Understanding EIS

a guide to tax-efficient investing

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Introducing the Enterprise Investment Scheme (EIS)

David **Brooks** | Tax Partner, BDO LLP

The Enterprise Investment Scheme (EIS) was introduced in 1994. Since then it has helped over 28,000 companies and raised more than £20bn in equity finance. The EIS is vital for many companies seeking growth capital and helps solve the funding gap that most young companies encounter. The relief has been shaped by EU state-aid rules and it is hoped that following Brexit, some of the more restrictive rules can be relaxed to make this growth funding available to more companies.This could make the UK a more attractive place to start and grow a business.

From the investors' perspective, they are taking on additional risk by investing in unquoted companies in exchange for a generous raft of tax reliefs, including upfront income tax relief, exemption from capital gains tax (CGT) on disposal and, depending on the scheme, CGT reinvestment relief or deferral. Relief for losses and business property relief for inheritance tax (IHT) should also be available.

Investors in EIS companies generally take a portfolio approach, accepting that they will have gains and losses, with tax relief enhancing the gains and minimising the losses. Funding platforms allow an investor to identify a spread of suitable investments but, for those investors who do not have the time or the skills to identify investments themselves, EIS funds can be a helpful way of spreading risk, with the help of an experienced fund manager.

***David Brookes** is a tax partner at BDO LLP with 30 years' experience. He specialises in tax-efficient investing and is the author of Venture Capital Tax Relief. He also chairs BDO's national tax technical committee and sits on the EIS Association's tax and technical committee.* David can be contacted at david.brookes@bdo.co.uk.

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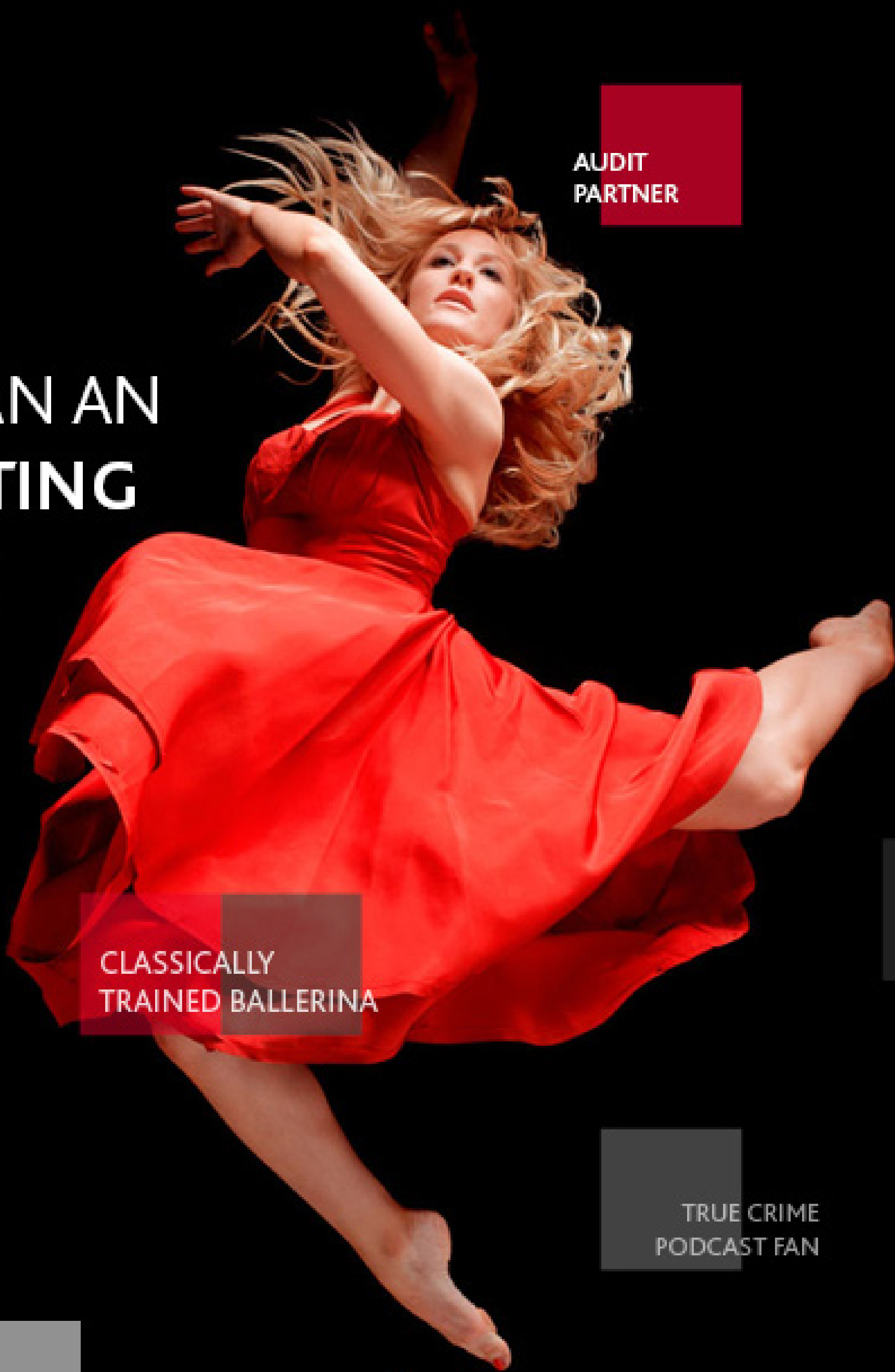

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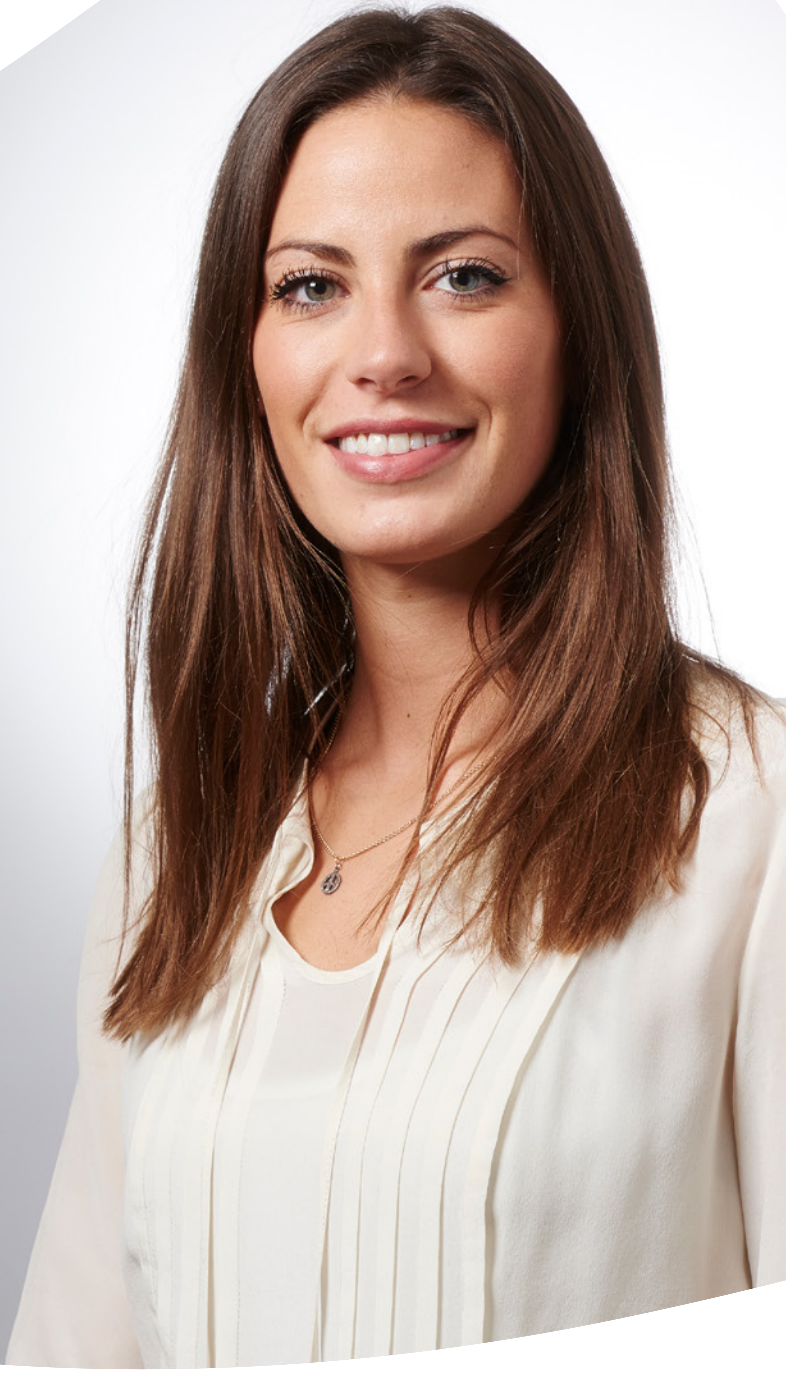
The importance of investing in startups



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At Silicon Valley Bank, we work with many early-stage companies and see at first hand the key role that business angels play in fuelling the innovation ecosystem. Not only does early-stage investing have the potential for outsized returns, but ‘first-ticket’ investors can help shape the future of these companies by allowing them to grow, in turn boosting the economy and creating new job opportunities.

Claire
Palmer

Senior Vice President,
Emerging Venture Capital Relationships,
Silicon Valley Bank

CASE STUDY 1

Epipole

You've probably been to an optician and experienced a moment where they look through a small device while shining a light in your eye. Sometimes you blink a lot and sometimes your eye darts around too quickly, making the viewing take longer than necessary. With Epipole's series of 'epiCams', they can record this examination and play it back for further inspection.

"This project is a matter of immense personal satisfaction as it addresses a growing need in the developing world, as well as providing a challenge to established technologies which currently dominate the market at a substantial premium." – Bob Henderson, Optical Design Engineer

Epipole was founded by an expert in vision systems, algorithm development and mathematical problem solving, Dr Craig Robertson. He works with Bob Henderson, who has over 35 years of experience in optical design and over 15 years in retinal imaging.

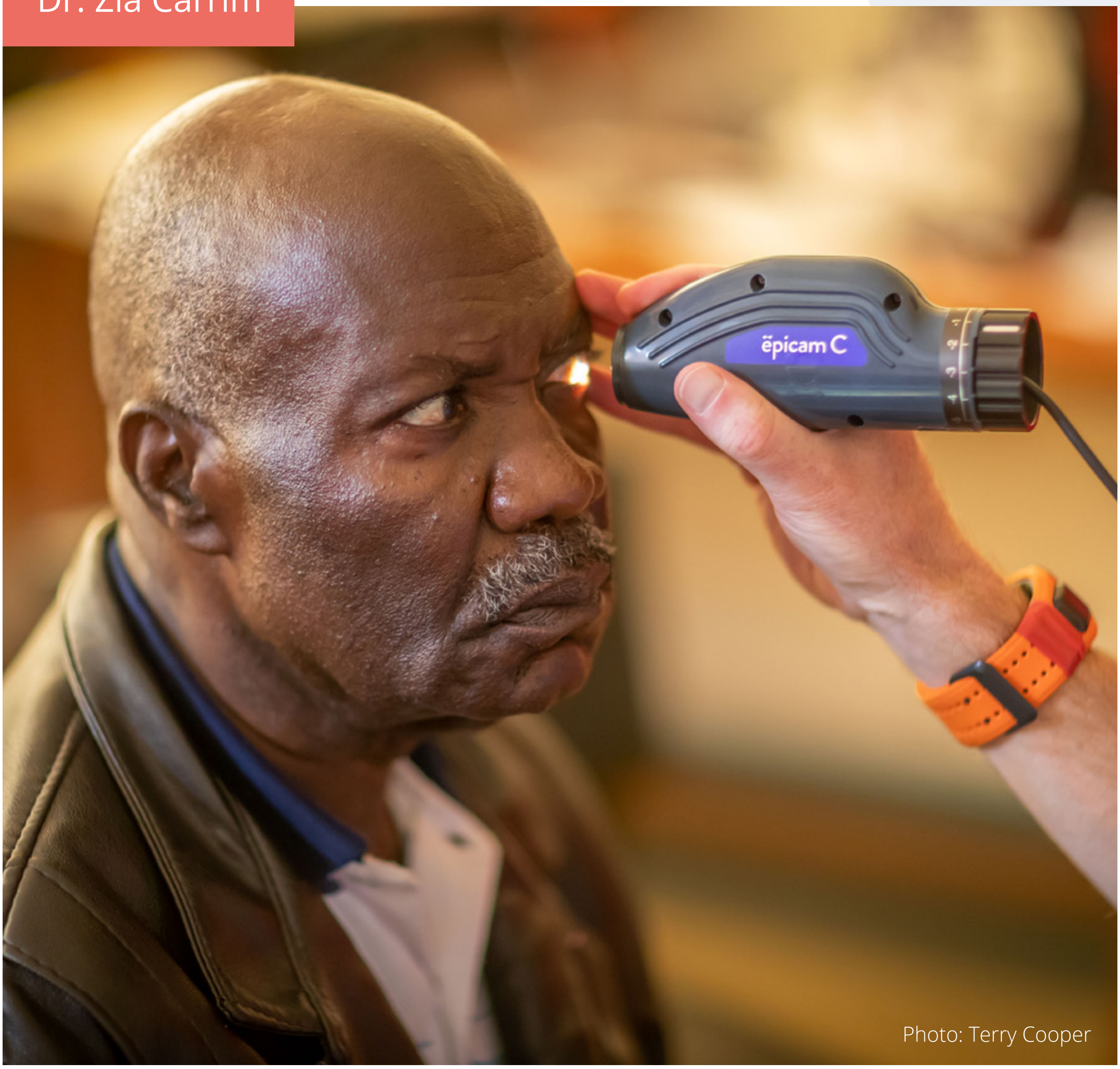
With the epiCam series, accompanying relatives and parents can see in real-time what the optometrist or ophthalmologist is seeing. For veterinarians, minimal handling is needed, reducing stress on the pet and owner. Overall, more time can be spent studying the image, and photos can be easily stored in patient records.

In late 2015 Epipole won the Higgs EDGE Award, a special award aimed at engineering, science or technology based businesses who have a product, or product under development, which is scalable and capable of globalisation

The business was funded by Access EIS in March 2020.

In my humble opinion, the epiCam is revolutionary.

Dr. Zia Carrim



epiCam is being used as part of a THET (Tropical Health and Education Trust) project in Uganda to screen for diabetic retinopathy.

EIS cheat sheet

The tax reliefs available for EIS investment are generous, but there are a lot of detailed requirements that could catch out the unwary. As well as independent financial advice, anyone considering investing through the EIS should take personal tax advice, as the availability of the tax reliefs will depend on the individual's personal tax position. The following is based on EIS legislation as at 20 December 2020, which may be subject to change.

Summary

In brief, the tax reliefs available for EIS investment are:

Income tax relief	-	30% of the amount invested
CGT disposal relief	-	Zero CGT on disposal
Loss relief	-	Option to claim losses against capital gains or income
CGT deferral relief	-	Defer CGT payable on disposal of any asset
IHT relief	-	Business property relief should be available after two years

Illustration

A 45% taxpayer invests £10,000 in an EIS company.

	Company fails	Company breaks even	Company doubles in value
EIS investment	£10,000	£10,000	£10,000
Income tax relief	-£3,000	-£3,000	-£3,000
Net investment	£7,000	£7,000	£7,000
Proceeds on disposal	£0	£10,000	£20,000
Income tax loss relief	-£3,150*	-	-
CGT payable	-	nil	nil
Net profit/loss including income tax relief	-£3,850	£3,000	£13,000

By comparison, an individual investing £10,000 in a non-EIS company who exits with a 2x return would see a profit, after CGT at the current, 20% rate, of just £8,000.

Clearly it isn't quite as simple as this, and it is important to read and understand the further information regarding EIS tax reliefs set out below.

*The loss after income tax relief is £7,000 x 45% = £3,150

CASE STUDY 2

Nuggets

Nuggets is an award winning B2B2C platform that keeps personal and payment information secure, and does away with passwords. Blockchain technology provides the security, while biometric verification means never having to remember another password or username.

"These days, the average person has sensitive personal data – emails, payment card details, home addresses, passwords – stored with over 100 online accounts. And that's set to double in the next five years" – Alastair Johnson, Founder & CEO

Instead of handing over payment and personal information just to use an online service, the customer chooses if and when to share their data, and only on their terms. Nuggets also liberates companies from the burden of trying to manage and secure huge data silos. That removes the biggest challenge facing companies today: cybersecurity.

For consumers, Nuggets makes life simpler, faster and safer. For businesses, it spells the end of costly, damaging data breaches – as well as massively reducing fraud and false positives, and the number of sales lost to complex checkout processes.

The business was funded by Access EIS in February 2020.

EIS today

Mark **Brownridge** | Director General, EISA

After the global financial crisis (GFC) of 2008, many now successful companies started up, innovated and flourished, including the likes of TransferWise and Funding Circle.

But early-stage businesses often struggle to raise equity finance, particularly in challenging circumstances, such as the GFC and now, during a pandemic.

This is why EIS and SEIS investment is so important, for providing 'smart', seed capital for innovative companies.

Looking back on the market in 2020, the usual end of tax year, fundraising season in March and April took a massive hit from the first lockdown and for many, was a non-event. This is normally the biggest fundraising time of the year for EIS and SEIS investments, so Covid-19 striking then had a devastating effect on fundraising, with investors becoming more risk averse. In fact, EIS and SEIS fund managers report that their fundraising fell by as much as 60-80% of what they were expecting.

As we begin to focus on the 2021 tax year end, we are starting to see an uptick in interest from planners and advisers. There are now high levels of demand for equity funding from companies as well as lower valuation points, so there are a number of exciting companies available for investment at great value.

EIS and SEIS have established a long and demonstrable track record as trusted and crucial sources of equity funding, most notably to those companies at the forefront of technological and knowledge-based development with the most productive potential. These are exactly the type of companies the UK will be relying on most to restart and grow our economy in a post-pandemic world.

These companies use funding to employ people, grow revenue and build sustainable, world-class businesses. We know that for every £1 they generate, the government receives £4 in revenue, so the schemes are net revenue generators rather than a cost to the Exchequer.

When we look back on the current health crisis, there's no doubt that we'll learn that EIS and SEIS investments resulted in a number of innovations: new drugs and medical devices; improved health-care processes; and manufacturing and technology breakthroughs.

Mark Brownridge *has over twenty years' experience in financial services and prior to becoming Director General of the EIS Association, he was Head of Research and Development at Mazars, a leading UK financial planning firm. Mark's involvement with EIS began 8 years ago and he has since championed EIS investing within a financial planning context.*

CASE STUDY 3

Oxwash

Oxwash aims to disrupt the traditional, environmentally costly washing and dry-cleaning industry. This starts by using ozone to sterilise fabrics at lower temperatures. It continues with utilising electric cargo bikes for hyper-local pickups and deliveries, with the intention to become the first truly sustainable, net-zero impact washing company in the world.

The company was founded in 2017 by Dr. Kyle Grant, who had become frustrated with the perpetually broken washing machines in his college laundry. Using his bike, he started collecting and washing clothes for fellow students. This quickly snowballed into a growing on-demand laundry business as interest grew.

Oxwash is now fully operational in London, Oxford and Cambridge with an ever growing team. It's developing a modular and rapidly scalable model that it aims to deploy into new cities across the UK as well as to other countries.

Oxwash's cleaning process saves up to 60% of the water consumption versus a typical commercial washing machine and 70% compared to a domestic washing machine. Its London and Cambridge facilities, which it calls 'lagoons', have second generation weighting technology that removes the requirement to recycle water as less is used in the process, proportional to the weight of the load.

It implements microfibre filtration to capture more than 95% of all the fibres shed during washing, reducing the pollution of our waterways and drinking water with plastic. Disinfection of washing is done using ozone, biodegradable disinfectants (PAP) and quaternary ammonium compounds. Generated using renewable electricity and oxygen from the air we breathe, ozone is an extremely powerful disinfecting agent against many microorganisms.

The business was funded by Access EIS in April 2020.

One third of ALL ocean plastic is microfibres from our clothes. This has to stop.

Oxwash

How to claim the reliefs

Before we consider the tax reliefs, it is worth looking carefully at whether an individual meets the qualifying requirements. The reliefs are only available to individuals, not to companies, partnerships or trusts (with the exception that certain trusts can claim EIS deferral relief). There are a number of factors that need to be considered to establish whether an individual qualifies, as follows:

- The investor must have no existing shares in the company the fund invests in, unless they are EIS or seed EIS shares.
- EIS reliefs are not available to individuals who are, or whose associates are, employees, directors or partners of the investee company.
- An individual will not be eligible for EIS relief if they, together with their associates, hold more than 30% of the investee company.
- There is no requirement to be a UK national or a UK resident; however, the investor must have a UK tax liability against which to claim relief.

Associates are business partners, spouses, children, parents and all other lineal descendants, but not siblings. In practice, these issues are unlikely to be a problem for investors in an EIS fund, but if you are in any doubt, you need to take personal tax advice.

The three-year holding period

If the shares are disposed of, or the investee company ceases to qualify as an EIS company, before the end of the three-year qualifying period, the tax reliefs will be withdrawn. EIS3 certificates should show a termination date, which is the end of the holding period.

Income tax relief

Income tax relief is available on qualifying investments at 30% regardless of the individual's marginal rate of tax.

This is restricted to the amount of income tax paid by an individual in the tax year.

The maximum amount on which an individual can claim relief in any tax year is £1m, but this is increased to £2m per year where the excess over £1m is invested in knowledge-intensive companies.

Carryback

Under the EIS, an individual may elect to carry back a claim to the previous tax year, subject only to the availability of relief in that year. The effect of carrying back is that the shares are treated as having been issued in that prior year, although, of course, there is no effect on the holding period. Generally, carrying back will be better, as it accelerates relief and leaves capacity for further investment in the later year.

CGT disposal relief

Provided the shares are held until the termination date and income tax relief is given but not withdrawn, there will be no CGT payable when the shares are sold.

Loss relief

In the event of a loss on disposal of the EIS shares, the loss can be claimed against either:

a) capital gains of the current or future tax years, or

b) income of the current year or the previous year.

CGT deferral relief

EIS deferral relief can be claimed against any type of gain made by an individual, including deferred gains that have come back into charge. There is no limit on the amount that can be deferred. Gains can be deferred by an EIS investment made up to three years after or one year before the date of the gain.

It is also worth bearing in mind the time limits. An investor who makes a CGT disposal on say, 31 January 2020, has until 31 January 2023 to make an EIS investment and use this to defer the capital gain, and even then, the election to do so can be made up to five years later. There is therefore a great deal of flexibility, allowing for a 'wait and see' approach, which will be useful given the current uncertainty around CGT rates and the annual exemption.

There will, of course, be cash-flow considerations, in that the tax liability on an end of 2019 disposal will be payable on 31 January 2020.

When deferred gains do come back into charge, they will do so at the rate applicable at that time. Claiming deferral relief could result in an individual paying more CGT than they would have done.

IHT relief

Subject to meeting the two-year holding requirement, SEIS and EIS qualifying shares will be eligible for IHT business property relief.

There is no specific provision in the tax legislation on this point, but the qualification rules for SEIS and EIS qualifying companies are such that an SEIS/EIS qualifying company should always meet the business property relief qualifying conditions.

Direct investing vs investing in an EIS fund

SyndicateRoom (SR) has an established track record in offering both individual deals for direct investment and EIS funds, which package a highly diversified selection of qualifying investments inside one wrapper. Currently it operates a single EIS Fund called Access.

Which is better? There is no simple answer to this question, so we set out below a framework for how you might identify your preference. If you like to invest only in deals that you have chosen yourself, and want to keep very close control over exactly what's in your portfolio, direct investing may be the better choice. However, if you're unsure how best to source reliable, quality deal flow, want a heavily diversified portfolio and to minimise the time you spend on paperwork, an EIS fund is probably more suitable for you.

The differences between direct and fund investing relate to six key factors: time, effort, diversification, knowledge, deal flow and control. We'll look at each in turn.

Time

Preparing your own portfolio is a time-consuming endeavour. Everything from sourcing deal flow, reviewing each opportunity and speaking with founders, to negotiating terms and keeping abreast of a company's EIS status will take time. Alternatively, investing in EIS funds like Access takes only a few moments, because you're making a single investment into a fund and letting the fund manager take care of everything else.

Effort

The effort involved in sourcing deals – not to mention trying to work your way into the latest round – can be huge. Without specialist legal or accountancy advice, you might find yourself out of your comfort zone, where some terminology or points of discussion are concerned, and if you don't want to spend the time navigating this yourself, external advice can be costly. Funds benefit from broad and specialist in-house and advised knowledge of investments, which they can apply to the benefit of all the fund's investors at scale.

Diversification

Our research shows that most self-driven, startup portfolios tend to be on the smaller side, and also that investors who are self-selecting investments are less likely to diversify to the extent needed for success.

This is because they are more inclined to be drawn towards the same types of investments repeatedly (for example in the same sectors, with identical risk profiles – or they have a particular bias towards a certain team structure). A fund like Access diversifies across 50 startup investments that are truly multisector, and although any fund will have certain restrictions (for example, Access has a minimum round size requirement, as our data analysis demonstrates this is advisable), beyond that, the scope of the fund's selection is truly wide-reaching.

Knowledge

Beyond experience of angel investing and sector expertise, investing responsibly can require a significant knowledge of common issues and typical pitfalls. Experienced investors pick these up over time by working through the whole process of an investment from start to finish, time and time again. SR's 'super angels' – who invest alongside the Access Fund – are so-called precisely because they have this in-depth knowledge. What's more, their investment results are borne out in practice in their returns data, which we study extensively. These are important factors to bear in mind when weighing up direct investments against fund investments: you want to make sure you're seeing the full picture.

Deal flow

Getting access to the hottest deal flow is a struggle, even when you have an established 'name'. Being in all the right circles (at the right times) isn't easy to achieve. However, there is a handful of angels who are so well-integrated within the startup ecosystem that they can achieve this almost without trying. In other words, top-tier companies come to them. SR's super angels fit this description and they introduce their deal flow to the Access Fund because we can mobilise meaningful extra capital to these funding rounds within days. This kind of access to deal flow is prized and is notoriously difficult for most investors to replicate.

Control

Some investors enjoy having full control over their portfolio: they simply don't want to hand over the fun of the choice or the chase, to a fund, to invest on their behalf. This is entirely understandable, particularly where startup investing is first and foremost a hobby (and returns are perhaps secondary). However, where an investor is seriously concerned with seeking returns from their startup investment endeavours, they may wish to seriously consider whether they have the access to the right sorts of deal flow, and the negotiating power or the investment knowledge, to better the strategy of a fund for seeking results.

CASE STUDY 4

Pharmenable

PharmEnable is a Cambridge (UK) based drug discovery company that is using a combination of medicinal chemistry and AI computational approaches to design the next generation of small molecule drugs. Its mission is to develop novel and specific drugs for otherwise untreatable conditions.

It combines machine learning and a diverse virtual compound library in an efficient drug discovery platform. This platform is rapid, cost-efficient, and effective at identifying new hit candidates. Its computational screening programme provides novel chemical starting points for challenging biological targets, which could lead to the development of next-generation medicines. These could include a novel antibacterial agent or a much-needed cancer treatment.

CEO Dr Hannah Sore is a medicinal chemist by background, and has worked across academia and pharma, as well as having a successful business consulting career.

In 2012, after being seriously ill from sepsis, Hannah decided to leave consulting behind, and instead dedicate herself to creating the next generation of new small molecule drugs. She put together a team of Cambridge scientists and entrepreneurs, in order to create innovative solutions to some of the world's biggest healthcare challenges.

CSO Dr Natalia Mateu is an organic and medicinal chemist. Her strong chemistry background, with a particular focus on diversity generating methodologies, has shaped the scientific methods that form the foundation of PharmEnable's offering.

Natalia and Hannah met while they were both in the research group of Prof. David Spring, working on the development of novel diversity-oriented synthesis approaches. Natalia's career had already spanned the pharmaceutical sector and academia, and she had a deep passion for bringing powerful and innovative chemistry to drug development. Hannah and Natalia teamed up to make this vision a reality.

The business was funded by Access EIS in May 2020.

Introducing Access EIS

Fran **O'Brien** | Head of Clients & Investments, SyndicateRoom

Taking a look around the EIS investment market in 2021, you might notice two things: firstly, that there's a lack of data-driven investment methodologies. There's plenty of sector-specialist experience, and certainly some big names that are known for being tapped into the right network, but nothing taking into account how the market as a whole really behaves.

Second, there's a lack of truly diversified methodologies. Some funds might invest in 15 deals rather than the average 10, but you'd be hard pressed to find a fund that offers to spread your risk across many dozens of investments. We were fortunate to have the right skills, network and timing to address both of these shortcomings in one fund: the Access EIS Fund.

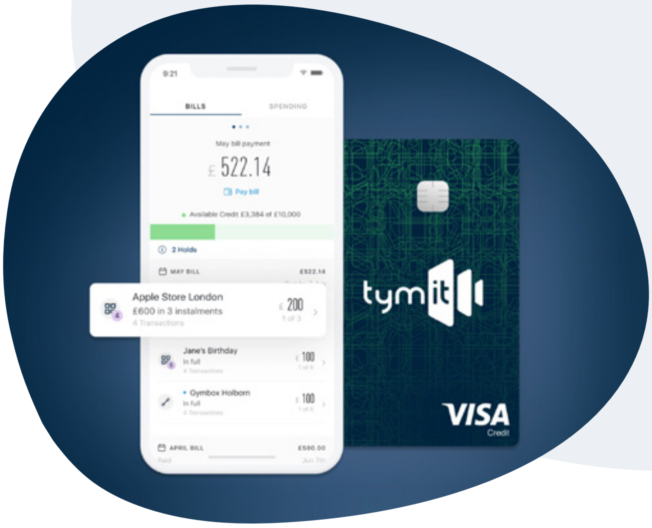
Access EIS will invest your capital into at least 50 different startups in a single year. Every single deal we source has one of our super angels investing in it. These are angels with such established investment track records – which we verify through analysing their entire portfolios – that they justify being called 'super'. You can invest from £5,000 at any time of year that suits you, and we guarantee you'll pay lower overall fees than with any other EIS fund: we even commissioned a review of legacy funds' fees to be certain. Our mission is to bring EIS investing right up to date. We hope you'll join us.

***Fran O'Brien** has seven years' investment experience, with in-depth knowledge of a wide range of sectors, investment terms, due diligence and industry matters such as EIS. Her academic background spans psychology, law and finance and she is passionate about the startup ecosystem.*

Access EIS

Co-invest with top-performing startup investors

Find out more
www.syndicateroom.com



CASE STUDY 5

Tymit

Tymit believes that traditional credit cards from banks have clunky mobile experiences, unclear pricing, lots of fees, and a lack of features to keep balances and costs under control. So it's on a mission to re-invent the credit card to make it honest, safe, and more transparent.

By scrapping complicated charges, removing minimum payments, and eliminating any small print like temporary 0% interest, it aims to reduce the numbers of people who end up in debt, and who avoid credit cards completely.

Tymit started with two brothers, Martín and Nico, who believed that there should be a better way of financing purchases over time to manage a monthly budget than using credit cards or loans. With experience of consumer credit products both as users and as professionals through their experience in banking, they considered credit cards very easy to use but saw that they offered a very poor experience when it came to financing a purchase.

Cards often had unclear pricing, lots of fees, and a lack of features to keep balances under control. Alternatives like store loans required applying and running credit checks every time they were used and were not readily available in most places when needed.

After spending many years working with major high-street banks, both founders were convinced that they could leverage the latest technology in cards and payments to offer a much better experience to the customer. One that was cheaper, more transparent, more flexible, and easily available anywhere.

In the summer of 2017 Martín moved from New York to London to join Nico to start Tymit. Since then, Juan and an experienced team of engineers and designers joined the team. Together, they have rapidly built the technology behind Tymit entirely from scratch.

The business was funded by Access EIS in October 2020.

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