



## Personal Tax

# 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 and CGT reliefs for investors in qualifying shares in these companies.

There are really two separate schemes within EIS:

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

An individual can take advantage of either or both of these schemes.

### The Reliefs Available

#### Income tax relief

- Investors may be given income tax relief at 20% on their investments of up to £200,000 a year (£150,000 up to 5 April 2004).
- For share issues after 5 April 2000, the income tax relief is not withdrawn provided that the shares are not disposed of within three years (five years for share issues prior to 6 April 2000).

#### CGT exemption

- Gains on the disposal of EIS shares are exempt unless the income tax relief is withdrawn.
- The CGT exemption may be restricted if an investor does not get full income tax relief on the subscription for EIS shares.
- Losses on the disposal of EIS shares are allowable. The amount of the capital loss is restricted by the amount of the EIS income tax relief still attributable to the shares disposed of.
- A capital loss arising on the disposal of EIS shares can be set against income.

#### CGT deferral

- Gains arising on disposals of **any** assets can be deferred against subscriptions for shares in any EIS company.
- 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 although there is a limit on investment in a single company or group of companies.

### Qualifying Companies

Companies must meet certain conditions for any of the reliefs to be available for the investor.

- 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.
- All the shares comprised in the issue must be issued to raise money for the purpose of a qualifying business activity.
- The money raised by the share issue must be wholly employed within a specified period by the company.

### Qualifying business activities

A trade will not qualify if excluded activities amount to a substantial part of the trade. The main excluded activities are:

- dealing in land, in commodities or futures or in shares, securities or other financial instruments
- financial activities
- dealing in goods other than in an ordinary trade of retail or wholesale distribution
- leasing or letting assets on hire
- receiving royalties or licence fees, other than, in certain cases, such payments arising from film production, or from research and development
- 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.

### Time period in which the money is invested

In most cases at least 80% of the money must be used within 12 months after the date on which the shares were issued and the remaining balance within the following 12 month period. Where the qualifying business activity has not started:

- the company must begin to carry on the trade within two years after the date of issue of the shares
- the above deadline is extended to 12 months and 24 months after the date on which trading commences.



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## How to Qualify for Income Tax Relief

Eligibility for income tax relief is restricted to companies with which you are not 'connected' at any time during a 'four year period'. The four year period begins one year before the date of issue of the shares and ends three years after that date.

You can be connected with a company in two broad ways:

- by virtue of the size of your stake in the company or
- by virtue of a working relationship between you and the company.

In both cases the position of your 'associates' is also taken into account.

### Size of stake

You will be connected with the company at any time when you control directly or indirectly possess, or are entitled to acquire, more than 30% of the ordinary share capital of the company.

### Working relationship

You will be connected with the company if you have been an employee or a paid director of the company.

There is an exception to this rule if you become a paid director of the company **after** you were issued with the shares.

You must never previously have been connected with the company and must not become connected with it in any other way. Also, you must never have been involved in carrying on the whole or any part of the trade or business carried on by the company.

## How to Qualify for CGT Deferral Relief

You can defer a chargeable gain which accrues to you on the disposal by you of any asset. In addition, you can defer revived gains arising to you in respect of earlier EIS, Venture Capital Trust (VCT) or CGT reinvestment relief investments.

There are some restrictions on investments against which gains can be deferred. These are designed, broadly, to prevent relief being obtained in circumstances where there is a disposal and acquisition of shares in the same company.

## 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.

Examples of the circumstances in which you would be treated as receiving value from the company are where the company:

- buys any of its shares or securities which belong to you
- makes a payment to you for giving up the right to payment of a debt (other than an ordinary trade debt)
- repays a debt owed to you that was incurred before you subscribed for the shares
- provides you with certain benefits or facilities
- waives any liability of yours or an associate's to the company
- undertakes to discharge, any such liability to a third party
- lends you money which has not been repaid before the shares are issued.

Receipts of 'insignificant' value will not cause the withdrawal of relief.

## How We Can Help

It is not possible to cover all the detailed rules of the scheme in a factsheet of this kind. If you are interested in using the EIS please contact us if you need further information about the scheme.

We can advise you as to whether your company has a qualifying trade.

We can also help to guide you through the implementation of a scheme which is suitable for your circumstances.