

Latest EIS Tax Benefits 2011-12

This document outlines and illustrates the key tax efficient benefits of investing in qualifying EIS companies and funds post the latest budget announced by George Osborne 23rd March 2011.

The examples are for illustrative purposes only and you should discuss options with an EIS expert.

The Enterprise Investment Scheme ("EIS") is a Government scheme that provides a range of tax reliefs for investors who subscribe between £500 and £500,000 for qualifying shares in qualifying companies. This document represents the very latest position on EIS Reliefs.

There are five current separate EIS tax reliefs:

1. 30% Income Tax Relief

If an EIS qualifying investment is held for at least three years from the date of issue, or three years from commencement of trade (if later) an individual (who holds no more than a 30% interest in the company) can reduce their income tax liability by 30% of the amount invested from April 6th 2011. Income tax relief on up to £500,000 can also be claimed for the 2010 tax year at the previous 20% rate. The minimum subscription is £500 per company and the maximum is £500,000 in EIS to get income tax relief in any year for 2011 and earlier. Income Tax Relief is offset in the appropriate year of claim, up to a maximum of the income tax liability. In other words, initial income tax relief could reduce your tax bill to nil. However, any excess should be applied to the previous tax year in order to maximise the effect of this relief.

Individuals may elect to treat their subscription for EIS shares as if made in the previous tax year, up to their maximum annual allowance, thereby effectively carrying income tax relief back one year.



Worked Example:-

Income tax relief is available to individuals (counting husbands and wives separately) for the entire amount subscribed for eligible EIS qualifying company shares at 30%, to a maximum of £500,000.

This relief is usually passed to the Investor in the form of a tax rebate or via an adjustment in PAYE code. The relief may only be claimed once the investor has received form EIS 3 from the company.

Initial Investment	£100,000
Less Income Tax Relief @ 30%	(£30,000)
Net Cash Outlay for Investment	£70,000

Subscriptions may be treated as made in the previous tax year, provided the total claim, with any amount already subscribed for the previous year has not exceeded the annual limit of £500,000 in any tax year. An investor who had made no EIS investment in a tax year may subscribe up to £1m in the following tax year and elect to carry back £500,000 to the previous tax year to claim income tax relief.

2. CGT Freedom

No Capital Gains Tax is payable on disposal of shares after three years or three years after commencement of trade, if later, provided the EIS initial income tax relief was given and not withdrawn on those shares.

Worked Example

There is no CGT payable on gains in respect of Investments made in an EIS Company (on which EIS Income Tax Relief has been obtained and not withdrawn) where the Investments have been held for at least three years from the date of subscriptions, or from the date of commencement of the EIS Company's trade, if later. Income Tax relief must be granted on shares in order to qualify for CGT Relief



Initial Investment	£100,000
Less Income Tax Relief @ 30%	<u>(30,000)</u>
Net Cash Outlay for Investment	£ 70,000
Hypothetical Realised Value of Investment after 3 years	<u>£160,000</u>
Total Gain	£ 90,000
Tax free profit being gain of £60,000 and income tax relief of £30,000	

3. Inheritance Tax Relief

Shares in EIS qualifying companies will generally qualify for Business Property Relief for Inheritance Tax purposes. Relief can be at rates of up to 100% after two years of holding such investment, so that any liability for Inheritance Tax is reduced or eliminated in respect of such shares.

Worked Example

If the shares have been held for at least two years before death, the investment should, in most cases qualify for Business Property Relief for Inheritance Tax purposes at rates of up to 100% and with the other benefits of the EIS, the effective cost of investment may be greatly reduced.

Example

Initial Investment	£ 100,000
Less Income Tax Relief @ 30%	<u>£ (30,000)</u>
Net Cash Outlay for Investment	£ 70,000
Hypothetical Realised Gain	<u>£ 160,000</u>
Gain on Investment	£ 90,000
*IHT relief @ 40%	£ (64,000)

IHT Relief above assumes the investment is worth £160,000 at the date of death. IHT relief would be obtained at up to 40% of the value.



There is no claw back of the income tax relief or deferral relief on death. Thus in this example £160,000 of value passes to beneficiaries free of inheritance tax and the estate is also augmented by income tax and capital gains tax saved by the deceased of £64,000 in this example. In total, the £100,000 investment has created an additional benefit to the beneficiaries of £94,000 which would not have been available if the investment had been in cash or quoted securities which attract none of the tax reliefs described above. In other words, the estate saved £64,000 in IHT, which would have otherwise been paid; the investment removes £160,000 of taxable value to the benefit of the estate; and any CGT deferral in the original investment would also fall away on death.

4. CGT Deferral Relief

Tax on gains realised on a different asset can be deferred indefinitely, where disposal of that asset was less than 36 months before the EIS investment or less than 12 months after it. Deferral relief is **unlimited** and can also be claimed by investors (individuals or trustees) whose interest in the company exceeds 30%.

Worked Example

Where an individual has a chargeable capital gain within the three years before or one year after a subscription has been made for ordinary shares in an EIS company or fund, a claim may be made to defer the assessment of that chargeable gain, or any part of it. The amount of the gains that may be held over has no maximum and is limited only by the amount subscribed for ordinary shares in an EIS qualifying company. Gains may be deferred until the EIS qualifying shares are disposed of or, if earlier, when other events trigger withdrawal of the deferral relief. Once the shares in the EIS Company or fund have been sold, the deferred gain will fall back into charge to Capital Gains Tax in the year of disposal.

If the shares against which the gains are deferred are held until death, the deferred gain is **never chargeable**, so the deferral is indefinite.



NB In the examples that follow, it is assumed the investor is liable to capital gains tax ("CGT") at the rate of 28%.

Example - £100,000 capital gain invested, assuming income tax relief is also claimed

Initial Investment	£100,000 April 2011
Less Income Tax Relief @ 30%	(30,000)
Capital Gains Deferral	<u>(28,000)</u>
Net Cash Outlay for Investment	£42,000

Shares sold August 2014

Hypothetical Value of Investment	£160,000
Chargeable gain	£nil - tax free if held for more than 3 years from issue or commencement of trade if later
Tax free gain	£60,000
Deferred gain from 2009/10 becomes chargeable 2013/14	£100,000
*Tax payable at 28%	£28,000

*Assuming current rates apply and annual CGT exemptions already utilised.

Those considering deferring capital gains should take professional advice, because of the potential to increase the actual tax payable.

5. Loss Relief

If EIS shares are disposed of at any time at a loss (after taking into account income tax relief), the loss can be set against the investor's capital gains, or his income in the year of disposal or the previous year. For losses offset against **income**, the net effect is to limit the investment exposure to 35p in the £1 for a 50% taxpayer, if the shares become totally worthless. Alternatively the losses can be offset against **Capital Gains** at the prevailing rate of 28%.

Worked Example



The loss can be offset against income tax of the same year or preceding year or against capital gains of the same year or carried forward to be offset against future gains. Loss relief can reduce the investor's exposure to 35% of the original investment (assuming a 50% tax payer) if the loss is offset against income tax due for the current year and onwards under current rates.

Example - Loss Relief against Income Tax

Initial Investment	£100,000
Less income tax relief at 30%	<u>(30,000)</u>
Net Cash Outlay for Investment	£70,000
If Investment fell to £0, Net loss	£(70,000)
Loss relief at 50%	<u>35,000</u>
Net loss	£(35,000)
Percentage of Original Outlay	35%

Example - Loss Relief against Capital Gains Tax

If the loss is offset against capital gains tax, this can be claimed against the same year or carried forward, at the prevailing rate currently 28%

Initial Investment	£100,000
Less income tax relief at 30%	<u>(30,000)</u>
Net Cash Outlay for Investment	70,000
If Investment fell to £0, Net loss relief at 28%	<u>(19,600)</u>
Net Loss	£ (50,400)
	50.4%

An individual who has income which is charged to income tax at higher rates is likely to wish to offset the loss against income rather than capital gains. Professional advice should be sought.





EIS is appropriate for those investors who wish to include in their portfolio some high risk companies.

The rules governing the EIS are complex and interrelated with other legislation so it is nearly always essential to consult a professional who is experienced in this area. It is a specialised area and you should check the credentials of the firm to make sure that it is sufficiently expert in the subject of EIS to be able to provide worthwhile advice. If in any doubt, please do consult a professionally qualified adviser.

HMRC publish relevant information on their website at <http://www.hmrc.gov.uk/eis>. A PDF of HMRC's guidance of the EIS can be found here <http://www.hmrc.gov.uk/eis/print.htm>

The content of this paper has been adapted from the EISA website. Highgate Associates and Enterprise Corporate Finance are both members of EISA.

This paper has been created by Highgate Tech Fund and Enterprise Corporate Finance.



For more information about EIS Funds and companies please email info@highgatetechfund.com or visit www.highgatetechfund.com

Warning - please note that EIS tax reliefs are dependent on personal circumstances. Generally the underlying investments are likely to be high risk, not suitable for all investors and you should not consider investing unless you can afford the full loss of your investment. EIS investments are often illiquid and there is likely to be limited information as to their value. This information has not been approved under section 21 of the Financial Services and Markets Act 2000. You may not invest on the basis of this information and should only consider investment on the basis of the full Investment Memorandum available from www.highgatetechfund.com link. If you are in any doubt about this information, you should seek advice from a professional suitably qualified and authorised under the Financial Services and Markets Act 2000, who specialises in advising on investment in shares and other securities.

