Specialist Tax Portfolio Service

Enterprise Investment Scheme (EIS)

Introduction

Rathbones
Look forward

The scheme

The Enterprise Investment Scheme was introduced in 1994 to encourage the provision of venture capital into smaller, unquoted companies in exchange for a suite of tax relief incentives. To qualify Companies must meet strict parameters set by HM Revenue & Customs which include a gross assets test, be carrying on a qualifying trade and having fewer than 250 employees at the time of share issuance (or 500 for 'knowledge intensive companies'). EIS investors can only participate in the primary markets where the Company issues new shares in exchange for cash as opposed to buying second hand shares; this means that deal flow can be unpredictable.

The tax reliefs

Income tax relief
Income tax relief is available of 30% of the value of funds invested into EIS qualifying shares, up to a maximum of £1,000,000 per year (or £2,000,000 for investment in knowledge intensive companies). This means that a client's income tax liability can be reduced by up to £300,000 per tax year (or £600,000); however the liability can only be reduced to zero, no refund of excess Income Tax Relief will be issued. There is a 'carry back' facility which allows the all or part of the cost of shares acquired in one tax year, to be treated as though those shares had been acquired in the preceding tax year. Relief is then given against the income tax liability of that preceding year, provided the limit for any year is not exceeded. Investments must be held for a minimum of 3 years otherwise the income tax relief will be withdrawn.

Capital gains deferral relief (EIS Reinvestment Relief)
The payment of tax on a capital gain can be deferred where the gain (not the tax liability) is invested into EIS qualifying shares. The gain can arise from the disposal of any kind of asset, but the EIS investment must be made within the period of 1 year before or 3 years after the gain arose. There are no minimum or maximum limits of investment for deferral relief nor is there a minimum period for which the shares must be held; the deferred capital gain is brought back into charge whenever the shares are disposed of, or are deemed to have been disposed of under the EIS legislation. If EIS qualifying shares are held upon death of the investor then the deferred gain is extinguihsed.

Inheritance tax relief (Business Relief)
EIS qualifying investments should also qualify for the business relief against inheritance tax, meaning that the value of the shares falls outside the investor's Estate after 2 years.

Loss relief
If EIS investments are disposed of at a loss, the client can use that loss, less any income tax relief given, against capital gains. Or, uniquely to EIS, they can elect for it to be set against income of the year in which they were disposed of, or of the previous year. Unlike income tax relief, loss relief is set against taxable income not the income tax liability. Loss relief can be limited where income tax relief has not been claimed on the investment.

Capital gains tax exemption
If the client claims income tax relief (which has not subsequently been withdrawn) on the cost of the shares, and the shares are disposed of after they have been held for the relevant period, any gain is free from capital gains tax. However, if no claim to income tax relief is made, then any subsequent disposal of the shares will not qualify for exemption from capital gains tax.

The Specialist Tax Portfolio Service

Rathbones has a dedicated service that provides clients with the ability to own a bespoke portfolio of investments in EIS qualifying shares, in addition to solely Business Relief qualifying investments where client requirements dictate.

The requirement of and the allocation of funds to each tax relief is formulated in conjunction with the financial adviser based upon the client's tax relief requirements. The client's position will be established at the outset and then reviewed on a regular basis as financial circumstances and requirements change over time.

Investment process
Prior to raising funds companies can apply to HMRC for Advanced Assurance that the shares should qualify for EIS. We seek this confirmation before undertaking an investment. In addition, we only consider companies that are or about to be traded on AIM, or occasionally another junior market. We aim to invest each client's portfolio across a minimum of 12 investments and guide that a portfolio can take up to 18 months, possibly longer, to be fully invested. As noted above, deal flow depends upon suitable companies issuing qualifying shares to the market and as such deal flow can be unpredictable and may be difficult to secure during times of profound economic uncertainty. However, where possible, we aim to ensure funds are invested in accordance with a client's investment deadlines.

After each investment is completed the investee company makes an EIS1 application to HMRC. Once processed and approved the EIS3 certificates are issued, which then allows the investor to claim the tax reliefs. This process can typically take 3 months after the investment is made, with a further four months for companies that have yet to start trading.

It is important to be aware of the timescales of the investment and EIS3 process in relation to the client's tax return and payment deadlines.

Some comments on risk

Investors using this Service must have a higher attitude to risk for this proportion of their asset base, even though their general attitude to risk for their overall wealth may be lower.EIS is higher risk due to the early stage 'venture capital' nature of the investments that qualify for the relief and risks surrounding the relief too which make this a complex asset class. An EIS investor must be prepared to accept significant movements in value and potentially a permanent loss of capital in exchange for a tax concession. In a higher risk asset like an EIS, investors must factor in the tax relief being sought in addition to the capital value to create a total return which makes this a very different proposition to that of a conventional stocks and shares portfolio. The value of the tax relief though is entirely personal to you and there is an advantage to making full use of the relief on offer.

There are a number of risks surrounding EIS and several are set out in the following bullet points:

— Investment: which is heightened as capital values of AIM traded smaller company investments are likely to move significantly.

— Diversification: the portfolio will be invested up to 100% in AIM traded direct equities. It will not include fixed interest or alternative asset classes.

— Opportunity: one of the criteria for shares to qualify for EIS is that they must be a new issue of shares by the company and not purchased second hand from the market. This means we can only invest when suitable opportunities arise and the time it takes to reach a fully invested position is likely to take time, in the case of new money at least 18 months to invest fully.

— Liquidity: the ability to buy and sell smaller company shares may be restricted and are treated as being less liquid or marketable than blue chip stocks meaning it could take some considerable time to complete a transaction, if at all. It is possible for companies to subsequently de-list from AIM and without a trading facility it could take some considerable time for an exit to materialise.

— Qualifying: an investee company may cease to qualify and the tax reliefs granted may be revoked which would lead to a reclaim of the relief.

— Tax relief: those available may change or be removed entirely following statutory or regulatory changes.

— Investor: each investor's unique personal circumstances may change the benefits received from tax reliefs or the requirement for the invested funds.

— Holding period: if the investments are not held for the relevant period tax reliefs may be reclaimed.

In summary this means that the risk is amplified beyond investment risk and is in exchange for generous tax concessions.

Examples of EIS investments

For illustration purposes only

Surface Transforms	
Date of investment:	April 2020
Status when subscribed:	AIM traded
Cost price:	13 pence per share
Mid price:	35.5 pence per share*
Current market capitalisation:	£85.4 million*

Amount and purpose of fund raising
Raised £1.4m gross from a placing and a further £300k from an open offer. The net proceeds of the fund raising will provide working capital to enable it to continue operating should COVID-19 impact the business in a material manner.

Description
Surface Transforms are experts in the development and production of carbon-ceramic materials and the UK's only manufacturer of carbon-ceramic brakes for automotive use.

Their material is a next-generation Carbon Fibre Reinforced Ceramic (CFRC) which is produced by a proprietary processes, transforming Carbon-Carbon into Carbon-Silicon Carbide (CSiC) ceramic.

While conventional carbon-ceramic brake discs use discontinuous (chopped) carbon fibre, Surface Transforms interweaves continuous carbon fibre to form a 3D matrix, producing a stronger and more durable product with 3x the heat conductivity compared to competitors; this reduces the brake system operating temperature, resulting in increased life of components with the same brake performance.

Surface Transforms works with a number of automotive manufacturers including mainstream OEMs and niche market/low volume car builders, designing and supplying carbon-ceramic brakes for a wide range of application. They have also developed performance brake packages for some of the most demanding vehicles around, including: Porsche GT2, GT3, Turbo and Cayman; Ferrari 430 and 458; Nissan GTR R35; Aston Martin V8 Vantage.

Intelligent Ultrasound Group	
Date of investment:	May 2020
Status when subscribed:	AIM traded
Cost price:	10.5 pence per share
Mid price:	11 pence per share*
Current market capitalisation:	£36 million*

Amount and purpose of fund raising
Raised £5.2m gross to complete the initial development work on the next ScanNav products, which include liver, prostate and Covid-19 variants; to develop a new neonate simulator; and to strengthen the balance sheet and for general working capital purposes.

Description
Intelligent Ultrasound develops artificial intelligence-based clinical image analysis software tools for the diagnostic medical ultrasound market and hi-fidelity virtual reality simulators for the ultrasound training market and operates through two divisions:

Clinical AI Division
Focuses on developing deep learning-based algorithms to make ultrasound machines smarter and more accessible.

Products in development include ScanNav which uses machine-learning based algorithms to automatically identify and grade ultrasound images to provide scan assessment and audit of protocol-based ultrasound scanning; and AnatomyGuide, which aims to simplify ultrasound-guided needling by providing the user with real-time AI-based needle guidance software for a range of medical procedures.

Simulation Division
Focuses on hi-fidelity ultrasound education and training through simulation. Its three main products are the ScanTrainer OBGYN training simulator, the HeartWorks echocardiography training simulator and the BodyWorks Eve Point of Care and Emergency Medicine training simulator.

*Share prices are those at the close of business 31 May 2023

Meet the team

IIvan Teare, Head of Specialist Tax Portfolio Service - Investment Director
Ivan began his investment management career in 1996 with Hargreave Hale, joining Rathbones from Gerrard Investment Management in 2005.

Having graduated in 1996 with honours in Politics, Economics and Law from the University of Buckingham he has gained the Chartered Institute for Securities and Investment Diploma and is a Chartered Fellow of the Chartered Institute for Securities and Investment.

Ivan is head of specialist tax portfolio service, responsible for Rathbones' specialist tax portfolios which incorporate AIM quoted inheritance tax and enterprise investment scheme strategies.

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Jaclyn King-Gibson, Investment Director
Jaclyn began her investment career at Rathbones in 2004 and has worked in a smaller companies investment team that covers AIM traded EIS and Business Relief investments since 2006. She has been awarded the Private Client Investment Advice Diploma, EIS Diploma, passed Level 1 of the CFA, and is a Chartered Fellow of the Chartered Institute for Securities and Investment.

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Emma Powell, Client Service Executive
Emma began her investment career in 2008 within operations for Deutsche Bank Private Wealth Management. She moved to Rathbones in 2012 working within client reporting and also the fees department. Emma graduated with a degree in Accounting & Finance from Liverpool John Moores University in 2007 and has since gained the Investment Operations Certificate to become an Associate member of the Chartered Institute for Securities and Investment.

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Robert Boyd, Client Service Executive
Robbie joined Rathbones in 2011. He has gained experience in a number of departments since joining including Fees, Capital Gains Tax, Provider Business Support, Client Reporting and Rathbones Online Help prior to joining the Specialist Tax portfolio service team. Robbie has successfully completed the Investment Operations Certificate to become an Associate member of the Chartered Institute for Securities and Investment.

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Jack Lynch, Client Service Executive
Jack joined Rathbones in 2016. He has gained experience in a number of departments within operations beginning with Static Data, working with the Account Opening & Standing Orders teams. Later working within the Oversight & Controls department with the Data Verification team before joining the Specialist Tax Portfolio Services team in 2022. Jack has successfully completed the Investment Operations Certificate to become an Associate member of the Chartered Institute for Securities Investment.

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Important information

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Look forward

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