Enterprise Investment Scheme & Seed Enterprise Investment Scheme

BUSINESS TAX GUIDE

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OVERVIEW

The Enterprise Investment Scheme ('EIS') was introduced in 1994 to encourage individuals to invest in small high-risk trading companies which may otherwise have difficulty in raising equity finance. The Seed Enterprise Investment Scheme ('SEIS') is effectively the 'baby brother' of EIS, and was introduced from 6 April 2012 to encourage investment in smaller start-up trading companies.

Whilst SEIS is broadly similar to EIS, different limits apply to each scheme. However, both EIS and SEIS offer individual investors significant income tax and capital gains tax ('CGT') benefits for making direct equity investments in a qualifying company, providing various requirements are met.

What are EIS and SEIS?

EIS and SEIS both allow individual investors to claim significant income tax and CGT benefits for making direct equity investments into small high risk trading companies. The reliefs provide an incentive for investors to make investments into these types of companies which would otherwise find it difficult to raise equity finance because they are too small for private equity type investors.

Why Invest Through EIS / SEIS?

Individual investors who subscribe for new ordinary shares in a qualifying company under EIS / SEIS can claim the following tax reliefs:

- *Income Tax Relief* - at 30% on equity investments up to £1 million in a tax year under EIS and at 50% on equity investments up to £100,000 in a tax year under SEIS.
- *CGT Exemption / Loss Relief* - a full exemption from CGT on disposals of qualifying shares that have been held for at least three years, if income tax relief has been claimed and has not been withdrawn. In addition, investors are still entitled to claim loss relief on the qualifying shares (after deducting the income tax relief already given), if the company fails.
- *CGT Deferral / Reinvestment Relief* - unlimited deferral of CGT arising on the disposal of any asset by reinvesting the proceeds in qualifying EIS shares within a period of one year before and three years after the chargeable gain has been realised, regardless of whether the shares qualify for income tax relief. The deferred gain comes back into charge on disposal of the EIS shares. Under SEIS, reinvestment relief of 50% of the CGT liability can be claimed on gains up to £100,000 arising in a tax year, provided the gains are reinvested in qualifying SEIS shares in that tax year or the previous tax year.

Requirements for EIS / SEIS

These are very valuable tax reliefs, so there are a number of requirements which must be met by both the individual investor and the company in order for the reliefs to be granted and not be withdrawn. The main conditions are set out below:

Individual Investor

- The individual investors must subscribe for new ordinary shares, fully paid up, in the qualifying company.
- The shares must be issued for bona fide commercial reasons.
- To retain/obtain maximum relief the shares must be held for at least three years from the date of issue.
- Income tax relief must be claimed.
- The individual must not be connected with the company; broadly the investor must not hold, or be entitled to, more than 30% of the issued share capital, voting power or assets, or be an employee of the company or its group. Subject to certain exceptions, relief will be withdrawn if the investor receives payment from the company in the period one year before and three years after the shares are issued. Note that an investor may be a director provided certain conditions are met.

Investee Company

- The company must be an unquoted trading company or a holding company of a trading group which is carrying on a qualifying trade and is not in financial difficulty.
- The company must not be controlled by another company subject to exclusions.
- The company must have a permanent establishment in the UK.
- For EIS relief, the gross assets of the company / group must not exceed £15 million before the share issue and £16 million after. In addition, there must be less than 250 full time employees.
- For SEIS, the gross assets of the company must not exceed £200,000 before the share issue, and there must be less than 25 full time employees.

Additionally, there are further limits on the amount the company can raise through such arrangements, how the funds are used and the timing of invesments.

EIS / SEIS in Practice

It is possible to obtain advance assurance from HM Revenue & Customs ('HMRC') that a company will be granted qualifying EIS / SEIS status. This advance clearance gives potential investors comfort that their investments will qualify for the tax reliefs as anticipated.

EIS and SEIS are valuable tax reliefs, and the rules relating to them are complex. Without professional advice it is easy to inadvertently trigger one of the anti-avoidance or clawback provisions which reduce or even eliminate the tax reliefs granted to investors. It is therefore vital that companies seeking to maintain EIS / SEIS qualifying status closely monitor their activities to ensure the rules are not breached.

How can Rawlinson & Hunter help?

We have a great deal of experience in dealing with the intricacies of the legislation and providing advice to companies both with obtaining advance assurance and assisting companies to ensure that investors do not lose their relief.

If you are interested in further information about these reliefs, please call the Rawlinson & Hunter partner who normally acts for you. If you are not one of our regular clients, please contact Craig Davies or Andrew Shilling, who would be delighted to discuss this with you in more detail.

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