

Business Toolkit



Enterprise
Investment Scheme
and Seed Enterprise
Investment Scheme

Since their introduction the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS) have been instrumental in encouraging individuals to invest in growing businesses. Together the two schemes are aimed at encouraging investment in SME's and startups.

For the investor

Investment in growing companies can be high risk; the tax reliefs offered through EIS and SEIS offer compensation to the investor. At a time when the government is set on closing tax avoidance schemes for high earners and the wealthy, an HMRC approved opportunity to substantially reduce an income tax bill, and a capital gains tax bill, and to make a tax free capital gain, is unique.

For the company

For the startup or SME looking for angel money, completing a process of qualifying as an EIS or SEIS investment before they pursue funding is almost essential as many funders will only look at qualifying businesses. However, companies benefiting from the scheme need to take care that they continue to meet the requirements on an ongoing basis, or their EIS or SEIS status could be lost.

Both EIS and SEIS have conditions that have to be satisfied both on the part of the investor and the company. Great care is needed in structuring an investment to ensure that the required relief is due. SEIS is aimed at the very early stages of a business whereas EIS is more likely to get used in the next funding round as the net is cast wider and as investors look to invest in more established businesses.

Enterprise Investment Scheme (EIS)

EIS can entitle the investor to:

- Income tax relief at 30% on their investment
- Deferral of capital gains when proceeds are invested in EIS shares
- Capital gains tax exemption on sale of the EIS shares
- Relief for capital losses against other income.

These reliefs are all subject to conditions being met by both the company being invested in and the investor.

Income tax relief

A qualifying investor will be entitled to obtain income tax relief at a rate of 30% on new, ordinary, fully paid up shares subscribed for in cash up to the annual investment limit (currently £1 million). An investment of £100,000 in a qualifying company can therefore come at a cost of only £70,000 to the investor.

The income tax relief can only reduce the income tax liability of the year to nil and will not generate a refund above the amount of tax paid by the investor.

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However, where an investment is made under EIS in one year it can, by election, be treated as though it was an investment made in the immediately preceding tax year, subject to the overall limit for that year.

The advantages of carrying back a payment to a previous year are that it speeds up the tax relief, gives a cash flow advantage and can increase the scope for using the income tax relief where the tax payer's income varies significantly from year to year.

Please be aware that the income tax relief can be clawed back if the company fails certain qualifying conditions within the first three years from the date the shares were issued (or the date it starts to trade, if later).

Qualifying as an EIS company

For a company to qualify as an EIS company it must meet the following requirements:

- The company must be unquoted (although it can be listed on AIM) and have a UK permanent establishment
- The company must exist to carry on a qualifying trade. Certain trades are excluded e.g. property investment, accountancy, legal services, farming and hotel development



- The gross assets (before liabilities) of the company must not exceed £15 million before the investment and £16 million after the investment
- The number of full-time employees of the company must not exceed 250 or 500 for certain 'knowledge intensive' companies.
- The company must not be a 51% subsidiary of another company.

The maximum annual amount that can be invested in a company through schemes such as EIS is £5 million in any year and the maximum total amount that can be invested in a company through such schemes is £12 million or £20 million for 'knowledge intensive' companies.

Knowledge intensive companies are broadly those which are innovative and meet criteria related to skills and ambitions.

New rule

From 2015, a company must normally raise its first EIS investment within seven years of its first commercial sale (or 10 years if it is a knowledge intensive company).

Investment requirements

There is a requirement that the money raised by the EIS scheme is used for the purpose of the trade within two years.

The money must have been raised for the purpose of business growth and development.

Shares issued must not be redeemable and must not carry any preferential rights to assets on a winding up.

Potential EIS investors

The main condition is that the investor must not be connected for EIS purposes with the company. Investors who are connected with the company may still qualify for capital gains tax deferral relief.

An investor will be connected with the company if they, either on their own or with associates, possesses or is entitled to acquire more than 30% of the issued share capital, voting power or assets of the company on a winding up.

The investor may also be connected with the company if they and/or their associates have a working relationship with the company. There are certain exceptions for directors, although it is very important that any amount which an EIS investor receives as remuneration as a director is not excessive in comparison to the services performed and that the relationship does not exist prior to the investment being made.



In addition, if the investor already holds shares in the EIS company, the new investment will only qualify if those shares also qualified or if they are subscriber shares.

CGT explained

Where an investor has realised a capital gain on the disposal of any asset, it is possible to defer that capital gain by subscribing for shares in an EIS company.

For the relief to apply, the investment in the EIS company will need to be made within three years of the relevant disposal, or up to one year before.

Where a disposal has already been made and capital gains tax paid (CGT), it is possible to obtain a refund of the CGT.

Capital gains when selling EIS shares

Where an investor subscribes for ordinary shares and is eligible for income tax relief under EIS then a disposal of those shares can be exempt from CGT, subject to the following two conditions:

- The shares have been retained for a three year qualifying period, commencing with the date of subscription for the shares, or the date the company starts trading, if later; and

- The company has not, during that period, ceased to qualify for EIS relief so that the income tax relief has been withdrawn.

Seed Enterprise Investment Scheme (SEIS)

The Seed Enterprise Investment Scheme is designed to help companies to raise finance when in the early stage of starting up. SEIS can entitle the investor to:

- Income tax relief at 50% on their investment
- A 50% capital gains exemption, when proceeds are invested in SEIS shares
- Capital gains tax exemption on the sale of SEIS shares.

Again, these reliefs are all subject to certain conditions being met by both the company and the investor.

SEIS offers a higher rate of tax relief than that offered by EIS, as SEIS recognises the particular difficulties which very early stage companies face in attracting investment. It is therefore specifically aimed at companies with a trade less than two years old, with gross assets of less than £200,000, and with fewer than 25 employees. With maximum income tax and capital gains tax relief, an investment of £100,000 in a qualifying company can come at a cost of only £40,000.

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The maximum total amount that can be invested in a company under SEIS is £150,000.

Qualifying as a SEIS company

SEIS applies to shares issued on or after 6 April 2012. The rules for SEIS mirror those for EIS, and it is anticipated that companies may want to go on to use EIS after initially taking investment under SEIS.

Capital Gains Tax relief

Where an investor disposes of an asset which would give rise to a capital gain and reinvests all or part of the gain in shares which qualify for SEIS income tax relief, 50% of the gain reinvested will be exempt from capital gains tax.

The £100,000 investment limit that applies for the income tax relief also applies for the capital gains re-investment relief.

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EIS and SEIS in numbers – a comparison

Based on an investment of £10,000

| For tax year 2016/17 | EIS | SEIS |
|------------------------|--------|--------|
| Investment | 10,000 | 10,000 |
| CGT exemption | - | 1,000 |
| IT relief at 30% / 50% | 3,000 | 5,000 |
| Net cost of investment | 7,000 | 4,000 |

How much is at stake if the business fails after 3 years?

| For tax year 2016/17 | EIS | SEIS |
|--------------------------------|-------|-------------------------|
| Net investment | 7,000 | 4,000 |
| Loss relief at 45% | 3,150 | 2,250 (5,000 at 45%) |
| Net loss after all tax reliefs | 3,850 | 1,750 |

Comparison table of EIS and SEIS

| Qualification criteria | EIS | SEIS |
|--|--|--|
| Company structure | Unlisted company (although it can be listed on AIM) | Unlisted company (although it can be listed on AIM) |
| Subsidiaries | May have subsidiaries subject to certain conditions | May have subsidiaries subject to certain conditions |
| How to qualify | <ul style="list-style-type: none"> • Gross assets of no more than £15 million pre-investment • Gross assets of no more than £16 million post-investment • Fewer than 250 employees (500 for 'knowledge intensive companies') • Raise first investment within seven years from first commercial sale (10 years for 'knowledge intensive companies') | <ul style="list-style-type: none"> • Trade carried on for less than two years • Gross assets of no more than £200,000 • Fewer than 25 employees |
| What is the investment limit? | £12 million (£20 million for 'knowledge intensive companies') | £150,000 |
| How to use the money | Must be used for qualifying business activity within two years | Must be used for qualifying business activity within three years |
| Investor qualification criteria | | |
| What is the maximum individual investment per tax year | £1 million | £100,000 |
| What is the form of investment | 100% shares | 100% shares |

Comparison table of EIS and SEIS (continued)

| Investor qualification criteria (continued) | EIS | SEIS |
|---|---|--|
| Is the investor “connected” | <ul style="list-style-type: none"> • No employee investment • Cannot hold more than 30% of share capital, voting rights, entitlement to assets on winding up • Investors can be directors subject to certain rules | <ul style="list-style-type: none"> • No employee investment • Cannot hold more than 30% of share capital, voting rights, entitlement to assets on winding up • Directors can invest subject to the 30% rule |
| Tax reliefs | | |
| Income tax relief | 30% | 50% |
| Period for qualifying conditions to be met | Three years | Three years |
| Can you carry back tax relief to previous year? | Yes, up to 100% of investment | Yes, up to 100% of investment |
| Is there CGT reinvestment relief? | Yes, CGT deferral for gains when investment in EIS made within one year before or three years after the gain arose | Yes, CGT exemption for 50% of gains realised and reinvested in the same tax year |
| CGT liability | Nil after 3 years | Nil after 3 years |

Applying for EIS/SEIS

The rules can be complex and each case needs to be approved by HM Revenue & Customs. It is therefore advisable to engage a tax specialist to complete the application, as they will help to avoid the many pitfalls. We at Kingston Smith have:

- An experienced sector team who regularly structure EIS and SEIS investments
- A strong history of successful applications agreed with HM Revenue & Customs
- A full understanding of the market place with our dedicated technology and telecoms team

Kingston Smith

At Kingston Smith we adopt a collaborative approach, gaining an understanding of our clients, their needs and aspirations. This in turn allows us to tailor our expertise and provide solutions that help SMEs we work with achieve their goals. Our client service team comprises business advisers as well as specialists to ensure that we always have the right combination of professionals taking care of our clients' needs. Our team provides the right advice at the right time to give our clients a competitive edge in the market place.

We offer our clients a range of support from up-to-date technical information to business networking forums, through seminars, toolkits and events. Visit our events page for our seminar programme at www.ks.co.uk/events.



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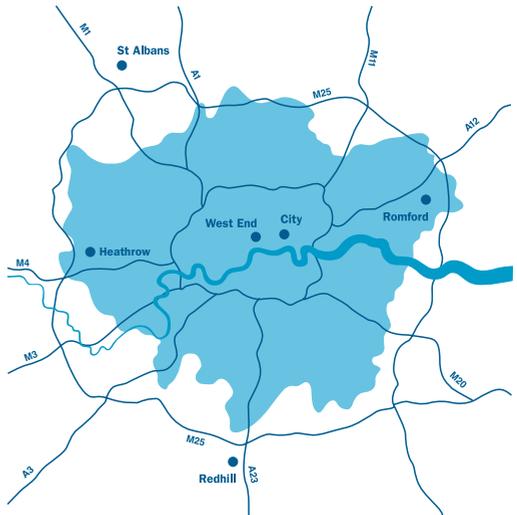
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