EIS and SEIS tax breaks explained

The Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) are government initiatives offering some of the most attractive tax breaks available in the UK.

To access them, you need to invest in the shares of a small, unlisted company. Small means 250 employees or less, and maximum gross assets of £15 million (before the investment). Unlisted means that the company is not quoted on a major stock market, although it can be quoted on a market for smaller companies like AIM or ISDX.

Obviously, investing in small companies is generally riskier than buying shares in giants like HSBC or Shell. And the fact that the companies are not listed on the stock market means that there's no easy way to sell your shares.

But small companies can grow very quickly because they are coming from a low base. With a small company, you're more likely to lose your money, but you're also more likely to make double, treble, or an even bigger multiple of the amount you invested.

You can read the What Investment guide to EIS and SEIS for tax planning here

Enterprise Investment Scheme (EIS) tax breaks

The UK government set up the Enterprise Investment Scheme in 1994. Today, it offers a number of tax breaks to investors who buy shares in small, private companies:

- You get **income tax relief** of 30 per cent. So if you invest £10,000 in a company that is eligible for EIS, you can knock £3,000 off your income tax bill in the year that you invest.
- You'll pay **no capital gains tax** on any profits you make from an EIS investment. So if you invest £10,000 and five years later sell your shares for £20,000, you'll get the full benefit of the £10,000 profit, saving you at least £1,800.
- If you make a loss on your investment, you can **offset that loss** against income tax. So let's say you lose your entire £10,000 investment. Because of income tax relief, your actual loss is only £7,000 (£10,000-£3,000). So you can, if you choose, reduce your taxable income for the year in which you disposed of the shares by £7,000, resulting in a saving of £2,800 (40 per cent of £7,000) for a higher-rate taxpayer. If you want to offset your loss against other capital gains in the normal way, you can do this instead.
- There's **no inheritance tax** to pay on shares bought through EIS.

To be eligible for these reliefs, you generally have to hold the shares for at least three years before selling them.

There's a few more catches. You still have to pay tax on any dividends – but most small private companies won't pay dividends anyway. There are certain restrictions as to what kind of business you can invest in (it can't be a bank, a farm or a nursing home, for example). And you can't be connected to the company or have a stake of more than 30 per cent of it.

You can invest a maximum of £1 million each year through EIS.

Seed Enterprise Investment Scheme (SEIS) tax breaks

The Seed Enterprise Investment Scheme is much newer than its parent initiative, EIS, having been set up as recently as 2012.

It is very similar to EIS but designed for investing in even smaller companies, and providing even more generous tax breaks.

While the maximum workforce and gross assets allowable under EIS are 250 staff and £15 million respectively, SEIS has lower limits of 50 staff and £200,000 gross assets. Businesses must also be less than two years old (there are no age restrictions under EIS).

The tax breaks are as follows:

- **Income tax relief** is 50 per cent, not 30 per cent. So you get £5,000 off your income tax bill for investing £10,000 under SEIS.
- As with EIS, there's **no capital gains tax** to pay on profits, **no inheritance tax**, and you can claim **loss relief** in the same way. See above for details.
- There is an extra relief called **capital gains reinvestment relief**. This is useful to you if you have recently paid capital gains tax on other investments. You can reclaim up to 50 per cent of the tax paid if you reinvest that money into SEIS. (This was originally introduced as a temporary measure, but in the 2014 Budget, chancellor George Osborne made it permanent.)

The tax reliefs available through SEIS are so generous that for the 2012/13 tax year, they added up to a potential 100.5 per cent of your investment in a situation where that investment was a complete failure. In other words, you literally could not lose provided you had paid enough tax to offset your SEIS investment against.

However, for the 2013/14 and 2014/15 tax years, the downside protection has fallen 86.5 per cent – so you'll get back £8,650 from a £10,000 investment that totally fails if you pay enough tax to use all the reliefs. This is still an excellent buffer, of course.

The maximum you can invest through SEIS in any tax year is £100,000.

How to access EIS and SEIS

If you invest through a business angel network or an equity crowdfunding website, the network or website should help you with the paperwork around getting your EIS or SEIS benefits.

You can also invest in a company you know, provided you are not considered to be connected to it by HMRC. Connection means being a partner, employee, director, or having a share of 30 per cent or more. If you do invest in a company you have come across privately, make sure you buy the shares *after* the company has been set up, otherwise EIS and SEIS won't apply.

You should always check that the company you're investing in is definitely eligible for EIS or SEIS – and make sure you're happy with it as an investment. Never invest just for the tax breaks.

EIS funds

Although EIS was originally designed to encourage direct investments in companies by individuals, there are a number of EIS funds where professional managers will choose companies to invest in.

Sometimes, the EIS fund manager makes investments on your behalf, with your name ending up on the shares. In this case, you only get the tax reliefs as and when your money is invested in qualifying companies. Other EIS funds that have been specially approved by HMRC can give you the chance to claim all your tax relief when the fund closes for investment.

EIS funds can help you spread risk across a larger number of companies, and effectively outsource your investment decisions to a manager who should have the time and skills to assess companies properly. However, this doesn't change the fact that an EIS fund is still a very risky investment, with a high chance of losing large chunks of your money. Use with caution.