

Enterprise Investment Scheme Guidelines

1. Can the company issue any kind of shares and securities?

Yes, but only 'eligible shares' can qualify for EIS relief.

2. Do any other conditions have to be satisfied in relation to the shares?

Yes. The main conditions applying to an 'issue of eligible shares' are

- the shares must be issued for bona fide commercial reasons and not for tax avoidance purposes
- all the shares comprised in any issue of shares on or before 16 March 2004 must be issued to raise money for the purpose of a qualifying business activity. For shares issued after 16 March 2004, all the shares (other than any which are 'bonus shares') included in the issue which are issued to investors who claim EIS income tax relief or deferral relief must be issued to raise money for the purpose of a qualifying business activity.
- all the money raised by the share issue must be wholly employed within a specified period by the company or a subsidiary
- the money raised by the share issue must be employed for the purpose of the qualifying business activity for which it was raised: no more than an insignificant amount of it can be used for any other purpose
- where the money raised by the share issue is used by a subsidiary, the subsidiary must throughout the company's 'relevant period' be a '90% subsidiary'
- whose only purpose of existence - apart from purposes incapable of having any significant effect on the extent of its activities, and ignoring certain intra-group activities - is that of carrying on one or more qualifying trades, or
- whose only purpose of existence - apart from purposes incapable of having any significant effect on the extent of its activities - is to hold or manage property for the group, or
- which has no profits for corporation tax purposes and does not make investments

For shares issued after 16 March 2004, where the money raised by the share issue is used by a subsidiary for the purposes of a qualifying activity, it is no longer necessary that the same subsidiary must carry on that activity throughout the company's 'relevant period'. But at any time during that period when a subsidiary is carrying on the activity, the subsidiary concerned must be a 'qualifying 90% subsidiary' of the company.

- the value of the company's gross assets must not exceed £7 million immediately before the shares are issued and must not exceed £8 million immediately afterwards (for shares issued before 6 April 2006 the limits are £15 million and £16 million). Where the company is a member of a group of companies, the limits are applied to the gross assets of the group, taken as a whole. (This condition is known as the **gross assets rule**, and our interpretation of it is given in a [Statement of Practice](#) (SP 2/00))

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3. How soon must the money raised by the share issue be employed?

For shares issued on or after 7 March 2001, at least 80% of the money must be employed for the purpose of the 'qualifying business activity within 12 months after the date on which the shares were issued, and any amount remaining must be used for that activity within the following 12 months.

Different rules applied to share issues prior to 7 March 2001. Those rules are not covered in this leaflet.

4. What conditions must be satisfied by the company issuing the shares if it is to qualify for the scheme?

The main conditions are that, throughout the company's 'relevant period' which applies for the shares in question

- the company must be an [unquoted company](#)
- the company must be either
 - a company whose only purpose of existence - apart from purposes incapable of having any significant effect on the extent of its activities - is that of carrying on one or more qualifying trades, or
 - the parent company of a trading group
- the company must not be a subsidiary of another company, or otherwise be under the control of another company, except in certain circumstances where it becomes a wholly-owned subsidiary of a new holding company after the shares have been issued, and

any company which is a subsidiary of the company must be a 'qualifying subsidiary', and the company must not control any company which is not a qualifying subsidiary.

For shares issued after 16 March 2004, the company must not have a "property managing subsidiary" at any time during the company's 'relevant period' that is not a 'qualifying 90% subsidiary'

- Please see attached links for further guidance, [Qualifying subsidiaries](#) and [Property managing subsidiary](#).

5. What does it mean to say that a company is the parent company of a trading group?

A company is the parent company of a trading group for EIS purposes if it has one or more subsidiaries, and non-qualifying activities do not form a substantial part of the business of the group taken as a whole.

Non-qualifying activities are, broadly, investment activities and non-qualifying trades. We will generally regard anything amounting to more than 20% as being a substantial part in this context.

6. Is a company which exists for the purpose of carrying on a qualifying trade unable to qualify for the scheme if it holds an investment in shares or securities?

Not necessarily. The fact that the company holds shares or securities will not prevent it from qualifying if

- they are held for the purposes of the trade, or
- the holding of them cannot have a significant effect on the extent of the company's activities.

7. What if the company is wound up or dissolved (or goes into receivership or administration)?

If, before the end of its 'relevant period', the company is wound up or dissolved without being wound up, it will generally not qualify for EIS purposes.

However, this general rule does not apply if the company is wound up (or dissolved without being wound up) for bona fide commercial reasons and not for the purpose of tax avoidance, and

Appendix B,, provides details of a further relaxation to the general rule where the company goes into administration or receivership after 20 March 2000.

8. What happens if any condition relating to the company or the shares is not met?

The investors will not be entitled to any EIS reliefs. Any income tax relief already obtained will be withdrawn. Where an investor has obtained deferral relief, a chargeable gain equal to the amount of the deferred gain will arise.

9. In what circumstances can the company become a subsidiary of a holding company without jeopardising its investors' EIS reliefs?

The rules provide for the continuity of income tax relief and deferral relief where a holding company issues new shares and securities to the holders of the shares and securities of the original company in such a way that, as far as its capital structure is concerned, it effectively takes the place of the original company. The holding company must not previously have issued any shares (other than subscriber shares) or securities.

The conditions are complex, and companies intending to undergo a reconstruction of this sort will normally wish to seek specialist advice beforehand in order to help ensure that their investors' EIS reliefs are not put at risk.

10. Can the company arrange for investors to realise their investments?

Yes, provided that it does not make, or agree to make, any such arrangements until after the shares in question have been issued. There is no reason why the directors of the company should not give potential investors an indication of the possible exit routes that they expect to be available in due course.

11. Can the company make arrangements for the investors to get a guaranteed minimum return on their investments?

No. Any arrangements made in connection with the share issue which are designed to secure the return to investors, or to protect them against the risks attached to the investment, will make them ineligible for relief.

12. What are qualifying business activities?

They consist of the company or any subsidiary carrying on (see below for the meaning of 'any subsidiary' for shares issued after 16 March 2004)

- a qualifying trade, or preparing to carry it on – in which case the company or subsidiary in question must begin to carry on the trade within two years after the date of issue of the shares
- 'research and development' which is intended to lead to a qualifying trade carried on by the company or any subsidiary (see below for the meaning of any subsidiary), or
- oil exploration which is intended to lead to a qualifying trade carried on by the company or any subsidiary. For shares issued on or after 7 March 2001 oil exploration is not a qualifying business activity, but oil extraction activities (previously excluded activities) are no longer excluded activities.

For shares issued on or after 16 March 2004:

- 'any subsidiary' relates to a 'qualifying 90% subsidiary' of the company
- the activities for which the money was raised must be carried on by the company that raised the money or any qualifying 90% subsidiary of that company. There is no longer a requirement that the same company must carry on the trade throughout.

The trade or activity must be carried on 'wholly or mainly in the UK' at all times it is carried on during the company's 'relevant period'.

In the cases of 'research and development' the activity must be carried on immediately after the shares are issued if it is not already being carried on.

A company whose main activity consists in undertaking 'research and development' for its customers can qualify for the EIS. In such a case, the qualifying trade is to provide 'research and development' services.

13. Can a qualifying company, or any of its subsidiaries, operate overseas?

Yes, but the trade or activity for which money is raised through the scheme must be carried on 'wholly or mainly in the UK' at any time in the company's 'relevant period' at which it is carried on.

14. Do all trades qualify?

Most do, provided that, throughout the company's 'relevant period', they are conducted on a commercial basis with a view to making profits.

A trade will not qualify if, at any time in the relevant period, one or more excluded activities together amount to a substantial part of the trade. The main excluded activities are

- dealing in land, in commodities or futures in shares, securities or other financial instruments
- financial activities such as banking, money-lending, insurance, debt-factoring and hire-purchase financing
- dealing in goods other than in an ordinary trade of retail or wholesale distribution
- leasing or letting assets on hire, except in the case of certain ship-chartering activities
- receiving royalties or licence fees, except in the case of the exploitation of an intangible asset created by the company or its group
- providing legal or accountancy services
- property development
- farming or market gardening
- holding, managing or occupying woodlands, any other forestry activities or timber production
- operating or managing hotels, guest houses or hostels in which the company carrying on the trade has an interest or which it occupies under licence or any other form of agreement
- operating or managing nursing homes or residential care homes in which the company carrying on the trade has an interest or which it occupies and
- providing services to another company in certain circumstances where the other company's trade consists, to a substantial extent, of excluded activities.

We decide whether excluded activities amount to a substantial part of a company's trade by reference to the relevant facts and circumstances of each case. But we will generally consider that they do where they amount to more than 20% of the trade.

15. What exceptions are made to the rule about receiving royalties and licence fees for film companies and companies engaged in 'research and development'? Share issues after 5 April 2000

For shares issued after 5 April 2000, the special provisions for the production, or production and distribution, of films were repealed and replaced. These new rules provide that a company whose trade at any time in its 'relevant period' consists to a substantial income from royalties and licence fees is not carrying on a qualifying trade for EIS purposes except where it is engaged in receiving

- the licence fees or royalties arise from the exploitation of an intangible asset (of any kind) and
- the whole, or the greater part (in terms of value), of the asset must have been created by
 - the company, or
 - a company which, at all times when it created the asset, was the parent company of the company carrying on the trade, or
 - a company which, at all times when it created the asset, was a 'qualifying subsidiary' of the parent company of the company carrying on the trade.

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Where the intangible asset is intellectual property (such as a patent, trade mark, copyright, or design right), references in the second condition to the creation of the asset by a company are to its creation in circumstances in which the right to exploit it is vested in the company (whether alone or jointly with others).

Shares issued on or before 5 April 2000

Where the shares in question were issued on or before 5 April 2000, the trade can qualify even though it consists to a substantial extent in receiving royalties or licence fees at some time in the company's 'relevant period' if the company engaged throughout that period in

- the production of films, or
- the production of films and the distribution of films it has produced in that period.

All royalties and licence fees received in the relevant period must, however, relate to films the company has produced in that period.

A similar rule applies for a company engaged in research and development throughout its relevant period, where at some time in that period the trade consists to a substantial extent in receiving royalties or licence fees. This may happen if, for example, the company allows another party to manufacture and distribute a product which it has developed itself.

The trade can qualify if all the royalties and licence fees the company receives in its relevant period are attributable to research and development' it has carried out. The 'research and development' giving rise to this income need not have been carried out during the relevant period.

16. Can the company or a subsidiary use money raised through the share issue to acquire a trading company?

Yes but only if

- the acquired company does not have any assets other than a qualifying trade or assets used wholly for the purpose of the trade, and
- for shares which were issued before 17 March 2004, the trade is transferred to the company in question as soon as possible after the trading company has been acquired. If the trade is transferred to a subsidiary of the company which issued the shares, the subsidiary must have been a subsidiary of that company when the shares were issued.

17. Can I get advance assurance that a company will qualify for the scheme?

Before subscriptions for shares are invited, the company secretary, or a director, or an agent acting on the company's behalf, may submit in writing the company's proposals for using the scheme to our Small Company Enterprise Centre (SCEC) (see [Further Information](#)).

If the SCEC is satisfied, on the basis of information supplied, that the conditions of the scheme which apply to the company and the shares will be met, they will say so in writing. The company can inform potential investors of this advance assurance, but whether the conditions of the scheme are, in the event, met is a question of fact which cannot be determined in advance.

The SCEC cannot give any advance assurance about whether particular potential investors will be entitled to claim income tax relief or deferral relief.

18. What information should the company supply to obtain an advance assurance?

All information which may be relevant, including

- a copy of the latest available accounts for the company and each of its subsidiaries
- an up-to-date copy of the Memorandum and Articles of Association of the company and each of its subsidiaries, and details of any proposed changes
- a copy of the draft of any document to be issued to potential investors
- confirmation that the company expects to be able to complete the declaration on form EIS1 in due course
- details of any subscription or similar agreement to be entered into by the shareholders
- details of all trading or other activities carried on, or to be carried on, by the company and its subsidiaries, and
- the approximate sum the company intends to raise through the share issue, and details of how it intends to use the money.

19. Once the shares have been issued, what procedures should be followed to enable the investors in the company to claim income tax relief or deferral relief?

Once the qualifying trade or 'research and development' for which the funds were raised has been carried on for four months, the company secretary or one of the company's directors should submit a [form EIS1](#) to the Small Company Enterprise Centre (SCEC). Copy on next page.

The time limit for submitting EIS1 is the later of

- two years after the end of the 'tax year' in which the shares were issued, and
- two years after the end of the four-month period mentioned above.

If the SCEC are satisfied that the conditions for qualifying investors to claim relief are met, they will authorise the company (on form EIS2) to issue certificates EIS3 to shareholders who require them. The investors use these certificates to claim income tax relief or deferral relief.