Capital gains tax deferral with EIS

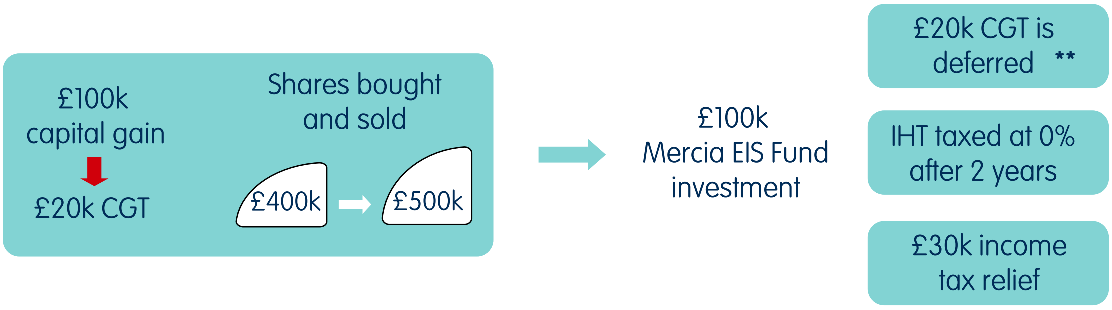
Cameron is a company director who originally purchased shares for £400k and has sold them for £500k: this created a taxable capital gain of £100k, and therefore a £20k capital gains tax (CGT) liability.

- His annual salary is £150,000, and he is approaching his pension lifetime allowance.
- He has significant wealth within pension & ISA and uses the allowances for both each year, as well as his CGT allowance.
- He has a significant capacity for loss, as he has savings in shares and cash (ISAs & other products).
- He is prepared to invest long-term, as he does not need the capital.

His financial adviser recommends an EIS to defer his capital gain, whilst also taking advantage of income tax relief.

As well as the income tax relief Cameron will benefit from, he will not pay any capital gains tax on his £100k profit until the EIS exits, or even indefinitely if he continues to re-invest.

In addition, any gain from the EIS investment is not liable for CGT.* After two years, the investment becomes eligible for Business Relief and taxed at 0% for inheritance tax (IHT).



On exit, the original gain will recrystallise and be taxed at the prevailing rate

If he wishes to pay the tax bill, Cameron may have offset the impact of the tax through growth in his EIS. The companies within his portfolio aim to be all sold within 5-7 years, meaning the gains may reappear across multiple tax years.

He may be able to reduce the amount of CGT he pays using the CGT allowances available in the years that the gains reappear.

Likewise, if Cameron wishes to reinvest the EIS sale proceeds to re-defer the gain, he may be able to reduce the amount he needs to reinvest using his CGT allowances.

Over the years the gain may be whittled away, or finally disappear on death. At the same time, Cameron potentially has built a rapidly growing asset that provides income tax relief with each re-investment and will qualify for Business Relief (if held for two years).

* Providing the shares have been held for at least three years, income tax relief has been claimed and not withdrawn, and no qualifying conditions have been breached.

** Providing the tax rate has remained the same as 2022/2023.

EIS Tax Planning with Mercia | how advisers can achieve attractive tax advantages for their clients

EIS allows investors to gain exposure to high-growth British SMEs, whilst also benefiting from very attractive tax reliefs.

EIS tax reliefs are designed to give investors an added incentive to support smaller, entrepreneurial businesses with the benefit of an asymmetrical return profile in the form of downside protection and tax-free growth.

Investors that may benefit from the below tax reliefs may wish to consider an EIS investment. If an individual can benefit from more than one relief, the rationale for an EIS investment will be even stronger.

Mercia's minimum subscription is £25,000. The maximum investment for income tax relief is £1m in any tax year or £2m if the additional investment is made into Knowledge-intensive companies.

Mercia also offers an Approved Knowledge Intensive (KI) Fund once a year, and always has a tranche of its main EIS fund open. We also offer a Business Investment Relief (BIR) service for UK resident non-domiciles.

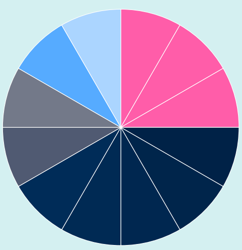
Tax incentives available

- Income Tax Relief - 30% income tax relief is available until the investor's income tax bill is reduced to zero.
- Capital Gains Tax (CGT) deferral - which can be used to manage a CGT liability. For example, when selling a business, a second home or a share portfolio.
- Inheritance Tax Relief - An investment into an EIS fund typically qualifies for Business Relief, reducing the inheritance tax to 0% for these assets.

Tax-free growth and downside protection

- Tax-free gains - if EIS shares are sold for more than was paid for them, any profits are free from capital gains tax.
- Loss relief - We expect a third of portfolio companies to fail (see image below) and when this happens investors can offset any loss against their income tax (or capital gains tax) liability.

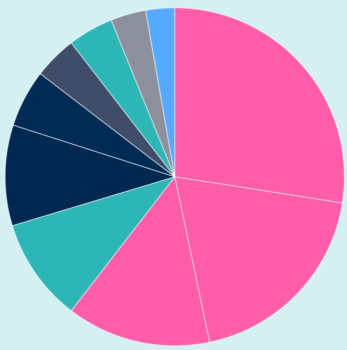
Mercia EIS model portfolio*



£120,000

12 companies @ £10,000

3x invested capital target



£360,000

The BIG Winner #12 (10x)	£100,000
Winner #11 (7x)	£70,000
Winner #10 (5x)	£50,000
Income tax relief	£36,000
Company 9	£30,000
Company 8	£20,000
Company 7	£16,000
Company 6	£12,250
Company 5	£10,000
Loss relief on companies 1-4	£15,750

*Please note that this model is not guaranteed and should only be used for illustrative purposes. It does not include any benefits from CGT deferral or IHT reliefs.

Risk warnings

EIS investment is restricted by the FCA rules to persons who qualify as high net worth, restricted or sophisticated, or who are acting upon advice from a suitably qualified financial adviser. Investing in early-stage businesses involves signficant risks. The risks may include, but are not limited to; illiquidity, lack of income, loss of investment and dilution, and it should be done only as part of a diversified portfolio. You should not rely on any past performance as a guarantee of future investment performance. Tax relief depends on an individual's circumstances and may change in the future. In addition, the availability of tax relief depends on the company invested in maintaining its qualifying status. You may lose all the money that you invested; the investments are highly illiquid and have no ready market for disposal; there is a risk from future dilution of your shareholding.