the other hand, capital losses arising on the disposal of EIS shares can be set against income in the year of disposal of EIS shares or carry back against any income of the previous year subject to the amount of the IT relief previously claimed.

Lastly, investment in shares of an EIS company can be used as a method of deferring gains arising on disposals of any assets. Shares do not have to have income tax relief attributable to them in order to qualify for deferral relief. The gain will become chargeable in the tax year when the subscription shares are disposed of. There is no upper limit on the amount of deferral relief available to an individual.

Rules for the investor and the company

The following is a high level guide and both parties should discuss them with their advisors before using the scheme. We would encourage the investor to also understand the rules the company has to adhere to as failure by the company to observe them impacts the investor's position.

Rules for the investor

When the shares are issued to the investor they must be fully paid up.

In addition, the investor must not be 'connected' at any time within the period of 3 years from the date of issue of the shares or three years from the commencement of the trade if later and two years before the issue of the shares[1].

Rules for the company

The following conditions must be met by the company for any of the reliefs to be available for the investor.

- It must not be controlled by another company.
- The company must be unquoted when the shares are issued and there must be no arrangement in existence at that time for it to cease to be unquoted.
- It must be engaged in or will undertake a qualifying business activity[2].
- The money raised by the share issue must be employed within two years from the issue of the shares or if later two years from the commencement of the qualifying activity.
- The company or group must generally have fewer than 250 full time employees.
- The size of the company is limited to £15 million (gross assets).
- The amount of capital raised in any 12 month period is limited to £5 million.
- The company must not be regarded as an ‘enterprise in difficulty’.
- The company must at least have a permanent establishment in the UK.

Receiving value from a company

The EIS is subject to a number of rules which are designed to ensure that investors are not able to obtain the full benefit of EIS reliefs if they receive value from the company during a specified period. If relief has already been given, it may be withdrawn. Receipts of 'insignificant' value will not cause the withdrawal of relief.

How we can help

If you are interested in using the EIS, please contact us at DRG Chartered Accountants on 01628 760 000.

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1 You can be connected with a company in two broad ways i.e. by virtue of the size of your stake in the company (more than 30%) or have a working relationship with the company (employee or director excluding business angels).
2 A trade will not be a qualifying business activity if it falls within excluded activities such as dealing in land or financial instruments, financial activities, leasing or letting assets on hire, receiving royalties or license fees, providing legal or accountancy services, property development, farming or market gardening, holding, managing, or occupying woodlands, operating or managing hotels, guest houses or hostels, operating or managing nursing homes or residential care homes, ship building and coal and steel production.