

# The Enterprise Investment Scheme

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## A summary of the reliefs and conditions

### The reliefs

- i. Capital Gains Tax deferral**  
You are able to defer a chargeable gain arising on the sale of any asset into EIS shares. The new shares must be acquired within one year before and three years after the sale of the original asset.
- ii. Income Tax relief**  
Income tax relief at 20% is available in the year of investment, on the amount invested in EIS shares up to a maximum of £500,000 per tax year. This investment may be carried back to the previous tax year.
- iii. Exemption from Capital Gains Tax**  
Where the EIS shares are held for at least three years and then disposed of at a profit any gain on the EIS shares will be exempt from Capital Gains Tax. The tax due on the original gain deferred into the EIS shares will then become payable unless a further investment is made.
- iv. Relief for losses**  
Where the EIS shares are disposed of at a loss, the loss (less Income Tax relief attributable to the shares) is available for off-set against either capital gains in the year of the loss or taxable income in the year of realisation or the previous year.

### Qualifying shares

The shares must be new ordinary shares, which throughout the 3 years from the date of issue have no preferential right to dividends or assets on a winding-up, and no right to be redeemed. The shares must be subscribed for in cash and must be fully paid up at the time of the issue.

### Qualifying investor

For Income Tax relief, an individual must not be connected with the company at any time in the period of two years before and 3 years after the share issue.

### Connected individuals

An individual is connected if he, or an associate:

- directly or indirectly possesses or is entitled to acquire more than 30% of:
  - The issued ordinary share capital of the company or any subsidiary
  - The loan capital and issued share capital of the company or any subsidiary
  - The voting power in the company or any subsidiary
  - The assets available for distribution on a winding-up
- is an employee or partner of the company or any of its subsidiaries
- is a director, unless as an unpaid director or a business angel.

Associate includes any partner or relative. Relative includes spouses or civil partners, lineal descendants and ancestors, but not brothers and sisters. A business angel, ie: a person previously unconnected with the company or the trade carried on by it, can be a paid director and still qualify for relief provided he only receives remuneration which is reasonable for the services provided to the company. He must not receive any other payment unless falls within a defined list of 'permissible payments'.

Connection with the company does not, however, preclude capital gains being deferred into EIS shares.

## **Qualifying company**

The company must satisfy certain conditions during the period of 3 years from the date of the share issue, or if later, from the date the company begins to trade.

A company is a qualifying company if:

- it is unquoted
- it is a “small company”, with gross assets of less than £7 million
- it has fewer than 50 employees when the shares are issued
- exists wholly for carrying out a qualifying trade, or is the parent company of a 90% trading group
- It is not controlled by another company
- It does not control another company that is not a qualifying subsidiary.

## **Qualifying trade**

A company must carry out a qualifying trade wholly in the UK, although it is not necessary for the company to be UK resident.

Excluded trades are as follows:

- dealing in land, commodities or futures in shares, securities or other financial instruments
- financial activities such as banking, money-lending, insurance, debt-factoring and HP financing
- dealing in goods other than in the ordinary trade of retail or wholesale distribution
- leasing or letting assets on hire, except in the case of certain ship-chartering activities
- oil extraction activities, except oil exploration leading to oil extraction
- receiving royalties or licence fees, other than, in certain cases, such payments arising from exploiting an intangible asset the company itself has created
- 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 steel production
- operating or managing hotels, guest houses, or similar establishments, or managing property used as an hotel or comparable establishment
- Operating or managing nursing homes or residential care homes, or managing property used as a nursing home or residential care home.
- Providing services to another company in certain circumstances where the other company's trade consists to a substantial extent in excluded activities.

The Revenue will generally consider that excluded activities do not amount to a substantial part of the company's trade where they amount to no more than 20% of the trade.

## **Use of funds**

The shares must be issued to raise money for the purposes of a qualifying business activity including Research & Development. The money raised must be utilised within 2 years of the commencement of the trade or the issue of the shares.

### **Withdrawal or reduction of relief**

A withdrawal or reduction of relief is made where during the specified period:

- the investor ceases to be a qualifying individual
- the company ceases to be a qualifying company
- the shares cease to be eligible shares
- the investor disposes of some or all of the shares
- the company acquires from the investor shares in a company which he controls
- value is received from the company by the investor or, in certain circumstances, by other shareholders.

### **Value received by EIS investors**

These rules apply where value is received within 3 years after the share issue.

Value is received where the company:

- redeems, repays or repurchases the investor's shares
- repays loans made by the investor before the issue of the EIS shares
- compensates for giving up rights to shares on cancellation
- compensates for giving up a debt
- releases or waives any liability to the company of the investor
- allows the investor to fail to discharge a liability within 12 months of the normal due date
- makes a loan to the investor
- provides a benefit to the investor
- gives an asset to the investor at undervalue or buys one from the investor at overvalue
- pays remuneration or other payments, except for 'permissible payments'
- makes a payment or gives an asset to the investor in a winding up.

In some cases, where value is received from the company of up to £1,000, it may be regarded by the Revenue as insignificant and thus not require a withdrawal of relief, but care is needed if this is to apply.

For further details regarding the Enterprise Investment Scheme please contact Alan Rolfe, Tax Manager on 023 8046 1200 or email [alan.rolfe@hwb-accountants.com](mailto:alan.rolfe@hwb-accountants.com).