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Use the Enterprise Investment Scheme (EIS) to raise money for your company

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The Enterprise Investment Scheme (EIS) helps unquoted trading companies raise equity finance by offering a range of tax incentives to their investors.

The tax reliefs in brief

The tax reliefs available to investors in enterprise investment scheme (EIS) qualifying companies are:

- Income tax relief of up to 30% of the sum invested
- Exemption from capital gains tax (CGT)
- CGT deferral relief
- Exemption from inheritance tax
- Loss relief.

Although the tax reliefs are available only to the investors, and not the company itself, the intention is that an EIS company will be attractive to potential investors, thus helping it raise finance.

How the scheme works

EIS is designed so that your company can raise money to help grow your business. It does this by offering tax reliefs to individual investors who buy new shares in your company.

Under EIS, you can raise up to £5 million each year, and a maximum of £12 million in your company's lifetime. This also includes amounts received from other venture capital schemes. Your company must receive investment under a venture capital scheme within 7 years of its first commercial sale.

You must follow the scheme rules so that your investors can claim and keep EIS tax reliefs relating to their shares. Tax reliefs will be withheld or withdrawn from your investors if you do not follow the rules for at least 3 years after the investment is made.

There are different rules for knowledge-intensive companies that carry out a significant amount of research, development or innovation, and either:

- want to raise more than £12 million in the company's lifetime
- did not receive investment under a venture capital scheme within 7 years of their first commercial sale

Approved EIS funds

The rules for EIS approved funds will be changing on 6 April 2020 to take account of the:

- changes that will focus approved funds on knowledge-intensive investments
- increased flexibility available to fund managers in the timing of investments

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What money raised can be used for

The money raised by the new share issue must be used for a qualifying business activity, which is either:

- a qualifying trade
- preparing to carry out a qualifying trade (which must start within 2 years of the investment)
- research and development that's expected to lead to a qualifying trade

The money raised by the new share issue must:

- be spent within 2 years of the investment, or if later, the date you started trading
- not be used to buy all or part of another business
- pose a risk of loss to capital for the investor
- be used to grow or develop your business

Qualifying trades

You must use the investment for a qualifying trade.

Most trades will qualify, including any research and development which will lead to a qualifying trade.

However your company may not qualify if more than 20% of your trade includes things like:

- coal or steel production
- farming or market gardening
- leasing activities
- legal or financial services
- property development
- running a hotel
- running a nursing home
- generation of energy, such as electricity and heat
- production of gas or other fuel
- exporting electricity
- banking, insurance, debt or financing services

Companies that can use the scheme

Your company can use the scheme if it:

- has a permanent establishment in the UK
- is not trading on a recognised stock exchange at the time of the share issue and does not plan to do so
- does not control another company other than qualifying subsidiaries
- is not controlled by another company, or does not have more than 50% of its shares owned by another company
- does not expect to close after completing a project or series of projects

Your company and any qualifying subsidiaries must:

- not have gross assets worth more than £15 million before any shares are issued, and not more than £16 million immediately afterwards
- have less than 250 full-time equivalent employees at the time the shares are issued

Your company must carry out a qualifying trade. If you're part of a group, the majority of the group's activities must be qualifying trades.

Limits on money raised

Your company cannot raise more than £5 million in total in any 12-month period from:

- EIS
- Venture Capital Trusts (VCT)
- the Seed Enterprise Investment Scheme (SEIS)
- social investment tax relief (SITR)
- state aid approved under the risk finance guidelines - check with the person who gave you the aid for advice

Your company cannot raise more than £12 million from these sources in your company's lifetime. This includes any money received by any subsidiaries, former subsidiaries or businesses you've acquired.

Limits on the age of your company

You can receive investment under EIS as long as it's within 7 years of your company's first commercial sale. If you have any subsidiaries (including former subsidiaries) or businesses you've acquired, the date of your first commercial sale is the earliest of the group.

If you received investment in this period (under EIS, SEIS, SITR, VCT or state aid approved under the risk finance guidelines), you can use EIS to raise money for the same activity as long as you showed you were planning to do so in your original business plan.

If you did not receive investment within the first 7 years, or now want to raise money for a different activity from a previous investment, you'll have to show that the money:

- is required to enter a completely new product market or a new geographic market
- you're seeking is at least 50% of your company's average annual turnover for the last 5 years

Qualifying subsidiary companies

If your company owns or controls any other companies they need to be 'qualifying subsidiaries'. This means:

- your company must own more than 50% of the subsidiary's shares
- no one other than your company or one of its other qualifying subsidiaries can control this subsidiary
- there cannot be any arrangements which would put someone else in control of this subsidiary

The subsidiary must be at least 90% owned by your company where either the:

- business activity you're going to spend the investment on is to be carried out by the qualifying subsidiary
- subsidiary's business is mainly property or land management

The subsidiary can be set up to complete a project or series of projects before closing, as long as it supports the growth and development of your company.

Risk to capital condition

The investment in your company must meet the risk to capital condition, which means:

- your company must use the money for growth and development
- the investment should be a risk to the investors capital

Growth and development means you'll use the investment to grow things like your revenue, customer base and number of employees.

The growth and development of your company should be permanent and not rely on the investor's continued support.

The investment should carry a risk that the investor will lose more capital than they are likely to gain as a net return.

HMRC will not consider the maximum return an investor could get if your company is successful, because this cannot be guaranteed.

The net return includes:

- income from dividends, interest payments and other fees
- capital growth
- upfront tax relief

When deciding if you meet the risk to capital condition, HMRC will look at things like your company's:

- sources of income
- assets
- structure
- use of subcontractors
- marketing of the investment opportunity
- relationship with other companies

You will not meet the risk to capital condition if there are risk reducing arrangements in place that result in an investor:

- getting priority over other investors
- being able to withdraw their money as soon as possible
- protecting their money so that other investors money is used first

When you issue shares

The shares you issue must be paid up in full, in cash, when they're issued. Your company should have a way to accept payment before shares are issued.

Your shares for EIS investments must be full risk ordinary shares which:

- are not redeemable
- carry no special rights to your assets

The shares you issue can have limited preferential rights to dividends. However, the rights to receive dividends cannot be allowed to accumulate or allow the dividend to be varied.

When you issue the shares there cannot be an arrangement:

- to guarantee the investment or protect the investor from risk
- to sell the shares at the end of, or during the investment period
- to structure your activities to let an investor benefit in a way that's not intended by the scheme
- for a reciprocal agreement where you invest back in an investor's company to also gain tax relief
- to raise money for the purpose of tax avoidance - the investment must be for a genuine commercial reason

Before raising your money

Your investors will only be able to claim tax relief if you meet the conditions for EIS.

How can we help?

If you would like more information about the EIS or other issues surrounding equity investment in your business, please contact Parker Russell.

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