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Client Briefing Note

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Enterprise Investment Scheme – an alternative solution

The Enterprise Investment Scheme (EIS) is intended to encourage investment in the shares of smaller trading companies by offering income tax and capital gains tax reliefs and exemptions where certain conditions are satisfied. This scheme can be very tax efficient for entrepreneurs and investors. The main advantages are noted below.

- Income Tax Relief of 20%, - on the lower of the amount invested (maximum £500,000) and the individuals tax liability for the year, given as a reduction in tax payable. The investment must be held for three years to avoid any clawback of relief.

- Capital Gains Tax (CGT) Deferral, - a capital gain made on the disposal of *any* asset, may be deferred if EIS shares are subscribed for. For every £1 invested the investor can defer £1 of gain. The gain is 'frozen' until, usually, the EIS shares are sold.
  This may be especially advantageous as on disposal the gain would then be subject to tax at the current rate and it may be possible to claim reliefs or implement further planning to reduce the liability further.
  As the rate of Capital Gains Tax has reduced to 18% there is therefore an opportunity to reduce the ultimate tax liability on a gain which has been taxed at a higher rate. If the tax has already been paid, a repayment would be due from HMRC

- Capital Gains Tax Exemption, - any disposal of the EIS shares at a gain after the 'relevant period' (broadly three years from the issue of the shares) will be exempt from CGT.

- Inheritance Tax, - after the investment has been held for two years it should be exempt from Inheritance Tax under Business Property Relief provisions. It may also be possible to avoid liabilities on lifetime gifts which have become chargeable.

- Loss Relief, - if EIS shares are sold at a loss this is allowable and can be set against general income of the same and/or preceding year.

There are various conditions to be satisfied by the company and the investor before relief can apply, including the requirement that the company must be carrying on a qualifying trade which excludes less risky trades such as farming and property backed businesses. For the income tax relief to apply the investor must not be connected with the company although this does not apply to the CGT deferral relief.

Various different investment schemes are available with companies specialising in providing packaged EIS investment products. Schemes can range from traditional small company investments to schemes with reasonable risk EIS strategies, offering a simple and potentially reduced risk solution to individuals who wish to defer Capital Gains Tax and also reduce income tax and inheritance tax liabilities.

Alternatively, it may be possible to register your existing business as an EIS qualifying company, with a view to subscribing for shares to defer capital gains, or as an incentive to outside investment.

If you have made capital gains in recent years or have money you would like to invest in a tax efficient manner, the Enterprise Investment Scheme is well worth consideration.

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