Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) was introduced in 1994 to encourage equity investment in small unlisted enterprises carrying on a qualifying trade in the UK. (For detailed guidance see HMRC Venture Capital Schemes Manual VCM10000 and HMRC Helpsheet HS431.)

Eligible enterprises can use the Scheme to attract up to £5m of equity investment in any 12 month period.

It provides tax relief for individuals (not corporate bodies) and is worth 30% of the cost of the shares, to be set against the individual's income tax liability for the tax year in which the investment is made. The shares must be new and additional capital and must be held by the individual for at least three years after they were issued or the enterprise started trading, whichever is longer. The maximum amount of individual tax relief that can be claimed in any one tax year is currently £300,000.

Although EIS is primarily targeted at private companies limited by shares, societies are also eligible, subject to the same restrictions that are imposed on companies, requiring share capital to be fully at risk, without any guaranteed or pre-arranged exits for the investor. This means that a society must have the powers to suspend or refuse applications to withdraw share capital. HMRC recognises that withdrawable shares are not the same as redeemable shares, and does not treat them as such, as long as the society has these powers.

The Finance Act 2015 introduced a number of reforms to EIS, including a new restriction preventing the investment funds from being used to acquire existing businesses or business assets. Taken together, these new criteria mean that many community led buy-outs of existing enterprises such as shops, pubs and football clubs will no longer be eligible for EIS.

Enterprises engaged in non-trading activities, such as investment deals or property rental, are not eligible for EIS. This means that societies that acquire assets, such as pubs, which are leased to a tenant, do not quality for tax relief. Similarly affected are societies that raise capital to invest in managed workspaces, or community buildings that are rented or leased to user groups. To qualify for EIS, the non-trading income of a society must not exceed 20% of its total income.

Most trades qualify, but some do not and these are referred to as "excluded activities". Among the excluded activities are some which are very popular with community enterprises, such as farming, market gardening, woodland management, and property development.

Changes introduced in the Finance (No.2) Act 2015, mean that from 30 November 2015 community energy societies engaged in the subsidised generation or export of electricity no longer qualify for any form of tax relief. From 6 April 2016 onwards this exclusion will be extended to include non-subsidised electricity and energy generation (renewable heat, anaerobic digestion etc.).

There are also rules about the maximum size of the enterprise. It must employ fewer than 250 full-time equivalent employees and gross assets must not exceed £15m. The enterprise must be an independent entity and not controlled by another person or entity; it may have subsidiaries as long as they are all majority owned, or at least 90% owned if the EIS capital is to be invested in the subsidiary.

EIS is administered by the Small Company Enterprise Centre (SCEC) at HMRC. The SCEC is responsible for deciding whether an enterprise and its share issue qualify for the Scheme. It does this by checking that the enterprise's accounts, governing

document, business plan and other documentation relating to the share issue, comply with the requirements of the Scheme. The SCEC operates an advance assurance scheme, whereby an enterprise can submit their plans and documents in advance, using the form EIS(AA), and the SCEC will advise on whether or not the proposed share offer is likely to qualify. Advance assurance is not mandatory; an enterprise and its investors can still qualify for the scheme after the shares have been issued, but potential investors are likely to take comfort from advance assurance when deciding whether to invest.

Connected persons are not eligible for EIS tax relief. This includes anyone who is an employee, paid management committee member, or large shareholder (defined as holding more than 30% of the share capital) of the enterprise, or anyone who is an associate of such a person. An associate is defined as a spouse or civil partner, lineal ancestor or descendant, a business partner, or certain persons with whom the individual has connections through a trust. Joint shareholders (see Section 3.2.4) are treated as though they invested an equal amount for tax relief purposes, even if they have not contributed equally to the joint purchase. If shares have been bought as a gift, it is the recipient, not the purchaser, who receives the tax relief (see Section 5.9).

Regardless of whether advance assurance was obtained or not, the enterprise must submit a compliance statement (form EIS1) to the SCEC after the shares have been issued and the enterprise has been trading for a minimum of four months. If the SCEC accepts that the enterprise, its trade, and the shares all meet the requirements of the scheme, it will issue form EIS2 to that effect, and supply sufficient forms EIS3 for the enterprise to send to the investors so they can claim tax relief.

In order to claim EIS tax relief investors must first obtain a form EIS3 from the enterprise they have invested in. The investor should use this form to claim the tax relief for the year in which the shares were issued, or it can be carried back to the previous tax year. If the investor normally pays income tax by PAYE and the total tax relief is less than £5,000 then the tax relief can be claimed in one of two forms: either as an adjustment to the PAYE code if the tax relief is being claimed in the current financial year, or as a carried back claim against income tax on the previous year, in which case the investor will receive the tax relief as a lump sum repayment. If the investor is claiming more than £5,000 in tax relief and currently pays income tax through PAYE, they will be asked to complete a Self Assessment tax form. If the investor already completes an annual Self Assessment form then they should claim the tax relief the next time they submit this form.

Investors can also benefit from capital gains tax deferral relief if they are reinvesting capital gains made elsewhere into an EIS eligible enterprise.

Seed Enterprise Investment Scheme (SEIS)

The Seed Enterprise Investment Scheme (SEIS) aims to encourage equity investment in new small enterprises. (For detailed guidance see HMRC Venture Capital Schemes Manual VC30000 onwards.)

The rules for SEIS have been designed to mirror those of EIS because it is anticipated that enterprises may want to go on to use EIS after an initial investment under SEIS. The same rules apply to the definition of qualifying trades, restrictions on connected persons, relationships with subsidiary entities, and the period shares must held for.

The connected person rules means that the maximum individual investment under SEIS is limited to30% or £45,000.

There are a number of key differences between SEIS and EIS. The enterprise must have been trading for less than two years when the SEIS shares are issued, it must have gross assets of less than £200,000 and it must have fewer than 25 employees.

The maximum amount it can raise under SEIS is £150,000 and this figure is reduced further by any amount of state aid the enterprise may have received in the preceding three years.

The tax relief available through SEIS is 50% and the annual maximum amount an individual can invest in SEIS shares is £100,000. Investors who are reinvesting gains are exempt from capital gains tax for half of the reinvested gain, up to the annual maximum of £100,000.

SEIS is administered by the SCEC at HMRC, using the same procedures as those for EIS. Enterprise can apply for advance assurance using the same application form as for EIS.

Following the share issue, the enterprise must submit a compliance statement (using form SEIS1), but only after it has been trading for at least four months or it has spent at least 70% of the funds raised. If the SCEC is satisfied that the enterprise meets the requirements of the scheme, it will issue a certificate to that effect and supply the enterprise with SEIS3 tax relief claim forms for investors.

Societies seeking to raise more than £150,000 can offer both SEIS and EIS, with the first £150,000raised qualifying for SEIS and subsequent amount qualifying for EIS. Any society planning to do this should make sure it has a robust procedure in place to identify the first £150,000 of investment, and this procedure should be made clear in the offer document.

Income Tax

In most circumstances, members of a society must pay income tax on all their earnings and receipts from the society (See HMRC Self-Assessment Claims Manual SACM). In the context of community shares, these receipts will normally be in the form of interest on share capital. Interest on share capital is a deductible expense for corporation tax purposes, but the receipt is liable for income tax payable by the member. HMRC does not normally require societies to deduct income tax on share interest paid to members; but it is the responsibility of members to declare their gross earnings and receipts to HMRC, including any such share interest payments. Societies are obliged to inform HMRC of any gross interest payments to members on shares or loans to the value of £250 or more per annum, by providing the names and contact details of these members. If share interest is paid to members who are non-UK residents, the society must deduct income tax from the payment (see HMRC manual SAIM 9200).

However, interest paid on withdrawable shares in societies is eligible for the new Personal Savings Allowance (PSA), introduced on 6 April 2016. The PSA will apply a new 0% rate for up to £1,000 of savings income received by a basic rate (20%) taxpayer, or up to £500 of savings income for a higher rate (40%) taxpayer. The PSA will not apply to savings income received by 45% additional rate taxpayers.

If a member already pays tax through a PAYE code, and their total untaxed income from savings and investments is less than £2,500, they can request that any tax they owe is collected through their tax code. If their income from these sources is £2,500 or more they will need to complete a tax return.

INHERITANCE TAX

Shares in unlisted companies qualify for business relief from inheritance tax, where these shares have been passed on during a person's lifetime or as part of their will. For people who died after 6April 1996 business relief on shares in unlisted companies is 100%. Business relief from inheritance tax may extend to withdrawable shares in societies, as long as the society is engaged in a trade which is it is carrying on for the purposes of making a gain. Evidence of this will be expressed in the objects of the society, and in its behaviour, for instance, through the payment of interest on share capital. Business relief is not available if the trade is carried on otherwise than for gain; this might apply to some charitable community benefit societies or societies that have stated an intention never to pay interest on share capital. (For detailed guidance see HMRC Inheritance Tax Manual IHTM)