Information for Professional Advisors

EIS Compared with Other Tax Efficient Investments

There have been many changes affecting the personal investment industry over the last 20 years including a number of tax incentives to encourage wider investment provision by the individual for their own benefit. In today's environment, tax-efficient investments are more limited, in particular, those related to pension schemes. The EIS and SEIS schemes are now the only UK tax efficient investments to offer Capital Gains Tax ("CGT") Deferral Relief. With the changes to the maximum level of contributions to pensions, investors may wish to consider alternative investments, such as EIS, SEIS and VCTs, alongside their pensions.

The following table sets out where the EIS and SEIS sits in comparison to other tax efficient investments, by way of illustration but please bear in mind these will depend on individual circumstances and the notes refer to the relevant section for each tax relief.

UK Tax-efficient Investments Comparison Table

	VCT	ISA	Pension	EIS	SEIS
Income Tax Relief	**30%**	**Nil**	**Up to 45%**	**30%**	**50%**
Capital Gains Deferral	**Nil**	**Nil**	**Nil**	**Up to 28% (A)**	
Capital Gains Reinvestment relief	**Nil**	**Nil**	**Nil**		**Effective relief up to 14% (B)**
IHT Relief	**No**	**No (C)**	**Yes (D)**	**Yes after 2 years**	**Yes after 2 years**
Tax Free Exit	**Yes**	**Yes**	**Yes/No**	**Yes/No (E)**	**Yes after 3years**
Tax Free Dividends	**Yes (F)**	**Yes**	**N/A**	**No (F)**	**No (F)**
Limits	**£200,000**	**£20,000**	**£40,000 (carry forward may be also available (G)**	**£1M (H)**	**£100,000 (I)**
Min Holding Period	**5 years**	**None**	**To age 55+**	**2 years for IHT 3 years for EIS**	**2 years for IHT 3 years for EIS and SEIS**

(A) Gains arising before 6 April 2021 to higher rate UK tax payers are chargeable at 28%. From 6 April 2021 the rate is generally 20% (but remains at 28% for certain assets.) The relief is a deferral only, and not an exemption and the deferred gain will crystallise on sale of the EIS shares.

(B) SEIS reinvestment relief exempts half of the gain reinvested up to the SEIS maximum investment of £100k i.e. for a gain of £100k reinvested in an SEIS investment, £50k of the reinvested gain is exempt.

(C) Some shares in AIM listed companies held in an ISA and held for at least two years may be eligible for IHT relief. All shares held in an ISA are exempt from CGT.

(D) In certain circumstances. Specific IHT advice is required

(E) There is no tax free exit for shares for which EIS deferral relief only was claimed.

(F) With effect from 6 April 2016 the 10% tax credit on dividends has been abolished and replaced with an annual dividend allowance (the dividend nil rate ('DNR)). The DNR charges income tax at 0% on the first £2,000 of an individual's dividend income which would be chargeable to tax but for the DNR. Chargeable dividend income above the DNR is chargeable to tax at basic, upper or higher rate dependent upon the tax rate which applies to the individual shareholder.

(G) Relief for pension contributions is complex and separate advice should be taken.

- In 2020/2021 those with annual income (including pension) over £2000,000 will have their annual allowance reduced by £1 to a minimum of £10,000 for every £2 over £200,000 for individuals with annual income excluding pension below £200,000 there will be no reduction
- Within the Annual Allowance, member contributions benefit from tax relief at the individual's marginal rate of tax, i.e. up to 45%
- Within the Annual Allowance, relievable member contributions are limited to 100% of employment earnings.
- The reduction in the Annual Allowance is, however, accompanied by a "Carry Forward" facility, allowing pension scheme members (if a member of a pension scheme at some time during the earlier tax years) to Carry Forward the difference between £40k from thye previous 3 tax years and the lesser level of total contributions made in the previous three tax years.

(H) Up to £1M of EIS investment may be carried back to the previous tax year if the limit for that year was not fully utilised.

(I) Up to £100k of SEIS investment may be carried back to the previous tax year if the limit for the year was not fully utilised.

EIS Funds and Portfolios

There are technically three types of EIS 'fund' – none of which actually have 'legal status' in that they are a series of individual investments into individual companies, which is logical in order to obtain the tax relief but an administrative headache!

EIS Portfolios – these tend to be managed as part of overall wealth management programmes and are bespoke to the individual investor, usually with quite a high minimum investment e.g. £50,000-£100,000.

EIS Approved Funds – this title tends to be interpreted by investors to mean something it does not! The "approved" status is simply an HMRC clearance that allows the investor to make a single claim for income tax relief at the date the Fund closes. In other words, an Approved Fund offers a clear determination of the tax year for which income tax relief can be obtained.

All EIS shares within the Fund are treated as if they had been issued on the Fund close date (provided at least 90% of the money is invested within 12 months). For EIS deferral relief and all other tax purposes, investing through an Approved Fund has no effect and the subscription for qualifying shares will still occur at the time it is actually made in each qualifying company via the Fund.

Approved funds have a number of criteria in order to fulfil this status, including the requirement that the fund must be 90% invested within twelve months of investment. The main conditions for Approved Funds are:

- Subscription must be made by the Fund for shares in at least four companies and allocated between investors in proportion to the amounts they have contributed
- No single investment should comprise more than half of the Fund.
- No investments may be made by the Fund until it closes (the Fund closes on the latest date on which applications in it can be accepted)
- It must be expected that the conditions of the EIS scheme which apply in relation to shares and companies will be satisfied for all the investments made by the Fund.
- Approved Funds are required to include the following statement in a prominent place in their promotional material:

  "The approval of the Fund by HM Revenue & Customs is relevant only for the purpose of attracting certain tax advantages under s.251 Income Tax Act 2007. Such approval concerns only certain administrative matters and the timing of income tax relief. It in no way bears on the commercial viability of the investments to be made; neither does it guarantee the availability, amount or timing of relief from income tax or capital gains tax."

In practice, there are now fewer of these since the changes made during 2009 enabled investors to carry back income tax relief up to £1M to the tax year prior to that in which the subscription was made. Whilst the tax relief for investments through an Approved Fund can be claimed by reference to the date the Fund closes.

Income Tax Relief cannot be claimed until all of the companies within the portfolio have received their forms EIS2 before the Investor's tax certificate can be issued, often resulting in considerable delays in the actual receipt of the tax relief.

Unapproved EIS Funds – these are by far the most widespread and represent the majority of investments through EIS Funds. The distinction is that the tax relief is granted with effect from the date of investment in the underlying **investee companies**. The ability to carry back income tax to the previous tax year, together with the greater flexibility and usually, the earlier release of EIS 3 certificates has rendered unapproved funds the more popular vehicle.

Although the technical title sounds less than appetising, 'unapproved' simply means that the Fund has not elected to apply for the status set out above. There are no restrictions on the number of investments or the timing of the investments, which arguably allows the investment manager to select investments on merit rather than to a fixed timetable.

There is no minimum investment by each investor in each EIS qualifying company in order to obtain EIS relief. Otherwise, Unapproved EIS Funds are conducted as a series of EIS investments with professional management. For this reason, investments are generally made on a timely basis and EIS 3 certificates obtained shortly after the issue of shares in investee companies, provided the fund invests in companies which are already trading at the time the shares are issued.

It is worthwhile checking the status of a fund/portfolio, especially if the timing of tax reliefs are important to an Investor's circumstances.