Case study: how does **EIS tax relief** work?

This case study is for illustrative purposes only. EIS legislation is complex and prescriptive and small changes in fact patterns or circumstances can affect outcomes; accordingly you should not seek to rely on this example or any general statements - tax advice should be sought by each individual prior to investing in order to confirm the applicability or otherwise of EIS to their own circumstances.

Following retirement from a family company, Sam sells his shares in the company. Sam is left with a gain of £100,000. Sam did not qualify for Entrepreneurs' Relief due to having retired from the business as employee and director more than two years prior to selling his shares. This means Sam is subject to CGT at 20%; £20,000 of tax to pay.

Sam's niece, Sam Jr, suggests that Sam could save this tax by investing into her start up tech company as an EIS investor. Sam Jr points out that the EIS tax relief Sam would get would be:

Income Tax Relief on £100k investment	£30,000
Deferral of CGT due	£20,000
CGT free gain on sale of tech co shares at £250k (150k gain) after 3 years	£30,000

Due to the tax reliefs, Sam's £100k investment into Sam Jr's company will only cost Sam £50k (the other £50k coming from repayment of income tax Sam had already paid in the year and the refund/ not being required to pay the CGT of £30,000 on the sale of the shares in his family company). If Sam Jr's company is successful and is sold, or if Sam alone sells his shares at a gain, the gain on sale will be CGT free for Sam as an EIS investor.

The disposal of Sam's shares will however bring his deferred gain back into charge.

+ If he reinvests into another EIS qualifying company, he can defer the gain again. This process can go on indefinitely, and if he holds EIS shares on death the deferred CGT falls out of charge; or
+ If he does not reinvest, the deferred CGT is payable, however he now has a tax free gain from the second company with which to pay it.

Sam asks Sam Jr what will happen if her company fails and he loses his investment. Sam Jr says that will never happen. But, just to be on the safe side, Sam checks with his EIS adviser. He is told that he will get "loss relief", and that this means in a worst case scenario he, in effect, only loses around 40% of his investment. His adviser draws him a table that shows the net position:

Income Tax Relief on £100k investment	£30,000
Loss relief on £70k (£100k - the £30k income tax relief given) - assume use against income tax @Scottish rate of 46%	£32,200
Net loss after tax reliefs	£37,800

Sam decides to invest in Sam Jr's start up. But, following his adviser's advice, he asks Sam Jr to make sure the company has an EIS advance assurance from HMRC in place first so that he can be confident there are no issues with the company qualifying.

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