KEY TAX RELIEF CONSIDERATIONS

For UK investors, there are some extremely beneficial tax reliefs for private investors investing directly into companies. We are grateful to Adrian Walton at Smith & Williamson for his contribution to this section.

WHAT ARE THE TAX BENEFITS OF THE ENTERPRISE INVESTMENT SCHEME (EIS)?

The Enterprise Investment Scheme (EIS) can be an important benefit for Investors in terms of offering generous Income Tax, Capital Gains Tax (CGT) and Inheritance Tax benefits. There is detailed information on the EIS scheme available from the Inland Revenue website at http://hmrc.gov.uk/eis

EIS is an extremely attractive tax relief used to encourage private individuals to invest in unquoted companies. The key benefits can include:

a) Income tax relief of 30% of the amount subscribed for eligible shares
b) Exemption from Capital Gains Tax (CGT) on any gains from selling your EIS shares
c) Further income tax relief at top rate of income tax (40% or 45%) for any losses made on the disposal of EIS shares and
d) Unlimited deferral of capital gains

Example of Income Tax relief under EIS

		40 % Tax Payer	45% Tax Payer	
Initial investment		£10,000		**A**
Tax relief	30%	£3,000		**B**
'Real' Initial Investment		£7,000		**C**
In the event of the company failing totally				
Disposal of shares ("£0" for total loss)				
Effective loss		£10,000	£10,000	**= A**
Further tax relief on		£7,000	£7,000	**= C**
Further tax relief		£2,800	£3,150	**D**
Total at risk		**£4,200**	**£3,850**	**A - (B+D)**

Due to the interaction of the above loss reliefs, an investor may be eligible for income tax relief of up to 61.5% of his/her original investment in the event of a total loss.

The qualifying company

The main condition is that the scheme be limited to unquoted companies with gross assets of less than £15 million immediately before, and no more than £16 million immediately after, the investment.

Qualifying trades

The definition of qualifying trades is quite extensive, but certain activities (such as most dealing operations, banking, leasing, legal, and accounting services) are specifically excluded, as are those considered to be 'asset backed' (farming, forestry, property development, hotels, and nursing homes).

For a full list, please see Section 2-4 at http://www.hmrc.gov.uk/eis/part2/2-4.htm
(Please note, the HMRC change their URLs frequently)

Outline of the scheme rules

Throughout its relevant three-year qualifying period, the company must:

• **Be an unquoted company** less than 12 years old. A company that is over 12 years in operation will need to show a significant change in business activities in order to qualify

• **Be a trading company**, carrying on a qualifying trade or have a 90% subsidiary which does so

• **Exist for genuine commercial purposes**, and not be part of a scheme for the avoidance of tax

• **Not be a 51% subsidiary of another company**, or otherwise be under the control of another company

• The company issuing the eligible shares must have a "**permanent establishment" in the UK**

In addition:

• An investor cannot be 'connected' with the EIS company, i.e. he or she cannot own more than 30% of the shares, directly or indirectly

• Individuals who are paid directors or employees of the EIS company at the time of the issue of shares are normally disqualified from claiming EIS relief. Qualifying investors can in certain circumstances be paid for their work as a director, provided they were not involved in carrying on the trade of the company and had not received remuneration up to the point of making the investment

• The money raised by the EIS share issue must be wholly used for the qualifying business
activity

• Schemes that involve guarantees of exit arrangements will not attract tax relief i.e. shares have to be straight ordinary shares

• The company must have a maximum of 499 employees and less than £15m and £16m of gross assets immediately before and after the investment respectively

• Total investment into a company under EIS is capped at £15m; the cap is a little higher - £20m - for knowledge intensive companies

• The amount of investment which a company can raise through EIS is £5m in any 12 month period

• The annual amount that an individual can invest in qualifying EIS companies is £1m

How to reclaim EIS relief (for investors)

A company in which you have invested should provide you with a EIS 3 form, usually four months after the investment has been made. You will need to enter the total EIS investment amount on your tax return. This will come off your next tax bill or a repayment will be received.

WHAT IS THE NEW SEED ENTERPRISE INVESTMENT SCHEME (SEIS)?

The Seed Enterprise Investment Scheme (SEIS) was described as “one of the best tax breaks on offer” James McKeigue, Moneyweek, offering a tax relief of 50% for all tax-paying investors, regardless of their marginal tax rate.

Please see below a quick Q&A to differentiate SEIS from EIS:

What is the tax relief on an investment made under the SEIS?

The rate of Income Tax relief given to investors in SEIS companies is 50%.

Does the 50% tax relief depend upon your higher level of tax?

No, the 50% rate is available to all UK tax payers, regardless of your marginal rate.

What size of business can I invest in?

The company must be unquoted, have 25 or fewer employees and assets of up to a maximum of £200,000 at the point of investment.

How much can I invest?

Up to £100,000 in a start-up company per tax year.

What is the maximum equity financing a Company can raise under SEIS?

The maximum cumulative investment in one company is £150,000 per three year period.

What Capital Gains Tax will I pay on any reinvested gains?

For 2014/2015, where a capital gain is realised and invested under this scheme in 2014/2015, the gain will be exempt from tax provided that the SEIS shares are held for the three year qualifying period. As under EIS, any gains made on the SEIS shares will be free of Capital Gains Tax once held for at least three years.

What else should I know?

- The investment must be in a new business. Broadly, any trade carried on by the company must be less than 2 years old at the date of the relevant share issue.

- Directors or executives cannot use the scheme to invest in their own companies if they hold more than 30% of the equity to the relevant company.

- HMRC will run checks to make sure that a business hasn't just been set up to access the relief.

- The combined effect of the CGT holiday and the income tax break offers relief of up to 72.5% in the first year.

- Once 70% of funds raised under the SEIS have been spent the company may raise funds under the EIS, or from VCTs

Example of Income Tax relief under SEIS

		40 % Tax Payer	45% Tax Payer	
Initial investment		£10,000		**A**
Tax relief	50%	£5,000		**B**
'Real' Initial Investment		£5,000		**C**
In the event of the company failing totally				
Disposal of shares ("£0" for total loss)				
Effective loss		£10,000	£10,000	**= A**
Further tax relief on		£5,000	£5,000	**= C**
Further tax relief		£2,000	£2,250	**D**
Total at risk		**£3,000**	**£2,750**	**A - (B+D)**