Understanding Enterprise Investment Schemes (EIS)

What is an EIS?

The Government introduced Enterprise Investment Schemes (EIS) in 1994 to encourage people to invest in smaller companies. They are designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

There are three different types of EIS:

Single Company EIS

If you are going to invest in a small business, you may be able to do so through a single company EIS. As the investment is concentrated in just one company, the lack of diversification brings additional risk to this approach. There is often no opportunity to sell your shares unless the company is sold or it has enough cash reserves to buy back its shares.

EIS Portfolio (or unapproved EIS funds)

An EIS portfolio is generally a professionally managed service that invests on your behalf in a number of underlying EIS investments –often at least 10 different companies. Tax relief is available from the date the EIS invests in each company, not when you place your money with the fund manager.

Approved EIS fund

An approved EIS fund must have four or more different underlying companies. HMRC provides clearance of the EIS qualifying status before its launch. This approval has no bearing on the underlying investments or whether the companies will be successful. However, it means income tax relief is given in the tax year the EIS fund closes. Capital Gains Tax (CGT) deferral is not available until the manager has made the underlying investments. An ‘approved knowledge-intensive fund’ which requires the funds to focus on investments in knowledge-intensive companies requires the manager to invest 50% of fund capital within one year of the fund closing and 90% within two years, compared to the current requirement of 90% within one year for funds which are not.

- **Please note, whilst the tax regulations refer to Enterprise Investment Schemes as “Funds” they should not be confused with mutual funds or collective investment schemes.**
- **An investor in an EIS fund will be the owner of shares in the underlying companies, rather than owning shares or units in any fund.**

Contribution Limits

The annual investment limit for EIS investors is **£2 million**, provided that any amount above £1 million is invested in knowledge-intensive companies.

Tax Reliefs and potential benefits

Provided the underlying investment remains qualifying and is held for at least three years, investment into an EIS offers significant tax reliefs including:

- 30% income tax relief (on investments up to £2million per tax year where the amount over £1m must be in “knowledge-intensive” companies). Relief is further restricted to your income Tax liability in the year of share acquisition (or the previous year if you elect to ‘carry back’ your purchase to the previous tax year.
- Capital gains tax deferral (assuming the investment is made within the period one year before or three years after the gain arose).
- 100% inheritance tax relief after two years through Business Relief(provided funds remain invested and remain qualifying at the time of death).
- Ability to offset losses against income tax.
- Disposal of qualifying shares at a profit are usually exempt from capital gains tax, as long as the shares have been held for three years. Income tax or capital gains tax relief is available on losses on such disposals (net of tax relief given).

Liquidity Issues

Generally there is little or no liquidity in EIS companies or funds. EISs are investments in individual unquoted companies and EIS funds can consist of as few as four unquoted companies. Shareholders are normally locked in to the investment with no means to dispose of the shares, until the company directors or fund managers achieve an exit (e.g. quoted market flotation, trade sale or share buy-back).

Important Information

Our advice has been prepared based on our company’s understanding of the current law and HM Revenue and Customs’ practice. Whilst we believe the interpretation is correct we cannot guarantee it. Tax treatment may change in the future.

PLEASE REFER TO YOUR SUITABILITY LETTER FOR THE SPECIFIC RISK WARNINGS RELATING TO YOUR EIS RECOMMENDATION.