Company Finance: EIS Shares

The use of Enterprise Investment Schemes (EIS) is a highly popular way of investing in a company and gaining tax relief. EIS relief is formed by two components; 30% Income Tax relief for subscription of EIS shares and Reinvestment relief which will defer Capital Gains Tax.

This factsheet discusses company requirements for issuing EIS shares.

Qualifying Shares

For an investment to qualify for EIS relief, it must be a subscription for new shares in an unquoted trading company, which carries out one or more qualifying trades wholly, or mainly in the UK, although the company, itself, is not required to be resident in the UK. The 2010 budget has changed the requirement for the company's trade to be carried on wholly or mainly in the UK to requiring the company to have a permanent establishment in the UK. This change is required to ensure that the EIS rules comply with the EU State aid guidelines. A qualifying trade is not defined, but trades, which are excluded from qualifying, are defined. In particular, trades which are asset-backed, those dealing in land and property development, leasing companies, and those in the financial and legal services are excluded. *For a full list please see the Tax Planner Booklet.*

To the extent that royalties received are for the exploitation of a "relevant intangible asset" the trade is regarded as a qualifying trade for EIS purposes. Relevant intangible asset is defined as an asset, the whole or greater part of which, in terms of value, has been created by the company, its parent, or subsidiary carrying on the trade.

Company Requirements

Throughout the period of 3 years from the date the shares were issued, or if later the date it commences to trade, exist wholly for the carrying on of one or more qualifying trades. It may carry out some non-qualifying activities provided that these are not substantial, which is normally taken to mean that the activities do not account for more than 20% or more of its total activities.

Not be a subsidiary of any other company, and if it has subsidiaries, it must possess at least 51% of the issued share capital, and voting power, and must be entitled to at least 51% of the assets available for distribution in the event of a winding-up etc.

Comply with the gross asset test whereby its gross assets must be not more than £7m before the issue of the EIS shares, and must not exceed £8m immediately afterwards. It is proposed to increase this limit to £15m of gross assets before the investment to have effect on or after 6th April 2012*.

The EIS company must have fewer than 50 full-time employees, or their equivalent on the date on which the EIS shares are issued. This limit should be increased to 250 employees from April 2012.

The EIS company must have raised no more than a total of £2m under the EIS, or Corporate Venturing Scheme in the 12 months ending on the date of the relevant investment. If the limit is exceeded none of the shares within the issue which exceeds the limit will qualify for relief under either of the schemes. It is proposed to increase this limit from £2m to £10m for investments after 5th April 2012.

The subscription funds raised by the company may be used to acquire the shares in another company provided that the subsidiary is at least a 90% subsidiary of the EIS Company.

The rules governing EIS relief are complex, and there are many pitfalls that need to be negotiated in all but the most straightforward cases. Specific advice should always be sought if consideration is being given to raising share equity capital in this way.