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THE ASSOCIATION FOR UK INTERACTIVE ENTERTAINMENT

Harbottle & Lewis

Enterprise Investment Scheme

This document has been prepared by Ukie Associate Member, Harbottle & Lewis. It provides a summary of the Enterprise Investment Scheme (EIS), the tax benefits relating to the scheme and the qualifying conditions that must be met by the investor and the company recovering the investment to obtain such reliefs. This document has been prepared in light of the applicable English tax legislation as at November 2014 which may be subject to change, possibly with retrospective effect. This document is intended to be used as guidance only and does not constitute legal advice from Harbottle & Lewis LLP. You should seek legal advice if you intend to use the EIS.

1. Introduction

The EIS is designed to help certain types of trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

This short guide summarises the various tax reliefs that are available through the EIS together with the criteria that must be satisfied by the investor and the company recovering the investment in order to ensure that the investment will qualify for the various tax reliefs.

2. Tax benefits

There are four possible tax benefits available through the EIS:

2.1. **Income tax relief** - 30 per cent. of the cost of the investment, up to the annual investment limit of £1 million may be offset against a qualifying investor's income tax liability in the tax year in which the shares are acquired. There is also a carry back facility that allows the shares to be set off against income tax liability in the preceding year, subject to the £300,000 maximum level of income tax relief per tax year.

2.2. **Capital Gains Tax (CGT) relief** - No CGT is payable by an investor on the first disposal of the shares.

2.3. **Loss relief** - If an investor incurs a loss on the first disposal of the shares, this capital loss (after deduction of income tax relief) may be set off against income in the tax year of disposal or the previous tax year, rather than against capital gains.

The reliefs described in paragraphs 2.1 to 2.3 above will be withdrawn or reduced if the shares are sold within three years of their issue to the investor.

2.4. **Deferral relief** - CGT arising from the disposal of any asset can be deferred by investing that capital gain in EIS shares, for a period commencing one year before and ending three years after the disposal. The original CGT that is deferred will be payable on the disposal of the EIS shares.

2.5. Deferral relief is not subject to the annual investment limit of £1 million and the connected person test, outlined at paragraph 3.2 below, and the investor does not have to hold the shares for a period of three years following subscription in order to obtain this relief.

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3. Qualifying conditions

In order to take advantage of the benefits of the EIS, both a qualifying company and a qualifying investor must meet the following conditions.

3.1. In order to qualify, the Company:

3.1.1 must issue full-risk ordinary shares carrying no preferential rights to dividends or assets on winding up and which are fully paid up in cash;

3.1.2 must be unquoted when the shares are issued;

3.1.3 must be a "small" company which means that it does not have assets exceeding £15 million immediately preceding and £16 million immediately following the issue of the shares and that it has less than 250 full-time employees;

3.1.4 must not have raised more than £5 million in the year preceding the investment through either the EIS or Venture Capital Trust schemes;

3.1.5 must not be the subsidiary of or controlled by another company and if the company receiving investment has any subsidiaries, these must be at least 50 per cent. owned by and under the control of that company;

3.1.6 must exist wholly for the purpose of carrying on a qualifying trade (ignoring any incidental purpose). A "qualifying trade" means most trades that are conducted on a commercial basis with a view to making profits, provided it is not an excluded activity (unless that excluded activity does not amount to a substantial part of the company's trade). A "substantial part" of the company's trade is deemed to mean more than 20 per cent. of the company's trade;

Examples of an "excluded activity" include dealing in land or shares; property development; money-lending, insurance and other financial activities; dealing in goods, other than ordinary wholesale and retail trades; leasing or letting assets on hire; receiving royalties or licence fees, other than those attributable to intangible assets created by the company; farming and market gardening; forestry; and operating or managing hotels, guesthouses, nursing or residential care homes. This acquisition of existing shares in another company is also specifically excluded from being a qualifying business activity;

3.1.7 must have a permanent address in the UK throughout the period starting with the issue of the shares and ending three years later. Provided the issuing company has such a permanent establishment, the money raised under the EIS subscription can be used for the purpose of its qualifying trade (even if not carried on in the UK); and

3.1.8 must apply the money raised from the issue of shares towards a qualifying trade within 2 years of the issue, or 2 years after commencement of trading, whichever is the later.

3.2. In order to qualify, the investor:

3.2.1 must not be "connected" to the Company for a period of 2 years before and 3 years after purchasing the shares. This means that he/his "associates" must not:

a) be an employee, partner or paid director of the Company; or

b) control or own more than 30 per cent of the Company.

"Associates" are defined as business partners, trustees of a settlement where the investor is settlor or beneficiary and the investor's lineal family (which does not include brothers and sisters);

3.2.2 must not dispose of any of his shares in the company (unless this is to his spouse) within three years from subscription;

3.2.3 must not receive any value from the company; and

3.2.4 may invest a maximum of £1 million in multiple qualifying companies in any tax year.

EIS relief is provisional and may be withdrawn if during the period of three years from the issue of the shares an event takes place which contravenes any of the above conditions governing relief. Additionally, the shares must not be issued in connection with, or as a consequence of, disqualifying arrangements which generate access to the reliefs where the benefit of the investment is passed onto another party or where the business activity would otherwise be carried on by another party.

What should I do next?

For further information on this document or EIS please contact David Scott (**david.scott@harbottle.com**).