Umesh Modi

Enterprise Investment Scheme

Enterprise Investment Scheme can help smaller, higher-risk companies raise money by offering relief on new shares in those companies that qualify.* Umesh Modi *explains how it can benefit pharmacists…

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 the 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 may be able to take advantage of either or both of these schemes as long as they meet the relevant conditions, which are considered below.

EIS reliefs available

Income tax relief

- Investors may be given income tax relief at 30% on their investments of up to £1,000,000 a year (£2 million a year for knowledge-intensive companies from 6 April 2018).
- The income tax relief is withdrawn if the shares are disposed of within three years. Eligibility for income tax relief is restricted to companies with which you are not 'connected'. This is considered in 'how to qualify for income tax relief' below.

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- Gains on the disposal of EIS shares are exempt unless the income tax relief is withdrawn.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.
- The investment must generally be made within seven years of the company's first commercial sale.
- 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 (£10 million for knowledge-intensive companies from 6 April 2018)
- The company must not be regarded as an 'enterprise in difficulty' under EC guidance.
- The company need only have a permanent establishment in the UK rather than carrying on a qualifying trade wholly or mainly in the UK.

Qualifying business activities

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

Time period in which the money is invested

The time limit for the employment of money invested is to two years from the issue of the shares or, if later, two years from the commencement of the qualifying activity.

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 period beginning two years before the issue of the shares and ending three years after that date, or three years from the commencement of the trade if later.

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.

Source: Practice Track

This article is based on current legislation and practice and is for guidance only. Specific professional advice should be taken before acting on matters mentioned here.

Umesh Modi BA ACA is a Chartered Accountant and Tax Advisor, and a partner at Silver Levene LLP. He can be contacted on 020 7383 3200 or umesh.modi@silverlevene.co.uk