

Enterprise Investment Scheme and Capital Gains Tax

i Contacts

Please phone:

- the number printed on page TR 1 of your tax return
- the SA Helpline on **0845 9000 444**
- the SA Orderline on **0845 9000 404** for helpsheets

or go to

www.hmrc.gov.uk

This helpsheet explains capital gains aspects of the Enterprise Investment Scheme (EIS) for investors. But it is only an introduction. If you are in any doubt about your circumstances you should ask your tax adviser.

We will also be pleased to help and will provide any forms you may require. You can also consult our Venture Capital Schemes Manual, which explains the rules in more detail. The manual is available at www.hmrc.gov.uk

This helpsheet will help you fill in the *Capital gains summary* pages of your tax return.

For more information about the Enterprise Investment Scheme and Capital Gains Tax go to www.hmrc.gov.uk Helpsheet 284 *Shares and Capital Gains Tax* and Helpsheet 286 *Negligible value claims and Income Tax losses on disposals of shares you have subscribed for in qualifying trading companies*, may also be of use to you.

This helpsheet describes the rules that apply to shares issued on or after 6 April 1998. If you acquired shares before 6 April 1998 ask us or your tax adviser for help.

There are two Capital Gains Tax reliefs within the EIS:

- **disposal relief**, where shares in an EIS company are disposed of and certain criteria are met, and
- **deferral relief**, where a gain arising on a disposal of any asset is deferred against a qualifying investment in shares in a company issued on or after 6 April 1998.

What is disposal relief?

If disposal relief is due you will not have to pay Capital Gains Tax on a gain on your disposal of the EIS shares. The following conditions have to be met:

- you must have held the EIS shares for at least three years (note that if you acquired EIS shares in a company which did not start to trade until a later date, the three years do not start until that later date). If you acquired EIS shares before 6 April 2000 you must have held them for more than five years
- you must have received Income Tax relief in full on the whole of your subscription(s) for the EIS shares and none of the Income Tax relief must have been withdrawn.

EIS Income Tax relief is given for subscriptions for shares in unlisted companies which meet certain conditions explained at www.hmrc.gov.uk

The maximum subscription which can qualify for Income Tax relief in a particular tax year is set out in the table below.

Tax year	Maximum subscription which can qualify for Income Tax relief in any tax year
2008-09 onwards	£500,000
2007-08 to 2006-07	£400,000
2005-06 to 2004-05	£200,000
2003-04 to 1998-99	£150,000
1997 and earlier	£100,000

You may not have to pay Capital Gains Tax on a gain on your disposal of the EIS shares, even if you did not receive Income Tax relief in full on all your EIS shares, provided you received some Income Tax relief. In this case, to qualify for disposal relief, none of that Income Tax relief must have been withdrawn and the only reason you did not receive Income Tax relief in full was that your claim reduced your Income Tax liability to nil. Only part of your gain may not be chargeable to Capital Gains Tax if part of the Income Tax relief on those shares has been withdrawn or if your acquisitions in the year exceed the maximum subscription.

When is disposal relief not due?

There is no disposal relief on any gain arising on a disposal within three years of the date the EIS shares were issued to you (five years if you acquired EIS shares before 6 April 2000). You can find the actual date of issue on the EIS certificate which the company sent you.

If you sell EIS shares within three years (five years if acquired before 6 April 2000) of the date they were issued (and the sale is not to your spouse or civil partner):

- Income Tax relief in respect of those you sell will be wholly or partly withdrawn
- if you make a gain on the disposal, it will be chargeable to Capital Gains Tax.

Disposal relief is not available against a deferred gain which is revived on a disposal of the EIS shares or some other event.

If you make a loss on a disposal of your EIS shares at any time you can set this loss against your chargeable gains or you may be able to set it against your income. In computing the loss, you must reduce the cost of your shares by the amount of any Income Tax relief given and not withdrawn.

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Example 1 – Where you sell your shares at a loss

You subscribe £100,000 for 50,000 EIS shares on 1 May 2010. Income Tax relief of £20,000 is given. Less than three years later you sell all 50,000 shares for £60,000. Income Tax relief of £12,000 is withdrawn. £8,000 Income Tax relief is not withdrawn and remains attributable to the shares sold.

The allowable loss is calculated as follows:

Disposal proceeds		£60,000
minus cost	£100,000	
reduced by the Income Tax relief which has not been withdrawn	(£8,000)	£92,000
Allowable loss		(£32,000)

Pages CGN 5 and CGN 6 of the *Capital gains summary notes* and *Helpsheet 286 Negligible value claims and Income Tax losses on disposals of shares you have subscribed for in qualifying trading companies*, explain how losses are allowed for Capital Gains and Income Tax purposes respectively. If you want to set the loss against your income you must claim loss relief within one year from the 31 January following the tax year in which the loss was made.

What are the main rules for calculating gains or losses on EIS shares?

The normal capital gains rules apply but with exceptions. The main exceptions are that there are special share identification rules. You identify disposals out of a holding of shares which includes shares to which Income Tax relief is attributable on a first in – first out basis. Shares disposed of are identified first against the earliest acquisition. But this does not help where you are disposing of some shares from a holding which includes shares acquired on the same day, which have different reliefs attributable to them. The share identification rules for this situation are set out at www.hmrc.gov.uk or you can ask us or your tax adviser for help.

Other points

What happens if you acquire more EIS shares in any tax year than can qualify for Income Tax relief and dispose of them at a gain after three years (five years if acquired before 6 April 2000)?

Only part of the gain on your disposal will not be chargeable to Capital Gains Tax.

Example 2

You subscribe £600,000 for EIS shares issued by a trading company in June 2008.

You receive the maximum Income Tax relief £100,000. You sell the shares at a profit in 2012 and no Income Tax relief has been withdrawn in the meantime. Disposal relief exempts $\frac{1}{6}$ of the gain from Capital Gains Tax. (The $\frac{1}{6}$ is the maximum investment for which Income Tax relief was available in the year your shares were issued, divided by the actual investment for which Income Tax relief was claimed, £500,000 ÷ £600,000.)

What happens when Income Tax relief has been partly withdrawn and you dispose of the EIS shares at a gain after holding them for three years (five years if acquired before 6 April 2000)?

Only part of any gain on your disposal will not be chargeable to Capital Gains Tax.

Example 3

You subscribe £150,000 for EIS shares issued by a trading company on 1 June 2008. You receive the maximum Income Tax relief of £30,000. In 2010–11 £10,000 of your Income Tax relief is withdrawn. You sell the EIS shares making a gain on 1 July 2012. Disposal relief exempts $\frac{2}{3}$ of the gain from Capital Gains Tax. (The $\frac{2}{3}$ is the Income Tax relief given and not withdrawn, divided by the full Income Tax relief originally given, £20,000 ÷ £30,000.)

What happens where your Income Tax liability is nil?

If you have no liability to Income Tax before taking account of your subscription for EIS shares, you will receive no Income Tax relief and any gain on the disposal of the EIS shares will be chargeable. You may be able to use your Capital Gains Tax annual exempt amount (£10,100 for 2010–11) to cover all or part of your gain.

Do you need to disclose any gain arising from a disposal of the EIS shares on your tax return?

You must give details of the disposal on the *Capital gains summary* pages of your tax return if either, the total value of the EIS shares and any other assets you disposed of in the tax year, or your total chargeable gains were more than the figures shown on page TRG 5 of the tax return guide.

What is deferral relief?

When you dispose of an asset and make a gain you usually pay Capital Gains Tax for the tax year in which you dispose of the asset. Deferral relief lets you treat the gain as not arising until some future date if you acquire EIS shares. If you make a claim to defer a gain, the gain may be charged to Capital Gains Tax in a later tax year, usually when you dispose of the EIS shares. If you obtain Income Tax relief on an acquisition of shares, then deferral relief can be claimed as well. You do not have to obtain Income Tax relief to claim deferral relief. To obtain full deferral relief you must invest an amount at least equal to the chargeable gain. See the *Capital gains summary notes*.

Which gains can you defer?

You can defer any gain which arises on your disposal of an asset on or after 29 November 1994. You can also claim deferral relief when a gain, previously deferred under the EIS, reinvestment relief or the Venture Capital Trust scheme, is revived. (Revived means the gain is brought back into charge to Capital Gains Tax.)

Which EIS shares qualify for deferral relief?

You can claim deferral relief if you subscribe for EIS shares and the shares are issued on or after 6 April 1998. If your EIS shares were issued before the date on which the gain you claim to defer arose, you must still hold them at that date.

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What are the time limits for subscribing for EIS shares to obtain deferral relief?

The EIS shares you subscribe for must be issued to you in the period beginning 12 months before, and ending 36 months after, the date of the disposal for which you wish to claim relief. We have discretion to extend these time limits. We can explain the circumstances in which we can do this.

Example 4

You dispose of an asset on 6 June 2010 making a gain. You can claim deferral relief against this gain if you subscribe for EIS shares and these shares are issued to you at any time between 6 June 2009 and 6 June 2013.

Who can claim deferral relief?

You can claim relief if you are an individual resident or ordinarily resident in the UK. You cannot claim relief if you are treated by Double Taxation Arrangements as resident elsewhere, so that (ignoring any disposal relief) you would not be liable to UK Capital Gains Tax on any gain from the EIS shares. The trustees of certain settlements may also claim relief. Ask us for details.

How do you claim deferral relief?

You must complete the claim form attached to the EIS3 certificate you should receive from the company you have invested in and attach the form to the *Capital gains summary* pages of your tax return. If the gain(s) against which you are claiming deferral relief arose in the tax year to which this return relates, please put 'X' in box 26 on page CG 2 and provide details of the claim in the 'Any other information' box, box 36, or in your computation, providing a clear statement that EIS deferral relief is being claimed.

How much deferral relief can you claim?

There is no upper limit on the amount you can invest in EIS shares in a year, though the amount you can invest in a single company is limited. You may claim less than the maximum deferral relief, for example, if you want to use your annual exempt amount to cover part of your gains.

Example 5

In one tax year you have a gain of £100,000 on a disposal and you subscribe £100,000 for 100,000 EIS shares issued to you (in the same tax year). The annual exempt amount for the tax year is £10,100. You can claim deferral relief on the full amount of the gain of £100,000 or on any smaller amount, for example £89,900, leaving £10,100 to be covered by your annual exempt amount.

What is the time limit for claiming deferral relief?

You cannot make a claim before you have received the relevant EIS3 certificate. The latest date for making a claim is five years after the first 31 January after the tax year in which the shares were issued.

Example 6

You disposed of an asset in May 2008 and were issued EIS shares in August 2010. You must make a claim to relief by 31 January 2017.

When is the deferred gain revived?

The whole (or part) of the deferred gain is revived when there is a chargeable event unless you die before a chargeable event occurs. There is a chargeable event if:

- you dispose of your EIS shares (unless the disposal is to your spouse or civil partner in which case the event occurs when that person disposes of the shares)
- you (or your spouse or civil partner to whom you have transferred your shares) cease to be resident in the UK, if this happens within three years (five if acquired before 6 April 2000 and no claim to deferral or Income Tax relief was made before 7 March 2001) from the time the shares were issued. But this does not apply if whichever of you holds the shares takes up employment outside the UK and becomes resident again within three years, without disposing of any of the shares in the meantime
- the shares cease or are treated as ceasing to be eligible shares, for example, because the company is prevented from being a qualifying company.

How do you report the revived gain?

You must give details on page CG 2 of the *Capital gains summary* pages. Please also explain in the 'Any other information' box, box 36, on page CG 2, or in your supporting computations, that the whole (or part) of the deferred gain to which the EIS deferral relief has been claimed is revived. Where the disposal of an asset to which deferral relief applies was before 6 April 2008, Entrepreneurs' Relief may be due in calculating the chargeable gain that is revived in 2008–09 or later. Guidance on Entrepreneurs' Relief can be found in Helpsheet 275 *Entrepreneurs' Relief* and in the Capital Gains Manual on our website at www.hmrc.gov.uk

You can deduct the annual exempt amount for the tax year in which the deferred gain is revived to cover the whole or part of that deferred gain.

How much of the deferred gain is revived?

The whole of any deferred gain is revived if:

- you dispose of all your EIS shares (see Example 7 below), or
- the chargeable event is not a disposal of your EIS shares (for example, if within three years from the time the shares were issued, you emigrate intending to stay outside the UK permanently).

Example 7

You defer a gain of £50,000 arising in 2010–11 by subscribing £50,000 for EIS shares issued on 10 March 2010. If you sell all the EIS shares in March 2012, the whole of the deferred gain of £50,000 is revived in the tax year 2011–12.

If you dispose of only some of your shares to which deferral relief is attributable, some of the deferred gain will be revived. The position is more complicated where you only dispose of some of your shares which you acquired at different times and you claimed deferral relief on some but not all of these shares. You have to identify the shares you have disposed of and the shares which have had deferral relief.

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Example 8

You defer a gain of £20,000 arising in 2010-11 by subscribing £20,000 for 20,000 EIS shares issued on 10 March 2010. If you sell 15,000 EIS shares in March 2012, part of the deferred gain is revived in the tax year 2011-12. As you have sold 15,000 out of the 20,000 shares the same proportion ($\frac{3}{4}$) of the deferred gain is revived: £15,000.

What are the identification rules?

You identify disposals out of a holding which includes shares to which deferral relief is attributable on a first in – first out basis. Shares disposed of are identified first against the earliest acquisition. When shares were acquired on the same day, and the only relief involved is deferral relief, you identify disposals first against shares acquired which do not have deferral relief attributable to them.

For more information where shares are acquired on the same day and reliefs other than deferral relief are attributable to them, go to www.hmrc.gov.uk or ask us or your tax adviser for help.

Example 9

You make one subscription of £80,000 for 80,000 shares which could qualify for EIS relief. You claim £60,000 deferral relief. You sell 50,000 shares in a subsequent tax year.

The £60,000 deferral relief is attributable equally to all 80,000 shares.

As you have sold 50,000 of the 80,000 shares, the same proportion ($\frac{5}{8}$) of the deferred gain is revived: £37,500.

What happens if the EIS company makes a bonus issue of shares?

Any deferral relief continues and is apportioned between the original shares and the bonus shares related to them.

What happens if the EIS company makes a rights issue of shares?

If you subscribe for the rights shares this is treated as a separate subscription for the purposes of the Capital Gains Tax reliefs. Any deferral relief continues but relates only to the shares on which it was originally given.

These notes are for guidance only and reflect the position at the time of writing. They do not affect any rights of appeal. Any subsequent amendments to these notes can be found at www.hmrc.gov.uk