The Enterprise Investment Scheme

Expert knowledge means success

Contents

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Introduction

The Enterprise Investment Scheme (EIS) is designed to help certain types of small higher-risk unquoted trading companies to raise capital. It does so by providing a range of tax reliefs for investors in qualifying shares in these companies. Investors are encouraged to increase the supply of finance to companies that might otherwise have difficulties in obtaining it. Those companies can then use the funding to improve their business performance.

The EIS is appropriate for individuals (and trustees of certain trusts) who wish to invest in higher risk small companies. Investors in EIS qualifying companies receive income tax relief of 30% and capital gains tax deferral of 40% of the value of their investment when they invest, subject to an annual investment limit. Any profit from the investment is free of tax, provided EIS shares have been held for no less than three years. Business Property Relief, which can provide exemption from inheritance tax, is also available once EIS shares have been held for a minimum of two years. Capital gains taper relief was available to investors who sequentially invested in unquoted companies. However, from 6 April 2008 taper relief and indexation allowance were withdrawn and replaced by a single rate of capital gains tax of 18 per cent.

The EIS offers an extremely attractive set of tax reliefs for individual investments into qualifying companies, including:

- Reduction of income tax liability by an amount equal to 30% of the share subscription. The annual investment limit per investor is £400,000 per annum (£500,000 from 6 April 2008)[4];
- Deferral of capital gains tax due on gains realised on a different asset, where disposal of that asset was less than 36 months before the EIS investment or less than 12 months after it;
- Exemption from capital gains tax payable on disposal of shares after three years[1], provided the EIS initial income tax relief was given and not withdrawn;
- If EIS shares are disposed of at any time at a loss, such loss can be set against the investor's capital gains or his income in the year of disposal.

Note: various changes to the scheme over time are covered in sidebars throughout this publication.

Subscriptions must be for new ordinary shares: no other kind of share or security can qualify for the scheme. Throughout the period of three years[1] beginning with the date on which they are issued, the shares must not carry any preferential rights to dividends or to the company's assets on its winding up. In addition, they must not at any time in that period carry any right to be redeemed.

The EIS can be used both by trading companies and by holding companies with trading subsidiaries. It is available for start-ups as well as established companies. Companies must meet certain conditions, and the funds which they raise through the scheme must be used for the purpose of a qualifying trade carried on wholly or mainly in the UK or another qualifying business activity. Most kinds of trade can qualify for the EIS, including manufacturing, the provision of services, construction, and retail and wholesale distribution.

Companies wishing to raise funds through the EIS need not be incorporated or resident in the UK.

To be eligible for income tax relief, investors must not be connected for EIS purposes with the companies in which they invest. Investors who do not qualify for income tax relief because they are connected with the companies for EIS purposes may nevertheless qualify for deferral relief. However, an unconnected person who invests in a company and then becomes a paid director of it whether in an executive or a non-executive capacity may be eligible for relief despite becoming connected with the company for EIS purposes on account of the paid directorship. Such investors are referred to in this publication as Business Angels. Their role is frequently that of providing managerial, financial or entrepreneurial expertise to small companies.

This publication looks first at how a company can raise capital through the EIS and then at what the EIS offers potential investors. It is not possible to cover all the detailed rules of the scheme in this guidance so companies and potential investors who are interested in using the EIS are strongly advised to consider seeking professional advice if they need further information about the scheme.

The Budget on 22 June 2010 announced changes to the capital gains rules. After that date it will no longer be possible both to defer such gains under the EIS rules, and for them to qualify for Entrepreneur's Relief. If you think that you may be affected by this, we suggest you should seek professional advice before proceeding with investment under EIS.

Hugely Popular

Since the EIS was established in 1994, over £7 billion had been raised by the scheme for UK companies by 2010.

Raising Capital through the EIS

If you are looking for a way to raise capital for your company, the EIS may be a suitable vehicle for you. This section considers the scheme from the point of view of those involved with the company. You should remember that your investors' EIS reliefs will be lost if the company does not satisfy the conditions throughout its 'relevant period'. In this situation, any income tax relief already obtained will be withdrawn. Where an investor has obtained deferral relief, a chargeable gain equal to the amount of the deferred gain will arise.

Outline of the scheme rules

Eligible shares

In order to be eligible for tax relief, subscriptions must be for new ordinary shares: no other kind of share or security can qualify for the scheme. Throughout the period of three years[1] beginning with the date on which they are issued, the shares must not carry any preferential rights to dividends or to the company's assets on its winding up. In addition, they must not at any time in that period carry any right to be redeemed.

The following conditions apply to an 'issue of eligible shares':

- the shares must be issued for bona fide commercial reasons and not for tax avoidance purposes;
- all the shares comprised in any issue of shares must be issued to raise money for the purpose of a qualifying business activity (other than any which are 'bonus shares' issued after 16 March 2004);
- all the money raised by the share issue must be wholly employed within a specified period by the company or a subsidiary[2];
- the money raised by the share issue must be employed for the purpose of the qualifying business activity for which it was raised: no more than an insignificant amount of it can be used for any other purpose;
- where the money raised by the share issue is used by a subsidiary, the subsidiary must throughout the company's 'relevant period' be a '90% subsidiary'[9];
  - whose only purpose of existence apart from purposes incapable of having any significant effect on the extent of its activities, and ignoring certain intra-group activities - is that of carrying on one or more qualifying trades; or
  - whose only purpose of existence - apart from purposes incapable of having any significant effect on the extent of its activities - is to hold or manage property for the group; or
  - which has no profits for corporation tax purposes and does not make investments; and
- the value of the company's gross assets must not exceed £15 million immediately before the shares are issued and must not exceed £16 million immediately afterwards[3]. This is known as the gross assets rule. Where the company is a member of a group of companies, the limits are applied to the gross assets of the group, taken as a whole.

Qualifying companies

In order for a company's shares to qualify for EIS purposes, throughout the company's 'relevant period':

- the company must be an 'unquoted company'[7];
- the company must be either
  - a company whose only significant purpose of existence is that of carrying on one or more qualifying trades; or
  - the parent company of a trading group;
- the company must not be a subsidiary of another company, or otherwise be under the control of another company, except in certain circumstances where it becomes a wholly-owned subsidiary of a new holding company after the shares have been issued; and
- any company which is a subsidiary of the company must be a 'qualifying subsidiary', and the company must not control any company which is not a qualifying subsidiary.

For shares issued after 16 March 2004, the company must not have a "property managing subsidiary" at any time during the company's 'relevant period' that is not a 'qualifying 90% subsidiary'. For further information on property managing subsidiaries visit:
www.hmrc.gov.uk/eis/part2/2-1.htm

Parent companies

A company is the parent company of a trading group for EIS purposes if it has one or more subsidiaries, and non-qualifying activities do not form a substantial part (more than 20%) of the business of the group taken as a whole.

Non-qualifying activities are, broadly, investment activities and non-qualifying trades.

Gross Assets Rule

The value of the company's gross assets must not exceed £15 million immediately before the shares are issued and must not exceed £16 million immediately afterwards. Where the company is a member of a group of companies, the limits are applied to the gross assets of the group, taken as a whole.

Companies holding an investment in shares and securities

Where a company exists for the purpose of carrying on a qualifying trade holds an investment in shares or securities, the fact that the company holds shares or securities will not prevent it from qualifying if:

- they are held for the purposes of the trade; or
- the holding of them cannot have a significant effect on the extent of the company's activities.

Companies that are wound up or dissolved

If the company is wound up or dissolved without being wound up (or goes into receivership or administration) before the end of its ‘relevant period’, it will generally not qualify for EIS purposes, unless the action is taken for bona fide commercial reasons and not for the purpose of tax avoidance.

Companies that become subsidiaries of holding companies

A company can become a subsidiary of a holding company without jeopardising its investors' EIS reliefs. The rules provide for the continuity of income tax relief and deferral relief where a holding company issues new shares and securities to the holders of the shares and securities of the original company in such a way that, as far as its capital structure is concerned, it effectively takes the place of the original company. The holding company must not previously have issued any shares (other than subscriber shares) or securities.

The conditions are complex, and companies intending to undergo a reconstruction of this sort should seek specialist advice beforehand in order to help ensure that their investors' EIS reliefs are not put at risk.

Arranging investment realisation

The company can arrange for investors to realise their investments provided that it does not make, or agree to make, any such arrangements until after the shares in question have been issued. There is no reason why the directors of the company should not give potential investors an indication of the possible exit routes that they expect to be available in due course.

Arranging guaranteed minimum returns

The company cannot make arrangements for the investors to get a guaranteed minimum return on their investments. Any arrangements made in connection with the share issue which are designed to secure the return to investors, or to protect them against the risks attached to the investment, will make them ineligible for relief.

For more information on the scheme rules visit:
http://www.hmrc.gov.uk/eis/index.htm

Qualifying business activities

Qualifying business activities are:

- a qualifying trade, or preparing to carry it on – in which case the company or subsidiary in question must begin to carry on the trade within two years after the date of issue of the shares;
- 'research and development' which is intended to lead to a qualifying trade carried on by the company or any subsidiary[8]; or
- oil extraction activities - for shares issued before 7 March 2001 oil exploration which is intended to lead to a qualifying trade carried on by the company or any subsidiary.

In the cases of 'research and development' the activity must be carried on immediately after the shares are issued if it is not already being carried on.

UK condition

The trade or activity must be carried on 'wholly or mainly in the UK' at all times it is carried on during the company's ‘relevant period’. A qualifying company, or any of its subsidiaries can operate overseas but the trade or activity for which money is raised through the scheme must be carried on 'wholly or mainly in the UK' at any time in the company's ‘relevant period’ at which it is carried on.

Qualifying trades

Most trades qualify provided that, throughout the company's ‘relevant period’, they are conducted on a commercial basis with a view to making profits. A trade will not qualify if, at any time in the ‘relevant period’, one or more excluded activities together amount to a substantial part (more than 20%) of the trade.

The main excluded activities are:

- dealing in land, in commodities or futures in shares, securities or other financial instruments;
- financial activities such as banking, money-lending, insurance, debt-factoring and hire-purchase financing;
- dealing in goods other than in an ordinary trade of retail or wholesale distribution;

Change to 90% subsidiaries rule

From 6 April 2007 a qualifying trade can be carried on by subsidiaries that are 100% subsidiaries of direct 90% subsidiaries of the parent, or 90% subsidiaries of direct 100% subsidiaries.

Previously, where a qualifying trade was carried on by a subsidiary company it was required to be a direct qualifying 90% subsidiary of the parent company.

- leasing or letting assets on hire, except in the case of certain ship-chartering activities;
- receiving royalties or licence fees, except in the case of the exploitation of an intangible asset created by the company or its group;
- providing legal or accountancy services;
- property development;
- farming or market gardening;
- holding, managing or occupying woodlands, any other forestry activities or timber production;
- operating or managing hotels, guest houses or hostels in which the company carrying on the trade has an interest or which it occupies under licence or any other form of agreement;
- operating or managing nursing homes or residential care homes in which the company carrying on the trade has an interest or which it occupies;
- shipbuilding and coal and steel production (from 6 April 2008); and
- providing services to another company in certain circumstances where the other company's trade consists, to a substantial extent, of excluded activities.

Licence Fees and Royalties

Companies which obtain a substantial amount of their income from licence fees and royalties are excluded from the schemes, except in limited circumstances where the fees or royalties arise from films or from research and development. This provision was extended in April 2000 to cover licence fees and royalties which arise from an intangible asset, the greater part of which has been created by the small company.

Acquiring a trading company

The company or a subsidiary can use money raised through the share issue to acquire a trading company where:

- the acquired company does not have any assets other than a qualifying trade or assets used wholly for the purpose of the trade; and
- for shares which were issued before 17 March 2004, the trade is transferred to the company in question as soon as possible after the trading company has been acquired. If the trade is transferred to a subsidiary of the company which issued the shares, the subsidiary must have been a subsidiary of that company when the shares were issued.

For more information on qualifying business activities visit: www.hmrc.gov.uk/manuals/vcmmanual/vcm20020.htm

Procedures

Assurance of EIS qualification

Before subscriptions for shares are invited, the company secretary, or a director, or an agent acting on the company's behalf should submit in writing the company's proposals for using the scheme to the Small Company Enterprise Centre (SCEC).

The company should supply to the SCEC:

- a copy of the latest available accounts for the company and each of its subsidiaries;
- an up-to-date copy of the Memorandum and Articles of Association of the company and each of its subsidiaries, and details of any proposed changes;
- a copy of the draft of any document to be issued to potential investors;
- confirmation that the company expects to be able to complete the declaration on form EIS1 in due course;
- details of any subscription or similar agreement to be entered into by the shareholders;
- details of all trading or other activities carried on, or to be carried on, by the company and its subsidiaries; and
- the approximate sum the company intends to raise through the share issue, and details of how it intends to use the money.

If the SCEC is satisfied, on the basis of information supplied, that the conditions of the scheme which apply to the company and the shares will be met, they will say so in writing. The company can then inform potential investors of this advance assurance, but whether the conditions of the scheme are, in the event, met is a question of fact which cannot be determined in advance.

The SCEC cannot give any advance assurance about whether particular potential investors will be entitled to claim income tax relief or deferral relief.

EIS adherence procedures

Once the qualifying trade or 'research and development' for which the funds were raised has been carried on for four months, the company should submit a form EIS1 to the Small Company Enterprise Centre (SCEC). Copies of EIS1 can be obtained from the SCEC.

Budget 2008 changes

Shipbuilding and coal and steel production will be excluded as qualifying activities for the EIS scheme for shares issued on or after 6 April 2008.

Companies whose trade consists to a substantial extent of those activities will no longer qualify under the EIS scheme. As a result, investors will not be able to receive tax relief under the scheme for investments in companies carrying on any of those activities.

The time limit for submitting EIS1 is the later of:

- two years after the end of the tax year in which the shares were issued; and
- two years after the end of the four-month period mentioned above.

If the SCEC are satisfied that the conditions for qualifying investors to claim relief are met, they will authorise the company (on form EIS2) to issue certificates EIS3 to shareholders who require them. The investors use these certificates to claim income tax relief or deferral relief.

For more information on procedures visit: http://www.hmrc.gov.uk/eis/part2/2-5.htm

Investing through an EIS scheme

Investors are encouraged to invest in higher risk small companies through an EIS by the attraction of tax reliefs.

If you subscribe for shares in a qualifying company you may be able to get an income tax reduction based on the amount invested. You may be entitled to income tax relief on the annual investment limit of £500,000 (£400,000 prior to 6 April 2008) in respect of eligible shares issued.

Provided that no income tax relief has been withdrawn, a gain which arises after at least three years on the disposal of any of the shares, on account of their increase in value over the holding period, will be exempt from capital gains tax where the annual investment limit is not exceeded. Some capital gains tax may be payable where the limit is exceeded or where the relief has been partly (but not wholly) withdrawn.

You may also be able to postpone the charge to capital gains tax (deferral relief) on gains arising on the disposal of other assets around the time that you make your investments.

If you make an allowable loss for capital gains tax purposes on disposing of the shares at any time, you may be able to obtain relief for the loss against income tax. Alternatively, you can set the allowable loss against chargeable gains in the usual way.

Income Tax Relief, Capital Gains Tax Exemption and Loss Relief

Income tax relief

The income tax relief is applied as a reduction in your income tax liability, calculated at the lower rate of income tax, normally on the full amount which you subscribed for the shares (currently 30% income tax relief - 20% before 6 April 2011). The reduction is generally made for the tax year in which the shares were issued to you, but, in certain circumstances, relief on some of the shares can be claimed for the preceding tax year.

You may be eligible for relief in circumstances where:

- you subscribe wholly in cash on your own behalf for 'eligible shares' in a qualifying company;
- the subscription is made for bona fide commercial reasons and not for tax avoidance purposes;
- the shares are issued to you, and are fully paid up at the time of issue;
- you are not connected (other than, possibly, as a Business Angel) with the company for EIS purposes at any time during your 'relevant period' [6];
- no loan which is 'linked to your share subscription' is made to you or any of your 'associates' at any time during your 'relevant period' [6]; and
- the arrangements under which the shares are issued to you, and any prior arrangements made in connection with the issue, do not include any provisions which are designed to enable you to realise your investment later on secure an investment return, or protect you against risks which the investment would otherwise involve.

The amount of relief you obtain for an 'issue of eligible shares' is allocated evenly between all the shares so that the amount of relief attributable to each share in the issue is the same as the amount attributable to every other share in the issue. If you obtain relief for two or more share issues, which are issued to you in the same tax year[5], the amount of relief is apportioned between the issues according to the amounts you subscribed for them, and the relief is attributed to the shares on that basis.

New investment limit rule

From 19 July 2007 (the date the Finance Bill 2007 received Royal Assent) the company (or group of companies) must have raised no more than £2 million under any or all of the venture capital schemes in the 12 months ending on the date of the relevant investment for the investment to qualify for relief under an EIS.

If the limit is exceeded, none of the shares or securities within the issue that causes the condition to be breached will qualify for relief.

From 2006/07, the carry back limit for investments made before 6 October in a tax year was increased to £50,000 from £25,000. For years 2009/10 and later, the Finance Act 2009 removed the restrictions on carry back of relief. The total investment that can be taken into account for the purposes of calculating income tax relief for any particular year will remain subject to a limit, currently £500,000 subscribed. For more information visit: http://www.hmrc.gov.uk/manuals/vcmmanual/VCM25410.htm

Investment limits for income tax relief

You can obtain income tax relief in respect of any of the shares issued to you by a company in a given tax year if the total amount you have subscribed for them is more than £1 but not more than £500,000. If you subscribe for more than one 'issue of eligible shares', the limit applies to the total amount of qualifying investment.

From 19 July 2007, the company (or group of companies) must have raised no more than £2 million under any or all of the venture capital schemes in the 12 months ending on the date of the relevant investment for the investment to qualify for relief under an EIS.

If the limit is exceeded, none of the shares or securities within the issue that causes the condition to be breached will qualify for relief.

Spouse subscriptions

If the aggregated subscriptions of spouses means that the amount of their combined investment accounts to more than a 30% stake in the company, neither spouse will qualify for income tax relief.

Investment via a nominee

For the purpose of the EIS, shares for which a nominee subscribes on your behalf are treated as though you had subscribed for them yourself. Similarly, shares which are issued to, held by, or disposed of by a nominee on your behalf are treated as issued to, held by, or disposed of by you.

Joint investments

You may invest jointly with other investors but you and the other investors concerned are treated for EIS income tax relief purposes as subscribing equal amounts for the whole of the investment, irrespective of the amount each of you actually contribute. For example, if you and your sister jointly subscribe £180,000 for 120,000 shares, and your contribution is £100,000 and hers is £80,000, you will each be treated as subscribing £90,000 for 120,000 shares.

Interaction with other income tax reliefs

Before the EIS income tax relief reduces your income tax liability you must deduct:

- relief for subscriptions for shares in venture capital trusts (VCTs);
- the relief which is given on taxable gains on life assurance policies.

All other reliefs and allowances which are given as reductions of income tax liability are deducted from your income tax liability after the EIS income tax relief.

Connection to a Company for EIS purposes

You can be connected with a company by virtue of a working relationship between you and the company, where you or any of your 'associates' are:

- an employee (other than a director who is an employee) of the company or any subsidiary; or
- a partner in any business partnership of which the company or any subsidiary is a member, or an employee (other than a director who is an employee) of such a partner; or
- a director of the company or any subsidiary, or a director of a partner in any business partnership of which the company or any subsidiary is a member; and
- you receive or are entitled to receive, or any associate of yours (or a business partnership of which you or any associate of yours is a member) receives or is entitled to receive, any kind of payment from the company (or any related person), apart from
  - payments for expenses incurred in the performance of duties as a director, which do not give rise to a tax charge in the hands of the director
  - fees for providing certain services to the company (or a related person), in the course of a business carried on by you or any associate of yours, excluding secretarial, or managerial services or services of a kind provided by the person to whom they are rendered
  - certain other kinds of payment (provided they are not in excess of a normal commercial rate). Broadly, these are dividends or other distributions, rent for property occupied by the company (or any

related person), interest on money lent to, or on behalf of, the company (or any related person), and payments for the supply of goods.

For further information on the definitions of “persons related to the company” and “subsidiaries” and how they apply to the connection rule visit: www.hmrc.gov.uk/eis/part1/1-3.htm

You may also be deemed connected with the company where whether on your own or together with your 'associates', you control the company or any subsidiary, or if you directly or indirectly possess, or are 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; or
  the assets of the company or any subsidiary on a winding-up.

However, if you or an associate of yours holds any shares in the company when it:

- has not issued any shares other than subscriber shares; and
- has not begun to carry on, or to make preparations for carrying on, any trade or business;

that fact will not cause you to be connected with the company for EIS purposes.

If an 'associate' of yours is connected with the company as a Business Angel but the relevant shares were issued before your associate became entitled to receive directors' remuneration (and hence became connected with the company for EIS purposes), you will not lose entitlement to income tax relief simply because you have become connected with the company in this way.

Also, provided you do not become connected with the company in any other way for EIS purposes, you may be eligible for income tax relief in respect of further investments you make in 'eligible shares' in the company.

Interest on financing loans

Although tax relief is available in certain circumstances for interest payments made in respect of loans used to acquire ordinary shares in 'close companies', you cannot qualify for such relief if you claim EIS income tax relief for the shares.

Loans to the company

You can lend money, or rent a property, to the company or any of its subsidiaries without putting your income tax relief at risk provided that:

- for a loan, it attracts interest at no more than a normal commercial rate; and
- for a property, the rent charged does not exceed market rent.

If you or an associate lend money to the company (or any person connected with it for corporation tax purposes) before the shares are issued to you, you may be treated as receiving value from the company if the debt is wholly or partly repaid in the ‘relevant period' [6].

For further information on income tax relief visit: www.hmrc.gov.uk/eis/part1/1-2.htm

Withdrawal of income tax relief

Claims to income tax relief are usually made before it is known whether all the conditions of the EIS have been satisfied in relation to the company and the shares. If it turns out that any of those conditions are not met, any income tax relief obtained will be withdrawn in full.

An investor's income tax relief will also be wholly or partly withdrawn in a number of other circumstances, many of which would trigger a chargeable event in relation to shares to which deferral relief is attributable.

There are six main circumstances in which income tax relief could be wholly or partly withdrawn:

- Relief will be wholly withdrawn if any of the share eligibility conditions of the scheme are not satisfied;
- Relief will be wholly withdrawn if any of the qualifying company conditions of the scheme are not satisfied;
- Relief will be wholly withdrawn if an event occurs which causes you not to meet the eligibility conditions for relief;
- Relief may be wholly or partly withdrawn if you dispose of the shares within three years;
- Relief will be wholly or partly withdrawn if you “receive value” from the company during the ‘relevant period’[6];
- Relief will be wholly or partly withdrawn in certain circumstances where other members of the company receive value during the ‘relevant period’[6].

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Income tax relief can be withdrawn if another member of the company receives value from the company during the 'relevant period'[6]. This may happen if the company buys back some of its shares from the other member. Your relief will not be affected, however, where the share buy-back causes any income tax relief or deferral relief attributable to that member's shares to be wholly or partly withdrawn.

If your income tax relief falls to be withdrawn you must notify your Tax Office, giving details of the reason. You may incur a penalty if you do not do this within 60 days of finding out that the relief falls to be withdrawn. If you receive value from the company before you claim income tax relief you will need to take the amount of value received into account when you make the claim, so that the amount of relief you obtain is correspondingly reduced. If the amount of value received is so great that relief would need to be withdrawn in full if you had already obtained it, you will not be able to claim any relief.

Where value was received on or after 7 March 2001, you may make restitution to the company in such a way that you are not treated as being in receipt of value.

For further information and examples of how to calculate the amount of income tax relief subject to withdrawal visit:
http://www.hmrc.gov.uk/eis/part1/1-5.htm

The Business Angel investor

To qualify for income tax relief as a Business Angel investor you must satisfy all other eligibility for income tax relief conditions except one: if you become a director of the company (or a subsidiary), you can receive payment for services you provided despite the fact that you thereby become connected with the company for EIS purposes. It is essential that you were issued with eligible shares before the start of any period for which you are entitled to receive payment.

You must never previously have been:

- connected with the company in any way for EIS purposes, and must not become connected with it in any way other than as described above; or
- involved in carrying on (whether on your own account or as a partner, director, or employee) the whole or any part of the trade or business carried on by the company or any of its subsidiaries.

If you make further investments in the company once you have become a paid director you can qualify for income tax relief subject to the usual annual investment limits, and if you do not become connected with the company for EIS purposes in any way other than by being a Business Angel (or because an 'associate' of yours is such a Business Angel), you can claim relief for further qualifying investments.

They must be made within the three years beginning with the latest date on which eligible shares were issued to you before you became connected with the company for EIS purposes as a paid director.

If you are already a director of the company, you can only become a Business Angel investor if you are not, and never have been a paid director of the company or any of its subsidiaries (or a paid director of a partner of the company or any of its subsidiaries), or connected with the company in any other way for EIS purposes.

Remuneration

The remuneration you receive, or are entitled to receive, must not exceed what is reasonable for the services you perform. Remuneration includes any payment, benefit or facility. The level of remuneration will not be challenged unless there are grounds for supposing that, in the circumstances, it is excessively high.

For more information on Business Angel investors visit:
http://www.hmrc.gov.uk/eis/part1/1-3.htm
or ask for our publication:
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Disposal of shares

You must keep your investment for at least three years after the date on which the shares were issued if you do not want to have any of the income tax relief withdrawn.

You can sell some or all of your shares within this period, but:

- you will lose some or all of the relief on the shares concerned; and
- any capital gain arising from the disposal will be taxable.

Transfers between spouses

Where shares are transferred to your spouse at a time when you are living together, any income tax relief attributable to the shares will continue to be attributable to them. The

Change to relevant intangible assets rule

From 6 April 2007 the rules relating to the transfer of a qualifying trade exploiting relevant intangible assets (RIAs) around a group of companies will be aligned with those currently relating to other qualifying trades so that RIAs can be moved around within groups without investors losing tax relief.

The previous rules restricted the transfer of a qualifying trade of exploiting relevant intangible assets (RIAs) around a group of companies.

tax treatment of any gain or loss arising from the subsequent disposal of the shares by your spouse is the same as if he or she had subscribed for them.

Making arrangements to ensure disposal

You will not be eligible for income tax relief if:

- the arrangements under which the shares are issued to you; or
- any arrangements made in connection with the share issue before the shares are issued to you.

include provision for their disposal during your 'relevant period'.

The inclusion of standard provisions in the company's Articles of Association, which require a shareholder to sell his or her shares if most of the shareholders accept an offer from a third party to purchase the entire share capital of the company, would not cause an investor to be ineligible for relief.

If, at any time during your 'relevant period'[6], you:

- are granted a 'put option', the shares to which the option relates will not qualify for income tax relief, and any income tax relief which has been obtained in respect of them will be withdrawn;
- grant a 'call option', any income tax relief attributable to the shares to which the option relates may be wholly or partly withdrawn.

Part disposals

Special identification rules apply if you make a disposal of part of your holding whenever income tax relief or deferral relief is attributable to some or all of the shares in it. For these purposes, the holding consists of all the company's shares you own which belong to the same class.

If income tax relief is attributable to shares which have been transferred to you by your spouse, they are treated for the purposes of the identification rules as though they were acquired by you on the day they were issued.

The first identification rule is the first-in-first-out (FIFO) rule. This treats shares you acquired on different days as being disposed of in order of acquisition.

The second rule applies where some of the shares you acquired on the same day have relief attributable to them and some do not. It is used only when, having applied the FIFO rule, it is necessary to determine which shares acquired on that day have been disposed of. Shares are treated as being disposed of in the following order:

(a) first, shares which do not have any relief attributable to them; then

(b) shares to which deferral relief, but not income tax relief, is attributable; then

(c) shares to which income tax relief, but not deferral relief, is attributable; then

(d) shares to which both income tax relief and deferral relief are attributable.

Where the income tax relief attributable to any shares falling within category (c) or (d) above was obtained as a reduction in income tax liability for the tax year preceding the one in which the shares were issued, those shares are treated as being disposed of before any other shares falling within that category.

Mergers and Takeovers

Where a company merges with or is taken over by another company, your shares are generally treated as if they had been disposed of. However, where the company becomes a wholly-owned subsidiary of a holding company in such a way that, as far as its capital structure is concerned, it effectively takes the place of the original company:

- any income tax relief attributable to shares you held in the original company which were exchanged for new shares in the holding company becomes attributable instead to those new shares; and
- the share exchange is treated for capital gains tax purposes as not involving a disposal.

Also an exception is made in certain circumstances where the merger or take-over takes place after the end of your 'relevant period' and after the other company has issued an EIS3 certificate.

For more information on disposal of shares visit:
http://www.hmrc.gov.uk/MANUALS/vcmmanual/VCM32300.htm

Capital gains and losses

Gains on disposal

If you make a gain on a disposal of shares to which income tax relief is attributable and the disposal is after the end of the 'relevant period', the gain which represents the increase in value of the shares over the holding period will be wholly exempt from capital gains tax if none of the income tax relief has been withdrawn, and the relief was:

- obtained in full on the total amount you subscribed for the shares; or
- not obtained in full solely because your income tax liability in the year for which relief was claimed was too low.

A proportion of this gain will be exempt from capital gains tax if the income tax relief was not obtained in full (unless this was because the income tax liability was too low), or the amount of income tax relief originally attributable to the shares has been partly (but not wholly) withdrawn.

The proportion is calculated by dividing the total amount of relief attributable to the shares disposed of by the amount of relief that would have been attributable to them if it had been obtained in full on the amount subscribed for those shares and none of it had been withdrawn. Examples of proportion calculation for capital gains tax exemption can be viewed at:
www.hmrc.gov.uk/cgt/shares/calc-cgt.htm

Loss relief

If you are an individual and dispose of shares to which income tax relief is attributable at a loss for capital gains tax purposes, you may claim loss relief on an amount equal to the loss (less any income tax relief attributable to those shares) provided that the disposal is made at arm's length.

You can also obtain loss relief where you do not actually dispose of the shares, if you:

- make a claim that the shares have become of negligible value; or
- receive a 'capital distribution' from the company in the course of its dissolving or winding up. In such circumstances the loss arises when the capital sum is received; or
- are treated for capital gains tax purposes as disposing of the shares on the dissolution of the company.

Loss relief is given as a deduction from your taxable income for the tax year in which the loss arises, or for the preceding tax year or both if there are sufficient losses. Your claim should specify which tax year you are claiming relief for and, where the claim is for two tax years, the year in which the relief should be given first.

Where you have insufficient taxable income in either or both of those years, any remaining part of the loss will be set against chargeable gains of the tax year of the loss or carried forward to be set against chargeable gains in future tax years.

Instead of claiming loss relief, you can, if you prefer, set the loss (less any income tax relief attributable to the shares) against chargeable gains in the usual way. Where you have insufficient income or gains to use up all of this adjusted loss, any unused part will be carried forward to set against chargeable gains arising in later tax years.

In some cases, if income tax relief is not attributable to the shares when the loss arises, it may still be possible for you to obtain loss relief.

For more information on capital gains and losses visit:
http://www.hmrc.gov.uk/cgt/shares/reliefs.htm

Deferral Relief

When a chargeable gain arises to you, it is usually assessed for the tax year in which it arises. Deferral relief enables you to postpone the gain until a later tax year if you subscribe for eligible shares in a qualifying company.

You can defer a chargeable gain which arises to you on the disposal of any asset, except where there is a disposal and acquisition of shares in the same company, or within the same group of companies. In addition, you can defer revived gains arising to you in respect of earlier EIS, Venture Capital Trusts (VCT) or capital gains tax reinvestment relief investments.

You can obtain deferral relief and income tax relief for the same share subscription provided you satisfy all the relevant conditions.

You cannot qualify for deferral relief if you are neither resident nor ordinarily resident in the UK when the gain which is to be deferred arises, or when you make the qualifying investment, that is, at the time the 'eligible shares' in question are issued to you.

Deferral relief can be claimed by individuals and by the trustees of certain trusts.

Outline of the main rules

In certain circumstances, if you make a qualifying investment you can claim to have some or all of the amount you subscribed for the shares concerned set against a chargeable gain.

Where an amount of expenditure is set against a gain in this way, an equal amount of the gain is treated for capital gains tax purposes as not having arisen. Instead, it is deferred until a chargeable event occurs in relation to the shares. A gain equal in amount to the amount of the deferred gain (or in some cases part of the amount of the deferred gain) is treated as arising when a chargeable event occurs.

Expenditure can be set against a gain in this way only to the extent that it has not already been set against a gain.

In this publication we refer to a gain which arises on account of a chargeable event in these circumstances as a revived gain.

Setting gains

You can set different parts of the total amount you subscribe for the shares against different gains or parts of different gains provided in each case that the gain arises to you at a 'qualifying time' in relation to the date of issue of the shares, and that no amount you have subscribed for 'eligible shares' or for shares in a Venture Capital Trust (VCT) has already been set against it (or against the part in question).

Trustees

There are two main categories of trustees who can obtain deferral relief in respect of qualifying investments.

The first category consists of trustees of settlements in which:

- the beneficiaries are all individuals or charities; and
- no beneficiary holds an interest in possession in the settled property either at the time of the disposal of the asset or immediately after the shares are acquired.

The second category consists of trustees of settlements in which:

- the beneficiaries are all individuals or charities; and
- at least one beneficiary holds an interest in possession in the settled property at the time of the disposal of the asset, and at least one beneficiary - not necessarily the same one - holds an interest in possession in the settled property immediately after the shares are acquired.

Joint investments

If you make an investment jointly with someone else you can obtain deferral relief but the amount of gain that you can defer in respect of the investment cannot exceed the amount you contributed towards the joint subscription. For example, if you and your spouse jointly subscribe £120,000 for eligible shares, and your contribution is £40,000, you cannot set more than £40,000 of the subscription against chargeable gains which arise to you.

Qualifying investments

You can make a qualifying investment if:

- you subscribe wholly in cash for 'eligible shares' in a qualifying company the subscription is made for bona fide commercial reasons and not for tax avoidance purposes;
- the shares are issued to you at a 'qualifying time', and, where this happens before the gain that is to be deferred arises, you still hold the shares when that gain arises;
- the shares are fully paid up when they are issued;
- the shares are not treated for deferral relief purposes as never having been eligible shares;
- the share issue meets the conditions applying to an issue of eligible shares; and
- the arrangements under which the shares are issued to you, and any prior arrangements made in connection with the issue, do not include any provisions which are designed to:
  - enable you to realise your investment later on; or
  - secure an investment return or protect you against risks which the investment would otherwise involve.

Connection to a Company for EIS purposes

You can qualify for deferral relief on making a qualifying investment if you are connected to the company for EIS purposes even if you wholly own the company in which you invest.

Interest on financing loans

You can use a loan to finance a subscription for shares provided that the loan is not 'linked to the share subscription'.

Although tax relief is available in certain circumstances for interest payments made in respect of loans used to acquire ordinary shares in 'close companies', you cannot qualify for such relief if you claim deferral relief for the shares.

Loans to the company

You can lend money, or rent a property, to the company or any of its subsidiaries without putting my deferral relief at risk provided that:

- for a loan, it attracts interest at no more than a normal commercial rate; and
- for a property, the rent charged does not exceed market rent.

If you lend money to the company (or any person connected with it for corporation tax purposes) before the shares are issued to you, you will be treated as receiving value from the company if the debt is wholly or partly repaid in connection with any arrangements concerning the share acquisition. The consequence of receiving value[6] in the 'relevant period' is that the shares are treated as ceasing to be 'eligible shares' or as never having been eligible shares, depending on when the value is received.

Share redemption by the company

You may be able to obtain deferral relief if the company has redeemed any of its shares depending on when the redemption occurred. You will not be able to obtain deferral relief in certain circumstances where the company redeemed any of its shares within the two year period ending on the date on which your shares were issued. You may also be denied relief if share redemptions are made during that period by subsidiaries of the company.

Deferral relief limits

There is no upper limit and no minimum amount that can be claimed as deferral relief. But, the maximum amount you can invest in a single company is limited if the investment is to qualify for deferral relief purposes. This is because an issue of eligible shares cannot qualify for EIS purposes if the gross assets rule is not satisfied.

For more information on the main rules regarding deferral relief visit: www.hmrc.gov.uk/manuals/vcmmanual/vcm68000.htm

Chargeable events, capital gains and losses

If you dispose of any shares to which deferral relief is attributable a chargeable event occurs in relation to those shares except where the disposal is a 'disposal within marriage', and the relevant revived gain will arise to you.

If you dispose of all the shares, then the amount of the revived gain will be equal to the total amount of the original gain against which expenditure on the shares was set.

If you make a disposal of part of your holding of shares to which deferral relief is attributable, then the revived gain will be equal to a proportionate amount of the original gain. Deferral relief will continue to be attributable to the remaining shares in the holding.

Transfers between spouses

If you subscribe for shares and subsequently transfer them to your spouse on a 'disposal within marriage', any deferral relief attributable to the shares will continue to be attributable to them after the transfer, and no chargeable event will arise in relation to the shares on account of the transfer.

If your spouse later disposes of the shares to a third party, the revived gain which arises on account of the disposal will arise to your spouse even though you were the person who deferred the original gain.

Capital gains tax exemption

Disposing of shares to which deferral relief is attributable at a profit has no bearing on whether any gain is exempt from capital gains tax. If EIS income tax relief is also attributable to the shares, part or all of the gain which represents the increase in value of the shares over the holding period may be exempt if the disposal takes place at least three years[1] after the shares were issued.

Part disposals

If deferral relief is attributable to some shares in your holding, and you make a part disposal, special identification rules apply. See the *"Disposal of Shares"* section.

Where you hold shares to which deferral relief is attributable which have been transferred to you on a 'disposal within marriage', they are treated for the purposes of the identification rules as though they were acquired by you on the date they were issued.

Loss relief

The circumstances in which loss relief is available where the investor is an individual and income tax relief is not attributable to the shares in question is covered in the section *"Capital gains and losses"*. Trustees of trusts cannot obtain relief for losses against taxable income.

Update: All change for Capital Gains Tax

From 6 April 2008 there is a single rate of capital gains tax of 18 per cent levied on the gains on disposal. As part of this new system, the annual exemption will remain in place, but taper relief and indexation allowance was withdrawn.

A new "Entrepreneur's Relief" offered some respite from the tax: qualifying capital gains for each individual are subject to a lifetime limit as follows:

- for disposals on or after 6 April 2008 to 5 April 2010, £1 million;
- for disposals on or after 6 April 2010 to 22 June 2010, £2 million;
- for disposals on or after 23 June 2010 to 5 April 2011; £5 million; and
- for disposals on or after 6 April 2011, £10 million.

Contact us for more information on how this may affect you or your business.

You will be able to set the loss against chargeable gains - including the revived gain which arises on account of the disposal - in the usual way if you do not qualify for loss relief or if you decide not to claim it.

Mergers and takeovers

Where a company merges with or is taken over by another company, your shares are generally treated as if they had been disposed of. However, where the company becomes a wholly-owned subsidiary of a holding company in such a way that, as far as its capital structure is concerned, it effectively takes the place of the original company:

- any deferral relief attributable to shares you held in the original company which were exchanged for new shares in the holding company becomes attributable instead to those new shares; and
- the share exchange is treated for capital gains tax purposes as not involving a disposal.

A further exception is made in certain circumstances where the merger or take-over takes place after the end of your 'relevant period' and after the other company has issued an EIS3 certificate.

Other chargeable events

The main events (other than a disposal) which can cause a chargeable event to occur in relation to shares to which deferral relief is attributable are where:

- you cease to be resident or ordinarily resident in the UK within three years after the shares were issued. This does not apply, however, if the reason for your change in residence status is that your employment duties are performed wholly outside the UK, provided that you become resident or ordinarily resident in the UK again within three years without having disposed of any of the shares in the meantime;
- the shares cease to be 'eligible shares' because at some time during the period of three years after they are issued they cease to be ordinary shares or, for example, acquire a preferential right to dividends; or
- the shares are treated for deferral relief purposes as ceasing to be 'eligible shares'.

Notifying a chargeable event

If a chargeable event occurs in relation to your shares you must give details on your tax return for the tax year in which you dispose of the shares, or in which any other chargeable event occurs which causes the revived gain to arise. If any chargeable event occurs within the period of three years after the shares are issued, you must notify your Tax Office within 60 days of finding out about it, giving details of the circumstances which caused the revived gain to arise.

Receiving Value from a Company

The EIS is subject to a number of rules which are designed to ensure that investors do not obtain the full benefit of EIS reliefs if they receive value from the company during the 'relevant period'[6]. The consequence of receiving value during the 'relevant period' is that the shares are treated as ceasing to be 'eligible shares' or as never having been eligible shares, depending on when value is received.

The value received rules were changed in Finance Act 2001 to enable investors who receive value to prevent their EIS reliefs being put at risk by making appropriate restitution of value. Provision was also made for receipts of insignificant value (£1,000 or less) in certain circumstances to be ignored.

Receiving value

The main circumstances that are regarded as giving rise to you "receiving value" are where the company (or any person connected with it for corporation tax purposes):

- buys any of its shares or securities which belong to you or an 'associate', or makes a payment in return for the holder giving up the right to them;
- makes a payment to you or an associate for giving up the right to payment of a debt (other than an ordinary trade debt);
- repays a debt owed to you or an associate that was incurred before you subscribed for the shares, except, for deferral relief purposes, where the repayment is not made in connection with any arrangements concerning the share acquisition;
- waives any liability of yours or an associate's to the company, or discharges, or undertakes to discharge, any such liability to a third party;
- lends or advances you or an associate money which has not been repaid before the shares are issued;
- provides you or an associate with certain benefits or facilities. The provision of a benefit or facility:
  - does not cause value to be received for deferral relief purposes if a payment of equal value would be a

Budget 2009 changes

Legislation was introduced in Finance Bill 2009 to make a number of improvements to the EIS scheme including:

- relaxing the time limits concerning the employment of money invested;
- removing the link to other shares of the same class issued at the same time as qualifying shares;
- extending the period for carry back of relief and allows the full amount subscribed (subject to the overriding limit) to be carried back;
- correcting an anomaly regarding the capital gains position for investors in the event of a share for share exchange.

'qualifying payment';
- as part of a Business Angel's remuneration package, is not treated as a receipt of value for income tax relief purposes if the package, taken as a whole, represents reasonable remuneration;

- acquires an asset from you or an associate for more than its market value, or disposes of an asset to you or an associate for less than its market value; or
- makes any other payment to you or an associate which is not a 'qualifying payment'.

You also receive value if:

- the company (or any company connected with it for corporation tax purposes) is wound up or dissolved and you or any of your associates receive any payment or asset in the winding up or in connection with the dissolution. (This is treated as a receipt of value only in relation to income tax relief); or
- anyone connected with the company for EIS purposes buys any of its shares or securities which belong to you (or an associate), or makes a payment in return for the right to those shares or securities being given up.

The value received rules were changed in Finance Act 2001 to enable investors who receive value to prevent their EIS reliefs being put at risk by making appropriate restitution of value. Provision was also made for receipts of insignificant value (£1,000 or less) and for a buy-back of shares from another investor in the company of an insignificant amount to be ignored in certain circumstances.

For shares issued after 16 March 2004, existing EIS investors will be able to lend money to the company to help tide it over a short-term cash flow problem without losing their claim to EIS income tax relief in the following twelve months, providing that the repayment of the loan is not made in connection with arrangements for the acquisition of those shares. Shares issued as a result of "converting" a loan will still not qualify for EIS relief.

Calculating the value received

The amount is calculated in the following way.

- If value is received because shares or securities are bought back, a debt is repaid, or a payment is made in return for the right to shares, securities, or a debt being given up, the amount of the value is the greater of:
  - the amount received; and
  - the market value of the shares, securities, or debt in question.
- Where a liability is waived, the value received is the amount of the liability;
- Where a loan or advance is made, the amount of the value is the balance outstanding when the shares are issued;
- Where a benefit or facility is provided, the amount of the value received is the cost of providing it less any consideration given for it by the person receiving it;
- Where an asset is acquired for more, or disposed of for less, than its market value, the amount of value received is the difference between the amount paid for the asset and its market value;
- Where value is received in the form of a payment or an asset, the amount of the value is the amount of the payment or the market value of the asset.

If the company buys back any of your shares to which income tax relief or deferral relief is attributable, you will not be treated as receiving value if you make a disposal of shares which:

- causes any income tax relief attributable to those shares to be withdrawn; or
- triggers a chargeable event for deferral relief purposes.

For more information on receiving value visit:
http://www.hmrc.gov.uk/manuals/vcmmanual/VCM40100.htm

Claiming Reliefs

In order to claim income tax relief or deferral relief you must first have received an EIS3 certificate from the company which issued the shares. In the case of joint investments, each co-investor who wishes to claim relief will need to obtain an EIS3 certificate from the company.

The latest date for making a claim is five years after the first 31 January following the tax year to which the claim relates.

Claiming income tax relief

Once you have received the EIS3 certificate from the company that issued the shares you can make the claim by entering it in your tax return for the tax year for which you obtain the relief.

Under certain circumstances a limited amount of income tax relief can be carried back to an earlier tax year. It cannot be carried forward to a later tax year.

Claiming loss relief

To claim relief for an allowable loss against income, you must give written notice either by letter or through your tax return to your Tax Office within 12 months from the first 31 January following the tax year in which the disposal takes place. There is no special form for claiming loss relief. For example, for the tax year 2010-11 you must make a claim by 31 January 2013. Relief must be claimed for the full amount of the loss (less any income tax relief attributable to the shares).

Loss relief may be claimed against your income for:

- the tax year in which the allowable loss arose; or
- the preceding tax year.

In your claim you should specify the source of the loss, the tax year of the loss, and the tax year for which income is to be relieved.

If the amount of the loss exceeds your taxable income for either of the two years for which loss relief can be claimed, you may claim to have the loss relieved against your taxable income of that year and the balance in the other year.

Where you also have trading losses, loss relief will be given before any relief from income tax that you claim in respect of losses sustained in a trade, profession, vocation or employment.

Where the shares have become of negligible value this can be declared by making an entry on your tax return or by writing to your Tax Office.

In some circumstances, loss relief can be carried back to a previous year or forward to be set against future gains.

Claiming deferral relief

Once you have received the EIS3 certificate you can make the claim by completing the claim section of form EIS3 and sending it to your Tax Office. You do not need to submit the claim with your tax return, but you should not send it to your Tax Office before you have submitted the tax return giving details of the gain to which your claim relates.

You will need to specify in your claim:

- the amount of the chargeable gain against which expenditure on the shares is to be set;
- the date on which the chargeable gain arose (if you have made two or more gains on the same day you will need to specify which gain is in point); and
- where expenditure on the shares is to be set against two or more gains, the amount of expenditure which is to be set against each gain.

Where a chargeable gain arose on the disposal of an asset you will also need to specify the nature of the asset.

Where expenditure on the shares is to be set against gains which arise at different times, you can claim deferral relief in respect of any gains arising after the form was submitted. You should provide your Tax Office with:

- the relevant details specified above in respect of each gain for which relief has not already been claimed; and
- the date of any earlier claim you have made for income tax relief or deferral relief in respect of the shares in question.

For further information on claiming reliefs visit:
www.hmrc.gov.uk/manuals/vcmmanual/VCM25470.htm

EIS Investment Funds

Investment through an EIS investment fund allows money pooled by several investors to be subscribed for shares in a range of companies selected by the fund manager.

There are two categories of EIS investment funds as far as tax is concerned, they are:

- approved investment funds (AIFs); and
- unapproved funds.

Approval, which is given by the Board of HM Revenue & Customs, does not guarantee the safety or success of the investments made through the fund in question. It simply means that the fund satisfies certain administrative criteria laid down by the Board.

Approved funds

If an EIS fund is approved under section 251 ITA, investors can claim EIS income tax relief on their subscriptions as if those subscriptions had been made on the date the fund closed.

For approved funds with a closing date on or after 7 October 2006, this is conditional on funds being at least 90% invested within 12 months of the closing date. Previously funds needed to be 90% invested within 6 months of the closing date.

Approved Funds

An investment fund must satisfy the following main conditions to be approved:

- shares in at least four companies must be acquired by the fund and allocated between the investors in proportion to the amounts they have contributed;
- no investments may be made by the fund until after it closes (the fund closes on the latest date on which applications to participate in it can be accepted);
- it must be expected that the conditions of the scheme which apply in relation to shares and companies will be satisfied for all the investments made by the fund; and
- there are rules about how much of an individual's investment in a fund must be subscribed by the fund as nominee within 12 months of the fund closing.

Full details are given in the document *Enterprise Investment Scheme: Guidelines for the Approval of Investment Funds* which prospective fund managers may get at:
http://tinyurl.com/c9rjcsr
or from:

Business Tax (EIS - Technical)
HM Revenue & Customs
100 Parliament Street
Spur 3/35
London, SW1A 2QB
Tel: 020 7147 2626

Special tax advantages are enjoyed by individuals who invest through AIFs as follows:

- the lower limit on the amount an individual used to have to subscribe for shares in a company to qualify for income tax relief does not apply where the investment in that company is made on his or her behalf by the manager of an approved fund; and
- for the purposes of determining the tax year for which you can get income tax relief, all shares acquired through the fund are treated as if they had been issued on the date when the fund closed, if certain conditions are satisfied.

NOTE: Where an AIF was approved before 22 March 2006 and started raising money before 6 April 2006, investment can be made in companies which meet the gross asset limit of £15 and £16 million.

Claiming the EIS relief

In the case of an approved fund, the manager issues a form EIS5 to the investor who uses it in place of form EIS3. Form EIS5 can be used to report investments in several companies.

If the fund is unapproved, the fund manager issues a separate form EIS3 to the investor for each company in which the fund invests.

For further information on EIS investment funds visit:
http://www.hmrc.gov.uk/eis/part1/1-6.htm

Useful Links

The following sources of information will be able to provide further information on the EIS.

Small Company Enterprise Centre (SCEC)

The SCEC deal with enquiries from companies using the Enterprise Investment Scheme (EIS), Venture Capital Trust (VCT) scheme, the Corporate Venturing Scheme (CVS) and Enterprise Management Incentives (EMI):

Small Company Enterprise Centre
HM Revenue & Customs
1st Floor Ferrers House
Castle Meadow Road
Nottingham, NG2 1BB
Tel: 0115 974 1250
Email: enterprise.centre@ir.gsi.gov.uk

Enterprise Investment Scheme Association (EISA)

EISA represents professional advisers of companies using the EIS, is able to provide information to investors, companies and financial advisers about the scheme:

Erico House
93/99 Upper Richmond Road
London, SW15 2TG
Tel: 020 8785 5560
Email: members@eisa.org.uk
Website: www.eisa.org.uk

The British Private Equity and Venture Capital Association (BVCA)

The BVCA lists many business introduction services in a free publication 'Sources of Business Angel Capital':

1st floor North
Brettenham House
Lancaster Place
London, WC2E 7EN
Tel: 020 7420 1800
Website: www.bvca.co.uk

HM Revenue & Customs

HM Revenue & Customs guidance is available at:
http://www.hmrc.gov.uk/eis/index.htm

Further Information

This publication is for general interest - it is always essential to take professional advice on specific issues. The main guidance from HMRC on the EIS is available online at: http://www.hmrc.gov.uk/eis/guidance.pdf

We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

If you would like to receive further information about this subject or other publications, please call us – see our contact details on the next page.

References and Acknowledgement

[1] Five years for shares issued before 5 April 2000. However if the shares were issued to raise money to enable the company (or a subsidiary) to prepare to carry on a qualifying trade, the period begins when the shares are issued and ends three years after the company (or subsidiary) begins to carry on that trade.

[2] For shares issued on or after 7 March 2001, at least 80% of the money must be employed for the purpose of the 'qualifying business activity within 12 months after the date on which the shares were issued, and any amount remaining must be used for that activity within the following 12 months. For investments made after 22 April 2009, the money raised must be wholly employed within two years, or, if later, within two years of the commencement of the qualifying activity.

[3] These gross asset figures were reduced in the Budget 2006 from £15 million and £16 million to £8 million and £7 million respectively for shares issued on or after 6 April 2006. The old rules continue to apply in relation to shares issued after that date providing they were subscribed for before 22 March 2006.

[4] The annual investment limit was doubled in the Budget 2006 from £200,000 to £400,000 for shares issued on or after 6 April 2006. The old rules continued to apply in relation to shares issued after that date providing they were subscribed for before 22 March 2006. The limit was further increased in the Budget 2008 to £500,000 from 6 April 2008.

[5] …or treated under the carry back provisions as issued in the same tax year.

[6] For EIS shares issued before 5 April 2000, the 'relevant period' was the "seven year period". For EIS shares issued after 5 April 2000 but before 7 March 2001, the 'seven year period' was replaced by a period starting two years before the share issue and ending immediately before the 'termination date' relating to the shares. A further change was introduced for value received on or after 7 March 2001, when the period in question was shortened so that it begins one year before the date on which the shares are issued and ends on the 'termination date'.

[7] For shares issued on or after 7 March 2001, the company need not remain unquoted throughout its 'relevant period' provided there are no arrangements in existence at the time the shares are issued for the company to cease to be an unquoted company. Similarly, if, at the time the shares were issued, arrangements existed for the company to become a subsidiary of a holding company (where as far as its capital structure is concerned, it effectively takes the place of the original company) there must not, at that time, have been any arrangements in existence for that holding company to cease to be an unquoted company. For shares issued before 7 March 2001, the company may cease to be an unquoted company during an investor's 'relevant period' without jeopardising his or her EIS reliefs provided this occurs on or after 7 March 2001 and, at the time the shares were issued, there were no arrangements in place for it to happen.

[8] For shares issued on or after 16 March 2004, 'any subsidiary' relates to a 'qualifying 90% subsidiary' of the company. NOTE: From 6 April 2007 a qualifying trade may also be carried on by subsidiaries that are 100% subsidiaries of direct 90% subsidiaries of the parent, or 90% subsidiaries of direct 100% subsidiaries.

[9] For shares issued on or after 16 March 2004, the activities for which the money was raised must be carried on by the company that raised the money or any qualifying 90% subsidiary of that company. There is no longer a requirement that the same company must carry on the trade throughout.

[10] © Much of the text in this publication is derived from HM Revenue & Customs (HMRC) and we acknowledge it as Crown copyright. The main guidance from HMRC on the EIS is online at: http://www.hmrc.gov.uk/eis/guidance.pdf

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Publication issued or updated on:
1 May 2012

Ref: 323

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