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# The advantages of investing in EIS and SEIS companies

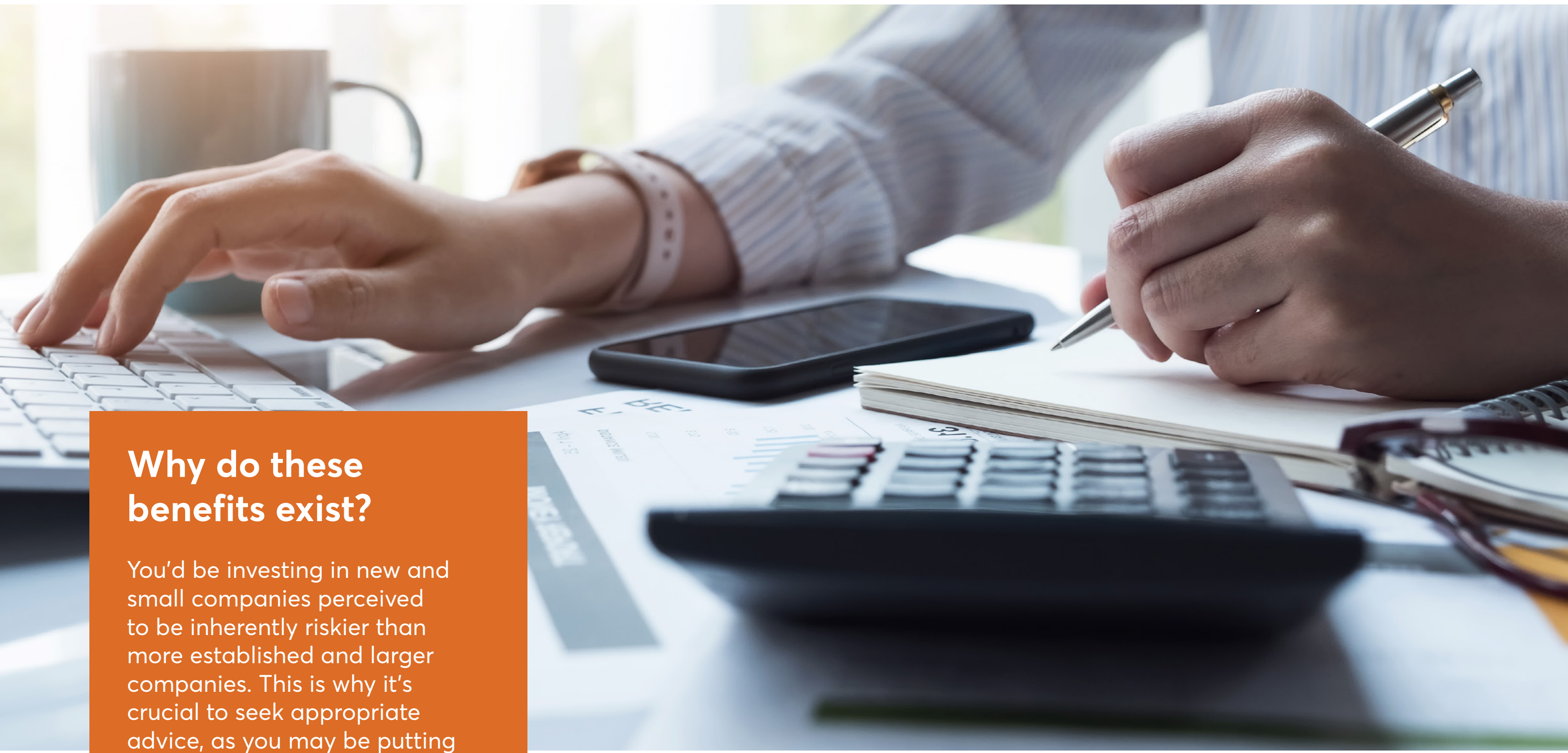
The information below is strictly limited to the tax implications of such investment schemes.

You should always seek advice from an independent financial advisor before making any investment.

## What is EIS and SEIS?

Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) are schemes designed to encourage individuals to subscribe for new shares in qualifying companies. By doing so, they can obtain income tax, capital gains tax (CGT) and inheritance tax reliefs. Whilst each scheme shares similar benefits, there are unique aspects to each one.

With regards to the term 'scheme', whilst discussions abound on shady tax-avoidance schemes, EIS and SEIS are fully recognised by HMRC and have existed for some time; EIS launched in 1994 and SEIS in 2012.



## Why do these benefits exist?

You'd be investing in new and small companies perceived to be inherently riskier than more established and larger companies. This is why it's crucial to seek appropriate advice, as you may be putting your capital at greater risk.

## What are the tax benefits?

**Enterprise Investment Scheme (EIS)**

**Income tax**

A qualifying investor receives a flat rate income tax reducer on any qualifying investment up to an annual limit of £1 million. This is increased to £2 million for knowledge-intensive companies.

A qualifying investor must be unconnected to the company. This includes employees or directors of the company, or those holding more than 30% of the company's shares.

The tax reducer is calculated as follows: investment made (restricted to £1/£2 million) x 30% = tax reducer. Therefore, somebody who invests £10,000 would benefit from an income tax reducer of £3,000.

### Example

During 2021/22, Mr Vadar had employment income of £30,000, against which £3,486 of tax was paid. He also invested £10,000 by subscribing for shares in Han Solo Ltd on 6 October 2021, a qualifying EIS company. The income tax reducer available was £3,000.

Without the EIS investment, his tax liability for the year would be £3,486; fully covered by the tax paid. With the tax liability of £3,486 being higher than the £3,000 tax reducer, he is due a £3,000 repayment.

### Carry back to prior tax year

There'll be circumstances where the tax reducer exceeds an individual's tax liability. In this event, the repayment is restricted to the tax liability with part of the tax reducer wasted. This is where a further benefit of EIS occurs, where an election can be made to treat part or all of any investment as occurring in the previous year. This could avoid wasting this generous benefit.

### Holding requirements

In order to maintain the tax relief, an investor must hold the shares for a minimum period of three years. If the shares are sold or gifted within three years, other than to a spouse or civil partner, the tax relief is repayable. However, any repayment of tax is restricted if the shares were sold or gifted at a loss.

## Capital gains tax (CGT)

Similarly, providing the shares are held for three years, any profit on disposal is exempt from CGT, potentially saving a small fortune if the company performs well.

The company could, of course, perform badly with the share value decreasing or worse, becoming worthless. Ordinarily, any loss would be treated as a capital loss and only able to offset against other gains, which may take years. However, both EIS and SEIS shares qualify for a specific relief, meaning a person could elect for the loss to be offset against their income. For many people, tax relief would be obtained much sooner, with the added benefit of saving more tax as the tax rates on income are higher than capital gains.

With EIS, an investor can elect to defer capital gains on the sale of other chargeable assets, e.g. shares or property, by investing in EIS within a qualifying window. Any reinvestment of proceeds in EIS must be within 12 months before or 36 months after the disposal of the original asset.

### Example

Mr Skywalker sold shares in Star and Wars Plc on 4 May 2021 for £150,000, realising a gain of £100,000.

He also invested £130,000 in Obi Won Ltd, a qualifying EIS company, on 5 August 2021.

As Mr Skywalker sold an asset and acquired new EIS shares, he can claim to defer the gain. The amount which can be deferred is the lower of the following:

- The gain of £100,000
- The amount reinvested, £130,000
- A specific amount

As he is entitled to the capital gains exemption of £12,300, providing he has no other chargeable gains in the year, it may make sense to avoid wasting this. As such, it could be beneficial to defer £87,700 as illustrated:

| | £ |
|---|---|
| Gain on Star & Wars shares | 100,000 |
| Less:<br>EIS reinvestment relief | (87,700) |
| Chargeable gain | 12,300 |
| Less: Capital gains exemption | (12,300) |
| Taxable gain | Nil |

The deferred gain is only brought back in to charge when the shares are gifted or sold, or in circumstances where the company no longer meets the conditions for EIS. This could be where the company is no longer a trading company or goes public and becomes listed on an exchange.

If the shares are sold and the proceeds reinvested in another EIS company, the gain can again be deferred.

## Seed Enterprise Investment Scheme (SEIS)

SEIS companies are smaller early-stage companies compared to EIS, with smaller assets and employee requirements. As such, whilst SEIS shares have many of the same benefits and conditions as EIS shares, there are some unique differences.

## Income tax

The income tax reducer is calculated as 50% on the amount subscribed, although the annual limit is much lower at £100,000.

An investor must again remain unconnected, although for SEIS the restriction for directors doesn't apply.

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## Capital gains tax (CGT)

Reinvestment relief operates differently for SEIS where, rather than simply deferring the gain, it exempts an amount from CGT. The amount of exempt gain is 50% of the available SEIS expenditure.

### Example

On 1 November 2021, Mr Kylo Ren sold shares in R2D2 Plc, realising a gain of £100,000.

He also invested £50,000 in C3P0 Ltd on 3 May 2021, a qualifying SEIS company.

The SEIS reinvestment relief is calculated as 50% x £50,000 = £25,000.

The chargeable gain is therefore as follows in the table below:

As with the holding requirements for income tax purposes, the shares must be held for three years otherwise the relieved gain becomes chargeable to tax.

### Inheritance tax

As EIS and SEIS companies are unquoted trading companies, providing shares are held for two years and their status remains unchanged, they will qualify for 100% business property relief.

This means that in the event the shares are transferred on death, the full market value of the shares will be inheritance tax free.

This compares very favourably to shares held in public trading companies such as those listed on stock exchanges, which will never be exempt from inheritance tax unless 50% of the shares are held, and thereby control the company.

## What should I do?

We strongly advise you to speak with an independent financial advisor before making any investments.

You can get in touch with your usual Larking Gowen contact to discuss how your specific anticipated investment will affect you.

You can find contact details in the Our People section of our website. Alternatively, call 0330 024 0888 or email enquiry@larking-gowen.co.uk.

| | £ |
|---|---|
| Gain on R2D2 shares | 100,000 |
| Less: SEIS reinvestment relief | (25,000) |
| Chargeable gain | 75,000 |

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