

Information For Professional Advisers

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 scheme is now the only UK tax efficient scheme to offer Capital Gains Tax ("CGT") Deferral. With the changes to tax relief on pensions, investors may wish to consider alternative investments, such as EIS and VCTs, alongside their pensions.

The following table sets out where the EIS 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

	VCT	ISA	Pension	EIS
Income Tax Relief	30%	Nil	Up to 50%	20%
Capital Gains Deferral	Nil	Nil	Nil	Up to 28% (B)
IHT Free	No	No	Yes/No	Yes
Tax Free Exit	Yes	Yes	Yes/No	Yes/No (C)
Tax Free Dividends	Yes	No	N/A	No
Limits 2010/11	£200,000	£10,200 (D)	100% of earnings up to £130000 for personal contributions	£500,000 (E)
Min Holding Period	5 years	None	To age 55+	2 years for IHT

(A) Broadly, up to 100% of earnings for those with total annual income of less than circa £130,000 for 2010/11 tax year (for those with income in excess of this figure their relief is available on "regular contributions" or £20,000, whichever is higher). For 2011/12 and onwards current consultation suggests an annual allowance of between £30,000 and £45,000 will be implemented.

(B) The rate of deferral may be as high as 40% for gains prior to 6 April 2008 reinvested within three years. It may also result in an overall tax saving if the deferred gain falls in after 5 April 2008 and before 23 June 2010 at a rate of 18%. Care is needed when considering

deferring a gain because of changes in the CGT rate - deferral can result in additional tax being payable if the CGT rate is higher at the time the gain crystallises compared to when it arose.

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

(D) Within this overall limit is an annual limit of £5,100 for the amount the ISA can hold as cash investments as opposed to stocks and shares.

(E) Up to £500,000 of investment may be applied to a previous tax year

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.

Approved Investment Funds – something of a misnomer, the "approved" status is simply an HMRC clearance that allows the investor to claim income tax relief at the date of investment into the **Fund**. 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 the qualifying company via the Fund.

Approved funds have a number of criteria in order to fulfil this status, including a minimum of 4 investments, pro-rata to the individual investment and 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 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 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 very few of these since the changes made during 2009 enabled investors to carry back income tax relief up to £500,000 to a previous tax year, dissipating the potential attraction of the crystallised tax relief date in the context of the relatively restrictive compliance requirements to operate an Approved Fund. In particular, whilst the tax relief may be crystallised at a given date, in practice, the Income Tax Relief cannot be claimed until all of the companies within the portfolio have to have complied before the Investor’s tax certificate can be obtained, 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 the industry. The distinction is that the tax relief is granted with effect from the date of investment in the underlying **investee companies**. The recent rule change allowing carry back of 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.

The minimum investment by each investor in each EIS qualifying company is £500 if EIS relief is to be obtained. 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.

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