CHAPTER 3
– TAX RELIEFS

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EIS Diploma
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CHAPTER 3

TAX RELIEFS

In this chapter you will learn about various tax reliefs including:
– Income Tax relief when subscribing for shares under the EIS;
– Income Tax relief when subscribing for shares under the SEIS;
– CGT relief for investing in EIS/SEIS; and
– IHT relief for shares in EIS/SEIS.

3.1 Income Tax Relief for EIS

In the last chapter we saw that a person’s Income Tax liability was based on their taxable income. Subscriptions in EIS and SEIS shares give rise to a form of Income Tax relief by way of a tax reducer. Tax reducers reduce the Income Tax liability and the following diagram shows where this reducer sits in the calculations:

```
Non savings Interest Dividends
Taxable Income (after PA) X X X
Tax @ 20%/10% X
@ 40%/32½% X
@ 45%/37½% X
Less: Tax reducers (X)
Income Tax liability X
Less: Tax credits (eg 10% on dividends) X
Income Tax due X
```

There are separate tax reducers for both the EIS and SEIS. Each tax reducer has its own conditions which must be satisfied before the taxpayer can claim the relief.

An individual (if eligible) may claim relief for both EIS and SEIS tax reducers in the same tax year.

3.2 EIS Tax Reducer

The tax reducer is in respect of the lower of the amount subscribed for the shares and £1 million.

This limit was £500,000 for the years 2008/9 to 2011/12, £400,000 for 2006/7 and 2007/8 and £200,000 for 2004/5 and 2005/6. Up to 5 April 2012, the minimum amount an investor could invest in any one company in any year and obtain Income Tax relief was £500; this minimum limit was removed for the 2012/13 tax year and going forward.

Tax relief is then given at the flat rate of 30% (20% for shares issued before 6 April 2011). Therefore, the maximum tax reducer in respect of an EIS subscription in 2013/14 is £300,000, being £1 million at 30%.
This tax relief from the EIS subscription will reduce an Income Tax liability, but it cannot turn the tax liability into a negative figure. Therefore, if the tax relief on the EIS subscription is greater than the amount that the taxpayer owes for the year, his tax liability is zero. Any tax deducted at source, for instance tax on bank interest or tax under PAYE, would therefore be repaid. Remember the 10% credit on dividends is not repaid.

It is important to note that the investor must subscribe for the shares in order to qualify for tax relief. This means the company is issuing brand new shares to the investor. Subscription is different to buying shares on the open market.

3.3 Carry Back of EIS Income Tax Relief

Income Tax relief is usually given to the investor in the year in which the subscription is made. However, it is possible to carry back an EIS subscription to the preceding tax year, providing the limit for relief was not exceeded in that earlier year.

For example, if a taxpayer subscribes for £200,000 of shares on, say, 30 September 2013, the taxpayer could elect for the full amount of the subscription to be carried back and relieved in the 2012/13 tax computation. However, if the taxpayer had already subscribed for £850,000 of EIS shares in 2012/13, only £150,000 of the 2013/14 investment could be carried back to 2012/13.

Where a subscription made in the current year is carried back to the previous year, it is treated as if it was actually made in the earlier year.

3.4 Clawback of EIS Income Tax Relief

There are anti-avoidance provisions to prevent an investor from obtaining Income Tax relief on their EIS subscription, then selling the shares shortly afterwards. If the investor disposes of his shares within three years of issue, or within three years of trade commencing if later, (where the company is preparing to trade when the shares are issued), there will be a clawback of the Income Tax relief originally given.

No clawback of relief occurs if the disposal takes place as a result of the individual's death.

If the investor gives away his shares within three years, all of the income tax relief originally obtained will be withdrawn. This will not apply when the gift is to the investor's spouse.

The clawback of Income Tax relief is slightly different where the shares are sold to an unconnected third party. If the shares are sold within three years, the Income Tax relief to be withdrawn is the sale proceeds multiplied by the initial rate of relief obtained.

The clawback of Income Tax relief cannot exceed the original tax reducer. This means that if shares are sold at a profit within three years of issue, an amount equal to the original tax reducer is clawed back.

Remember, for shares issued prior to 6 April 2011, the maximum relief available in respect of an EIS subscription was 20% of the amount subscribed.
HMRC will clawback the relief by raising an assessment for the tax year in which the relief was originally obtained. Interest will be charged from 31 January following the end of the tax year for which the assessment was made.

**Illustration 1**

In December 2010 an investor subscribed for £50,000 of shares in an EIS company. In this instance the investor would qualify for an Income Tax reducer of £10,000 in the tax year 2010/11 as the rate of Income Tax relief available in 2010/11 was 20%.

The investor disposes of the shares in June 2013 – i.e. within three years of their issue.

If the disposal is by way of a gift, all of the tax relief originally obtained will be withdrawn. This means that an assessment will be raised in respect of 2010/11 to clawback the relief of £10,000.

If the shares were sold for £60,000, the Income Tax relief to be withdrawn would again be £10,000. Remember that when the EIS shares are sold at a profit within three years, all of the original Income Tax relief given will be clawed back in the year of sale.

On the other hand, if the shares were sold at a loss within three years – here assume sale proceeds are £40,000, being less than the original subscription of £50,000 – the Income Tax relief to be withdrawn is restricted to the sale proceeds, multiplied by 20%. In this instance, £8,000 will be clawed back.

### 3.5 SEIS Income Tax Relief

As stated earlier, there is a separate tax reducer giving Income Tax relief for qualifying subscriptions of SEIS shares.

The SEIS Income Tax relief is calculated in respect of the lower of the amount subscribed and £100,000. Relief is given at a rate of 50%. Although the amount of investment which qualifies for relief is significantly lower than under the EIS, the rate of relief is higher to help make investments more commercially viable for investors.

The maximum amount of Income Tax relief that an individual can obtain under SEIS is therefore £100,000 @ 50% being £50,000. As with EIS, the amount of relief cannot exceed the individual’s tax liability for the year. A claim can also be made to treat the subscriptions as made in the previous tax year provided the limit for relief in the earlier year is not exceeded.

A disposal of the SEIS shares within 3 years will result in a clawback of the relief. The clawback operates in exactly the same way as it does for the EIS.

### 3.6 CGT Relief – EIS Reinvestment Relief

We’ve already said that when an individual subscribes for shares in a qualifying EIS company, he receives Income Tax relief by way of a tax reducer at 30% of the amount subscribed. This is capped at £1,000,000 giving a maximum tax reducer of £300,000.

Now we will look at EIS from a CGT perspective. If an individual sells an asset making a capital gain, and reinvests the sale proceeds in subscribing for qualifying EIS shares, he may claim EIS reinvestment relief (this also gets called deferral relief).
EIS reinvestment relief allows the taxpayer to defer the capital gain to a later time. There is no ceiling to the amount of the gain that can be deferred – the £1,000,000 subscription limit only applies for Income Tax purposes.

EIS reinvestment relief is flexible in that it allows the capital gain on the disposal of any asset to be deferred, as long as the proceeds are reinvested in qualifying EIS shares.

**Illustration 2**

Imran sells a painting for £200,000. The painting original cost £120,000 therefore a capital gain of £80,000 is realised on sale. Imran uses part of the money to subscribe for qualifying shares in an EIS company. The new EIS shares cost £120,000.

Because Imran has sold an asset and has subscribed for new EIS shares, he can make an EIS reinvestment relief claim to defer all or part of the capital gain of £80,000 from the sale of the painting. The amount of the capital gain that can be deferred is the lower of three amounts:

i. the capital gain;

ii. the amount reinvested;

iii. the specific amount claimed.

As Imran has made a gain of £80,000, it makes sense that he can only defer a capital gain of up to £80,000.

The EIS reinvestment relief claim cannot exceed the amount reinvested in the new shares. Here the maximum claim is therefore the lower of £80,000 or £120,000, being £80,000.

If Imran wishes, he could claim a specific amount, which is less than £80,000. The EIS reinvestment relief rules state that the investor must claim a specific amount of reinvestment relief, which could be less than the maximum permitted. This will allow the taxpayer, for example, to take advantage of any unused annual exemption or capital losses.

Assume here that Imran has already used his annual exemption so he claims the maximum amount of EIS reinvestment relief, being £80,000. This reduces his capital gain to zero.

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<tr>
<td>Proceeds</td>
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<tr>
<td>Less: Cost</td>
</tr>
<tr>
<td>Capital gain</td>
</tr>
<tr>
<td>Less: EIS reinvestment relief</td>
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<tr>
<td>Chargeable gain</td>
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### 3.7 How the CGT Deferral Operates

The £80,000 of deferred gain is not rolled over against the base cost of the new EIS shares (as is the case with some other reliefs for CGT), but is frozen instead.

The base cost of the replacement asset – i.e. the new EIS shares – remains the same for CGT purposes. So in our illustration above, Imran paid £120,000 for the EIS shares and for CGT purposes the cost of the shares remains £120,000. When Imran
comes to sell the shares later, he can use £120,000 in his calculation of any gain arising (although the gain on the sale of the EIS shares themselves may be exempt and this is covered later in this chapter).

This frozen gain of £80,000 on the sale of the painting will crystallise and become chargeable, in the year of what we call a “chargeable event”. We shall look at chargeable events later, but the most common chargeable event is the sale of the EIS shares.

3.8 Amount of EIS Reinvestment Relief

The claimant must stipulate the amount of EIS reinvestment relief he wishes to take. In the previous illustration the taxpayer, Imran, made a capital gain of £80,000 on the disposal of an asset and claimed £80,000 relief leaving no chargeable gain.

EIS reinvestment relief is very flexible in that it enables taxpayers to claim a lower amount so as to utilise losses or annual exemptions.

Illustration 3

Assume that Imran in the previous illustration had not made any other disposals in the year so the annual exemption of £10,900 was still available. The objective of the taxpayer is to restrict his EIS reinvestment relief claim as far as possible, without having to pay capital gains tax. The calculation will be as follows:

<table>
<thead>
<tr>
<th>£</th>
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<tbody>
<tr>
<td>Capital gain</td>
</tr>
<tr>
<td>Less: EIS reinvestment relief</td>
</tr>
<tr>
<td>Less: Annual exemption</td>
</tr>
<tr>
<td>Taxable gain</td>
</tr>
</tbody>
</table>

This deferred gain of £69,100 will be frozen until Imran sells his EIS shares. By restricting the claim to £69,100, Imran is reducing the amount of future CGT he will have to pay, and is also making sure that his annual exemption for 2013/14 does not go to waste.

3.9 Conditions for EIS Reinvestment Relief

There are certain conditions to be satisfied before an individual can claim EIS reinvestment relief. Firstly the investor must be UK resident at the time the gain was made and at the time of the reinvestment. The gain must arise on the disposal of an asset, as relief is not available for attributed gains.

The investor must be “subscribing” for shares in a qualifying EIS company. A qualifying EIS company is broadly an unquoted company with a permanent establishment in the UK, carrying on a qualifying trade.

There is a specific time window in which the investor must subscribe for his EIS shares. The reinvestment must be made within 12 months before or 36 months after the disposal of the original asset.

For an investor to obtain Income Tax relief on an EIS subscription, he must not be “connected” with the company (as explained in Chapter 1). This rule does not apply for EIS reinvestment relief for CGT purposes. Therefore if an individual sells an asset and subscribes for shares in an EIS company, he will receive reinvestment relief, regardless of his stake in the company.
Therefore, a CGT deferral claim can be made, even if the investor is an employee of the company, or he holds 100% of the shares. Therefore, a taxpayer can sell an asset, set up his own qualifying EIS company in which he owns all of the shares, and make a claim to defer the capital gain.

Whilst HMRC will give CGT deferral relief, in this instance no Income Tax relief is available, because the taxpayer has more than 30% of the share capital and is therefore “connected”.

3.10 The Frozen Capital Gain

We’ve already mentioned that the frozen gain becomes chargeable when there is a chargeable event.

The most common chargeable event is the sale of the EIS shares themselves. When the EIS shares are sold, there will sometimes be a gain on the shares themselves, and this disposal will also crystallise the frozen gain.

A gift of the EIS shares is also a chargeable event, unless the gift is to one’s spouse. If a taxpayer gifts shares to his spouse, this does not crystallise the frozen gain. However, when the spouse ultimately disposes of the EIS shares, this will be a chargeable event.

If the investor becomes non-UK resident within 3 years of the issue of the shares, this is a chargeable event which will crystallise the frozen gain. The exception to this is if the investor goes abroad on a full-time employment contract and returns to the UK within 3 years.

Finally if the EIS shares themselves cease to be eligible shares, the frozen gain will become chargeable. For example, if the EIS company changes its trade and engages in non-qualifying activities, the deferred gain is charged.

However, a flotation of the EIS company on the Stock Exchange does not crystallise the frozen gain. If the previously unlisted company became a quoted company, this will not result in the frozen gain being charged, unless there were “arrangements” in place for the company to float at the time the shares were originally acquired.

The frozen gain will crystallise in the year of the chargeable event, and not when the original disposal took place. The gain will be subject to tax at the rate of Capital Gains Tax applicable at the date of the chargeable event; this may not be the same rate of tax at the time the gain was originally made.

3.11 CGT Relief – SEIS Reinvestment Relief

We will now consider SEIS reinvestment relief.

This is a temporary relief which was introduced by Finance Act 2012. It applies where an individual makes a chargeable gain on a disposal in 2012/2013 or 2013/14 and also claims SEIS Income Tax relief by way of a tax reducer in respect of an investment in the same year.

Remember, that when an individual subscribes for shares in a qualifying SEIS company, he receives Income Tax relief by way of a tax reducer at 50% of the amount subscribed. This is capped at £100,000 giving a maximum tax reducer of £50,000.
If an individual sells an asset in 2012/13 or 2013/14, and reinvests the sale proceeds in subscribing for qualifying SEIS shares on which SEIS Income Tax relief is claimed in respect the same year, he may claim **SEIS reinvestment relief** for CGT purposes.

SEIS reinvestment relief does not just defer the capital gain, it **exempts a percentage of the gain** from CGT based on the **available SEIS expenditure**.

The amount of the available SEIS expenditure is the **lower of**:

i. The **capital gain**;

ii. The amount **reinvested on which SEIS income tax relief is claimed**;

iii. The **specific amount claimed**.

As the maximum amount on which SEIS Income Tax relief can be claimed is £100,000, **the maximum eligible for relief is £100,000**.

The amount of the exempt gain is the relevant percentage of the available SEIS expenditure. **The relevant percentage for 2013/14 is 50% (2012/13: 100%)**.

**Illustration 4**

Harriet sold a painting in December 2013 and realised a capital gain of £50,000. In February 2014 she subscribed £20,000 for shares in Tom Ltd and claimed SEIS Income Tax relief. The amount of the available SEIS expenditure is the lower of:

i. the gain – £50,000;

ii. the amount invested on which SEIS income tax relief is claimed – £20,000; and

iii. the amount claimed.

Harriet claimed available expenditure of £20,000.

The amount of SEIS reinvestment relief for the reinvested capital gain is 50% of the SEIS investment i.e. £10,000. The balance of the gain of £40,000 is chargeable to CGT as normal.

Provided the SEIS shares are held for three years the relieved gain is **wholly exempt**. If the SEIS Income Tax relief is withdrawn, most likely because the SEIS shares are sold within 3 years, the relieved gain becomes chargeable. The gain will be charged to CGT in the tax year the shares were originally issued, and at the applicable rate of CGT at that time.

3.12 **Tax Implications: EIS and SEIS Shares Sold at a Gain**

Where EIS and SEIS shares are sold at a gain, that capital gain is **sometimes exempt** from CGT.

The gain is exempt from CGT if **two conditions** are satisfied.

1. The shares must be sold outside the “relevant period”, which is **three years** after the issue of the shares, but can be longer than three years if the company was preparing to trade at the time of the EIS share issue.
2. Secondly, the investor must have obtained Income Tax relief on the subscription. To obtain Income Tax relief on the subscription, the investor must not have been “connected” with the company. Therefore if the investor is connected with the company – e.g. he is an employee or owns more than 30% of the shares – he will not obtain Income Tax relief on the subscription, so the gains on the shares will not be exempt from CGT.

If these conditions are not satisfied, a gain on EIS or SEIS shares is a chargeable gain for CGT purposes as usual.

Remember that the maximum investment qualifying for EIS Income Tax relief is limited to £1,000,000. The limit was £500,000 between 6 April 2008 and 5 April 2012, £400,000 for 2007/08, £200,000 between 6 April 2004 and 5 April 2006 and £150,000 prior to 6 April 2004. Subscriptions in excess of the limit applying in the year of acquisition would not have obtained Income Tax relief.

Also remember the maximum investment qualifying for SEIS Income Tax relief is £100,000. However, SEIS shares could only be issued from 6 April 2012, so any gain arising on SEIS shares sold in 2013/14 will be chargeable as the shares will not have been held for three years.

3.13 Tax Implications: EIS and SEIS Shares Sold at a Loss

Where EIS and SEIS shares are sold at a loss, the loss is always an allowable capital loss regardless of when the shares were sold. However, in order to calculate the amount of the allowable capital loss, any Income Tax relief obtained on the subscription and not clawed back reduces the base cost for Capital Gains Tax purposes. Essentially, any Income Tax relief obtained by the investor will reduce the capital loss that he or she may claim.

As we know, an investor will currently receive Income Tax relief by way of a tax reducer of 30% (20% pre 6 April 2011) of the amount of the EIS subscription, now capped at £1,000,000. The tax reducer in respect of a SEIS subscription is 50% of the amount subscribed, capped at £100,000. We’ve already seen that this Income Tax relief will be withdrawn if the shares are sold within three years of their issue. The amount of the Income Tax relief withdrawn, is the proceeds of sale multiplied by the rate at which Income Tax relief was originally given.

In the vast majority of instances, the rate of relief will be 20% in respect of EIS shares issued before 6 April 2011, 30% for EIS shares issued on or after that date and 50% for SEIS shares. The withdrawal will never exceed the amount of relief given in the first place. Income Tax relief is withdrawn by means of an assessment for the year in which the relief was originally obtained.

Illustration 5

In May 2011, Karen subscribed £50,000 for shares in a qualifying EIS company. She received Income Tax relief of £15,000 on the subscription being £50,000 at 30%. Karen sells the shares in March 2014. Her proceeds of sale are £32,000, so as you can see, Karen has made a capital loss.

Calculate the allowable capital loss available.

Karen received sales proceeds of £32,000, less the price she paid for the shares of £50,000, so her cash loss is £18,000. However, to arrive at the allowable capital loss for CGT purposes, we must deduct any Income Tax relief Karen has been given from the base cost of the shares for CGT purposes.
Karen’s original Income Tax relief was £15,000. However, because she sold the EIS shares within three years of issue, some of this Income Tax relief will be withdrawn. The sum on which Income Tax relief withdrawn is £32,000 – so multiplying the sale proceeds by the rate of relief which applied when the shares were issued, i.e. 30%, gives £9,600. In total therefore, Karen has only received £5,400 worth of Income Tax relief. The base cost of Karen’s EIS shares is therefore £44,600. Karen’s allowable loss for CGT purposes is therefore £12,600.

March 2014

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<tbody>
<tr>
<td>Sales proceeds</td>
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<tr>
<td>Cost</td>
</tr>
<tr>
<td>Less: Income Tax relief retained</td>
</tr>
<tr>
<td>Original – amount withdrawn (15,000 – 9,600)</td>
</tr>
<tr>
<td>Allowable capital loss</td>
</tr>
<tr>
<td>(44,600)</td>
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<td>(12,600)</td>
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Another way of arriving at this figure, is to look at the loss on the sale of the shares and deduct any Income Tax relief given. Karen lost £18,000 on the sale of the shares, but received £5,400 worth of Income Tax relief. Her effective loss is therefore £12,600 and this is the allowable loss for CGT.

Illustration 6

Consider whether the position would have been different if Karen had sold her shares in March 2015, again for £32,000.

Karen paid £50,000 for the shares in May 2011. The Income Tax relief obtained on the subscription was £15,000. This time, because Karen has sold the shares more than three years after their issue, none of the Income Tax relief is withdrawn. The total Income Tax relief given is therefore £15,000. This reduces the base cost of the EIS shares to £35,000.

Karen’s allowable loss for Capital Gains Tax purposes is therefore £3,000. Again this is the loss on the shares of £18,000, less Income Tax relief given of £15,000.

March 2014

<table>
<thead>
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<tbody>
<tr>
<td>Sales proceeds</td>
</tr>
<tr>
<td>Cost</td>
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<tr>
<td>Less: Income Tax relief retained</td>
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<tr>
<td>Original – amount withdrawn (15,000)</td>
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<tr>
<td>Allowable capital loss</td>
</tr>
<tr>
<td>(35,000)</td>
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<tr>
<td>(3,000)</td>
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3.14 S131 ITA 2007 Election – Use of Capital Losses Against Income Charged to Income Tax

Under normal rules, a capital loss on the sale of shares is relieved as any other capital loss (i.e. that loss is set against capital gains of the same year). We have seen that it must first be set against capital gains in the same tax year and any excess will be carried forward and set against future capital gains.

However, s.131 ITA 2007 allows an individual to use certain qualifying capital losses in a slightly different way. If a claim is made, the capital loss can be deducted in computing the individual’s net income for Income Tax purposes, either for the current year or of the preceding year.

This is very unusual and is the only time when a taxpayer can set a capital loss against income.
This relief is available on qualifying shares. These are either

- shares on which EIS income tax relief has been claimed; or

- unquoted shares in a qualifying trading company which have been subscribed for by the individual (which would include SEIS shares).

In practice, relief will most commonly arise when an individual makes losses on shares which have EIS or SEIS income tax relief attributable to them.

However, if an individual subscribes for shares in an unquoted trading company which meets the conditions for s.131 relief, which broadly means they do meet the conditions of qualifying EIS shares, then any capital loss arising on disposal can normally be set against net income, even where EIS Income Tax relief has not been claimed.

As such, any allowable loss on SEIS shares will also qualify for relief under s.131.

Relief under s.131 is one of the loss reliefs subject to a cap on the amount which can be deducted in arriving at taxable income. The total amount of reliefs which can be deducted is the greater of £50,000 or 25% of adjusted total income. However, the restriction does not apply where the loss relates to shares which have EIS or SEIS Income Tax relief attributable to them.

Illustration 7

Let's return to illustration 5 above. Assuming Karen sold the EIS shares in March 2014, she has an allowable capital loss of £12,600 for the tax year 2013/14. If no claims are made, this capital loss will first be set against Karen's capital gains in the same tax year, and any excess will be carried forward and set against future capital gains. In this situation the capital loss on the EIS shares are relieved in the same way as capital losses on other assets.

However, there is one more thing that Karen could do with this capital loss. If Karen makes a claim under s.131, instead of setting the capital loss against other capital gains, Karen could elect to set the capital loss against her income charged to Income Tax for 2013/14 or indeed against her income for the preceding tax year 2012/13.

Whether or not it is beneficial to make the claim will depend on the taxpayer's individual circumstances. However, given that CGT rates are generally lower than Income Tax rates, this will often be a desirable claim. Remember, Income Tax is generally charged at the non savings rates of 20%, 40% and 45% whereas CGT is charged at 18% and 28%.

There is a summary at the end of this chapter which recaps on both the Income Tax and Capital Gains Tax implications of subscribing for and selling EIS and SEIS shares.

3.15 Process for Claiming EIS Tax Reliefs

The EIS is administered in HMRC by their Small Company Enterprise Centre (SCEC).

The SCEC decides if a company and a share issue qualifies for EIS purposes. If they do, the SCEC then takes responsibility for checking the accounts etc. of the company to ensure that it continues to meet the requirements of the Scheme.
The SCEC also operates an advance assurance scheme, whereby companies wishing to raise funds from investors who wish to claim EIS tax reliefs can submit their plans to raise money, details of their structure and trade etc. before the shares are issued. The SCEC will then advise on whether or not the proposed share issue is likely to qualify for EIS purposes.

Advance assurance does not confirm whether a specific individual will qualify for the tax reliefs.

Companies are not required to obtain such an assurance, but companies, particularly those using the EIS for the first time, may consider it prudent to do so. It gives an opportunity to spot any problems before shares are issued and an assurance from the SCEC is also useful for companies to show to potential investors.

Once the shares have been issued, there are two stages to the claim for relief:

1. The company must make a claim that it is a qualifying company – irrespective of whether or not an advance assurance has been given; and then

2. The individual investors may claim relief.

The company makes its claim by completing form EIS1 and sending it to the SCEC. A separate form EIS1 must be submitted for each share issue.

Please note that a form EIS1 cannot be accepted by the SCEC unless the company has been trading for at least four months. The claim must be made within two years after the end of the tax year of assessment in which the shares were issued, or if later, two years after the end of the period of four months of starting the qualifying trade.

If the SCEC accepts that the company, its trade and the shares all meet the requirements of the Scheme, it will issue a form EIS2 to the company to that effect, and supply sufficient forms EIS3 for the company to send to the investors so they can claim tax relief.

This process is repeated each time a company issues shares which it wishes to attract EIS reliefs for investors.

Form EIS3 enables the investors to make the relevant claims for Income Tax and/or Capital Gains Tax reliefs in their self assessment tax returns.

An investor’s claim can be made on the self assessment tax return for the tax year in which the shares were issued. HMRC may request to see the form EIS3 to support the claim, therefore the investor should retain the EIS3.

If the shares were issued in a previous year, and/or if the claim is for capital gains deferral relief, then the claim part of the form EIS3 must also be completed and sent to the tax office.

If an investor has an EIS3 for a year for which they have not yet received a tax return, they can request a change to their PAYE tax code reducing the tax collected on their employment income, or to amend their Income Tax payments on account if appropriate. A claim itself still needs to be made on the tax return when it is received.

Claims for Income Tax relief and EIS reinvestment relief must be made no later than 5 years from 31 January after the end of the tax year in which the shares are
issued. Therefore for claims in respect of shares issued in the tax year 2013/14, a claim must be made no later than 31 January 2020.

If the investor does not hold form EIS3 he may not claim to defer payment of tax because of his EIS investment. This can cause particular difficulties for investors claiming CGT deferral relief, because until they have form EIS3 they have to fund both the share subscription on the new investment and the tax which arises from the disposal.

Claiming EIS Tax Relief Through Investing in EIS Funds

If the investment is through an approved EIS Fund (which invest in a number of qualifying companies on behalf of the investor as mentioned in Chapter 1), investors will receive an EIS5 from the fund manager covering all the investments made on their behalf instead of an EIS3 for each investment.

If someone invests through one of these approved funds, then providing certain conditions are met, they can claim income Tax relief as if the shares were subscribed for on the date the Fund closed, rather than the date when they were actually purchased. Capital gains deferral relief is still claimed by reference to the date the investment in the EIS qualifying company was made.

The remaining process for claiming the tax relief is the same as outlined above.

3.16 Process for Claiming SEIS Tax Reliefs

The process for claiming SEIS tax incentives is similar to that of EIS. The company may request advance assurance before the issue of shares and once the shares have been issued there are two stages starting with the company making a formal claim on an SEIS1.

Again HMRC will issue a certificate to the company once it is satisfied with the information on the form SEIS1. HMRC will also supply claim forms for the company to send to investors so they can claim their tax relief.

The company cannot issue these forms to the investors until the trade has been carried on for four months or at least 70% of the money raised has been spent.

Once the investors do have the claim forms, they may make the relevant claims in their self assessment tax returns for the year in which the shares were issued, or they can submit the claim form to HMRC if it is too late to make or amend the self assessment or if a claim for capital gains re-investment relief is to be made.

Claims for SEIS Income Tax relief and SEIS capital gains reinvestment relief must be made by the 5th anniversary of 31 January following the end of the tax year in which these shares are issued.

3.17 IHT Reliefs for EIS and SEIS

There are certain reliefs available from IHT for shares and these should apply to shares held in in EIS and SEIS companies. Provided that the shares have been owned for 2 years, then it is likely that relief from IHT is available. This is known as ‘Business Property Relief’ (or BPR). This applies to both lifetime gifts and shares in the death estate.

Business Property Relief is given for shares that are not listed on a recognised exchange (i.e. unquoted shares). EIS companies cannot have their shares listed
on a recognised stock exchange at the time of the issue of the shares. If the shares are subsequently listed then BPR will not be available. The Alternative Investment Market (AIM) and certain other junior markets are not “recognised stock exchanges”.

If the recipient of the gift of shares becomes entitled to the shares on the death of a spouse or civil partner, any period during which the spouse or civil partner owned the shares is counted towards the 2 year requirement. The 2 year period applies from the date the money was initially invested into the qualifying companies.

In certain circumstances relief is still available even if the shares have not been owned for two years where the property transferred replaced other relievable property.

Taking the EIS tax reliefs together with BPR, the initial cost of the investment is greatly reduced by the tax reliefs available.

**Illustration 8**

Let’s assume the initial investment is £100,000. Income Tax relief is given at 30% so the net cash outlay is £70,000. If the investment grows to £160,000 over two or more years there is a gain on the investment of £90,000 (£160,000 - £70,000).

If the investment is still worth £160,000 at the time of death then IHT relief would be 40% of £160,000 = £64,000.

This assumes that there is no nil band and the death rate of IHT is 40%.

There is no clawback of Income Tax relief or CGT deferral relief on death. Therefore, in this illustration all of the £160,000 value passes to the beneficiary. If the assets were quoted shares the beneficiaries would have received the £160,000 net of 40% tax.

**Q**

Now test your understanding by attempting the following examples.
**EXAMPLES**

✦ **Example 1**

Mike’s net income (before PA) for 2013/14 is £31,000.

Mike makes the following payment:

<table>
<thead>
<tr>
<th>Subscription for EIS shares</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4,000</td>
</tr>
</tbody>
</table>

**Calculate his tax reducer.**

✦ **Example 2**

Jenny generates a capital gain of £50,000 on sale of an antique dining table and chairs in 2013/14. She subscribes £35,000 for qualifying EIS shares in 2013/14. She has capital losses of £20,000 brought forward from last year.

**What amount of EIS deferral should she claim?**

✦ **Example 3**

Which one of the following is NOT a condition for claiming EIS reinvestment relief?

A. The investor must be UK resident

B. The subscription must be made 12 months before to 36 months after the disposal of the original asset

C. The claim must be made within 5 years of the end of the tax year of the share issue

D. The EIS company itself must have a permanent establishment in the UK
ANSWERS

✓ Answer 1

EIS tax reducer
4,000 @ 30% £1,200

Note:

Mike’s Income Tax liability before the tax reducer would be £4,312 therefore he would have sufficient liability to utilise the tax reducer in full.

(Net income £31,000 less PA of £9,440 gives taxable income of £21,560. This is all taxed at 20% giving a liability of £4,312).

✓ Answer 2

Jenny should claim £19,100.

If Jenny claims EIS reinvestment (or deferral) relief of £19,100 she will have no capital gain left to charge after utilising the losses brought forward and the annual exemption.

Maximum claim is lower of:

- The gain of £50,000;
- The amount subscribed of £35,000; and
- An amount of Jenny’s choosing.

£

Gain 50,000
Less: Capital losses brought forward (20,000) Gain after losses 30,000
Less: Annual exemption (10,900) Gain left after losses & annual exemption 19,100

✓ Answer 3

C – the claim is 5 years from 31 January after the end of the tax year
TAX RELIEFS

EIS INCOME TAX RELIEF
If a taxpayer subscribes for EIS shares, a tax reducer is given reducing income tax liability, being a percentage of the lower of:

• the amount spent; or
• £1 million.

For 2013/14 the percentage is 30%.

Carry back of relief is available for one tax year provided the limit wasn’t exceeded that year.

Relief is clawed back where shares are disposed of within 3 years.

SEIS INCOME TAX RELIEF
If a taxpayer subscribes for SEIS shares, a tax reducer is given reducing income tax liability, being a percentage of the lower of:

• the amount spent; or
• £100,000.

For 2013/14 the percentage is 50%.

EIS CGT RELIEF
EIS Reinvestment Relief is available to defer all or part of a capital gain arising on ANY asset. The amount that can be deferred is the lower of:

• The gain;
• The amount reinvested; and
• A specific amount claimed.

The gain will be charged when the EIS shares are sold.

SEIS CGT RELIEF
SEIS reinvestment relief is available for 2012/13 and 2013/14.

SEIS reinvestment relief exempts a percentage of the capital gain arising on ANY asset from CGT. The percentage for 2013/14 is 50%.

The maximum gain eligible for relief is £100,000.

CAPITAL GAINS AND LOSSES ON EIS AND SEIS SHARES
Sometimes capital gains on EIS/SEIS shares are exempt from tax. The shares must have
been **held for 3 years** and **Income Tax relief** must have been obtained.

EIS/SEIS shares sold at a loss is **allowable as a capital loss** but the loss is reduced for any Income Tax relief given.

S.131 ITA 2007 **allows a capital loss to be used against income charged to Income Tax.**
CLAIMING EIS RELIEFS

The company wishing to raise the funds submits an **EIS1 form** to HMRC after 4 months of carrying on the qualifying trade.

Once HMRC is satisfied with the information on the EIS1 they will issue an **EIS2 form** to the company.

The company will then send an **EIS3** to the investor enabling them to claim the Income Tax and Capital Gains Tax reliefs.

EIS claims are made via self assessment by the **fifth anniversary of the 31 January following the tax year of assessment in which the investment is made**.

CLAIMING SEIS RELIEFS

The company wishing to raise the funds submits a **SEIS1 form** to HMRC after 4 months of carrying on the qualifying trade or when at least 70% of the money raised has been spent on the qualifying activity for which it was raised.

Once HMRC is satisfied with the information on the SEIS1 they will issue a **certificate** to the company and supply **claim forms** to the company to send onto the investors.

SEIS claims for Income Tax and Capital Gains Tax reliefs are made via self assessment by the **fifth anniversary of the 31 January** following the tax year of assessment in which the investment is made.

IHT RELIEFS FOR EIS AND SEIS SHARES

There are **certain reliefs available from IHT for shares in EIS and SEIS companies**. Provided that the shares have been **owned for 2 years**, then it is likely **100% of the value will be relieved from IHT**.
# Tax Consequences of an Individual Subscribing for EIS Shares

**Income Tax Reducer**
- 30% × amount subscribed (max £1,000,000 × 30%)
- Can only reduce Income Tax liability to nil

**Capital Gains Tax Deferral**
- Can defer the gain on the disposal of any asset
- Gain normally becomes chargeable when the EIS shares are sold

**Conditions:**
- Must **not be ‘connected’** with the EIS company (e.g. must not be an employee nor hold > 30% shares in the company)
- Must own the shares for ≥ 3 years (otherwise Income Tax reducer withdrawn)
- Maximum subscription £1,000,000
- Can **carry back** the EIS subscription to the previous tax year (up to maximum for previous year)

**Can defer the lower of:**
- Gain on any asset
- Amount subscribed for EIS shares
- Any other amount (to utilise AE, losses)

**Other Points:**
- **Can be connected** with the EIS company
- EIS shares must be subscribed for in the period:
  - 12 months before, and
  - 3 years after
  
  the gain being deferred arises.
- Claim must be made by 5 years from 31 January after the end of tax year of issue of shares (i.e. by 31 January 2020 for an investment made in 2013/14)
### TAX CONSEQUENCES OF INDIVIDUAL SELLING EIS SHARES

<table>
<thead>
<tr>
<th>WITHDRAWAL OF INCOME TAX REDUCER</th>
<th>DEFERRED GAIN BECOMES CHARGEABLE</th>
<th>EIS SHARES THEMSELVES</th>
</tr>
</thead>
<tbody>
<tr>
<td>• If sold within 3 years</td>
<td>• Any gains deferred upon the subscription become chargeable in tax year of sale</td>
<td><strong>Capital Loss</strong></td>
</tr>
<tr>
<td>• Clawback is the lower of:</td>
<td>• If only a proportion of the EIS shares are sold, only the same proportion of the gain becomes chargeable.</td>
<td>• Always allowable regardless of how long EIS shares owned</td>
</tr>
<tr>
<td>– Original Income Tax reducer, and</td>
<td></td>
<td>• Capital loss restricted by any Income Tax reducer retained</td>
</tr>
<tr>
<td>– Sale proceeds received × rate of initial relief (only applicable if sold for a loss)</td>
<td></td>
<td>• Can claim to use this loss against net income in the Income Tax computation instead of as a capital loss (under s.131 ITA 2007)</td>
</tr>
<tr>
<td>• Income Tax reducer clawed back by assessment for tax year in which given</td>
<td></td>
<td><strong>Chargeable gain</strong></td>
</tr>
</tbody>
</table>

No withdrawal of Income Tax reducer if sold ≥ 3 years

• Exempt if shares owned ≥ 3 years (and IT relief on subscription)

• Otherwise gives rise to a normal chargeable gain
TAX CONSEQUENCES OF AN INDIVIDUAL SUBSCRIBING FOR SEIS SHARES

INCOME TAX REDUCER
- 50% × amount subscribed (max £100,000 × 50%)
- Can only reduce Income Tax liability to nil

Conditions:
- Must not be ‘connected’ with the SEIS company (eg must not be an employee nor hold > 30% shares in the company)
- Must own the shares for ≥ 3 years (otherwise Income Tax reducer withdrawn)
- Maximum subscription £100,000
- Can carry back the SEIS subscription to the previous tax year (up to maximum for previous year) although carry-back not available to 2011/12.

CAPITAL GAINS TAX EXEMPTION
- Can exempt a percentage of gain on the disposal of any asset in 2012/13 or 2013/14
- Percentage for 2013/14 is 50% (2012/13: 100%)

Can exempt the percentage of lower of:
- Gain on any asset;
- Amount on which SEIS income tax relief claimed; and
- Any other amount.

Other Points:
- Only applies if the disposal and investment take place in 2012/13 or 2013/14
- Claim must be made by 5 years from 31 January after the end of tax year of issue of shares
## TAX CONSEQUENCES OF INDIVIDUAL SELLING SEIS SHARES

<table>
<thead>
<tr>
<th>WITHDRAWAL OF INCOME TAX REDUCER</th>
<th>RELIEVED GAIN BECOMES CHARGEABLE</th>
<th>SEIS SHARES THEMSELVES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>• If sold within 3 years</strong></td>
<td><strong>• If SEIS shares sold within 3 years</strong></td>
<td><strong>Capital Loss</strong></td>
</tr>
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<td>- Original Income Tax reducer, and</td>
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</tr>
<tr>
<td>- Sale proceeds received × rate of initial relief (only applicable if sold for a loss)</td>
<td>- Chargeable in the year the shares were issued</td>
<td>- Capital loss restricted by any Income Tax reducer retained</td>
</tr>
<tr>
<td><strong>• Income Tax reducer clawed back by assessment for tax year in which given</strong></td>
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<td>- Can claim to use this loss against net income in the Income Tax computation instead of as a capital loss (under s.131 ITA 2007)</td>
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No withdrawal of Income Tax reducer if sold ≥ 3 years

**Chargeable gain**

- Exempt if shares owned ≥ 3 years (and IT relief on subscription)
- Otherwise gives rise to a normal chargeable gain