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CHARTERED ACCOUNTANTS

EIS – Recap and warnings

Dorset Business Angels - 26 November 2018

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EIS - Investor reliefs

- 30% Income Tax reduction for subscription cost
  - Maximum £1M
  - Up to £2M for “knowledge intensive” companies
- IT relief for current year or previous year
- Hold for three years otherwise relief clawed back
- CGT or IT relief if loss on investment
- Become Director after investment - not employee
  - Reasonable payment for services
  - Following 3 year investment tax relief restriction

EIS - Investor reliefs

- Capital gains deferral (no max.)
  - Gains in three years before investment
  - Gains in following year after investment
- CGT exemption on EIS shares after three years
- 100% IHT relief after 2 years on EIS shares

SEIS - Investor reliefs

- 50% Income Tax reduction for subscription cost
  - Max £100,000
- Capital Gains exemption - 50% of subscription cost
  - Max £50,000
- CGT exemption on SEIS shares after three years
- 100% IHT relief after 2 years
- Income Tax relief if loss on investment
- Become Director after investment - not employee
  - Reasonable payment for services
  - Following 3 year investment tax relief restriction

EIS/SEIS - Caution

- Associates
    - business partners, trust which the investor is a settlor or beneficiary, spouses and civil partners, parents and grandparents, children and grandchildren (not brother or sister)
- Substantial shareholding - +30% of
    - Ordinary shares and/or Voting rights
    - Rights on winding up and/or Control of the company
- 2 years before and 3 years after share issue
- No related investment arrangements
- No loan linked investments

EIS/SEIS - Caution

- Un-commerciality & avoidance motives
- Investor cannot own shares already when they first invest through EIS

- IT relief clawed back if within 3 years;
  - Receive value
  - Dispose of shares
  - Company stops qualifying

EIS/SEIS comparison

The table below highlights the main reliefs. For further details see the factsheets for each type of investment.

	EIS	SEIS
Annual investment limit	£1million	£100,000
Income tax relief for subscribers	30%	50%
Clawback if held for less than	3 years	3 years
Reinvestment relief period - before gain - after gain	 1 year 3 years	Same tax year
Tax free dividends	No	No
Tax free capital gains	Yes – 3 years	Yes – 3 years
Tax relief for losses	Yes	Yes
IHT business property relief	Yes	Yes

This is increased to £2 million provided that anything above £1 million is invested in knowledge-intensive companies. There is no limit on CGT deferral.

EIS - Pitfalls

- **Share structure**
- Founder carefully set-out share structure of company including potential EMI share pool
- Investor's holding of 25% appears to qualify
- However, EMI share pool is not issued on Day 1, therefore Investors holding is in excess of 30% and doesn't qualify!
- **Loans from Investors**
- Investor is considering acquiring shares but to assist with company's cashflow makes short term loan
- Cash investment made for issue of shares
- Loan repaid to investor by company
- 'Return of value' rules prohibit this
- **Trading period**
- Company incorporated from existing sole trader business
- EIS claim made
- Trade actually found to have been in existence for in excess of seven years.

EIS - Pitfalls

- **Advance assurance (AA)**
- Don’t wait to get AA, HMRC can take a while to respond
- Don’t assume that once AA has been provided company will continue to qualify for SEIS/EIS – changes to legislation and company circumstances may affect the position - three year requirement.
- **Returns of value**
- Company offers discounts to potential investors
- Rules permit insignificant amounts (<£1,000) over three year period
- Value calculated as cost to company

Budget 2018 - Entrepreneurs’ relief

- The Budget introduced 2 new criteria for the disposal of shares to qualify for the relief (in addition to the existing criteria) being:
  - To be beneficially entitled to 5% of distributable profits; and
  - To be beneficially entitled to 5% of any assets on the winding up of the company.

- This appears to cause major issues where company’s share capital is dividend into ‘Alphabet’ shares i.e. A and B shares to allow for the payment of variable dividends, or
- Where the return of capital is ‘tiered’, such that A shares are repaid before B Shares, etc.

- The result is that ER may not be available!

- **Solution**

- Potential solution is to re-classify all share classes into Ordinary shares BUT
- This will require the holders to retain the shares for a further two years, and
- May have potentially adverse tax consequences where HMRC take the view that value has shifted.

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