The adviser's guide to the Enterprise Investment Scheme (EIS)

Everything you need to know about the EIS to stay on track.

Contents.

The ABCs of EIS.

Recommending the Enterprise Investment Scheme (EIS).

This comprehensive guide will outline everything that you need to know about EIS and the advantages of investing with EIS for your clients. We also outline the risks and the suitability of investing in EIS.

The UK government introduced EIS in 1994 to incentivise investment into early-stage companies and help them attract more funding. Start-up businesses contribute significantly to economic growth, production output and job creation, so galvanising support for them is vital. Over £24bn has been invested into early-stage companies through EIS investment since this scheme started.

The Government incentivises investment into early-stage businesses with generous tax-reliefs to investors and partially protect the downside of what is a higher-risk investment. Although start-ups are more likely to fail than well-established companies, those that succeed can provide attractive returns for your clients. Investors can invest into companies that qualify for the scheme in an individual capacity as an "angel" or into EIS funds managed by professional fund managers.

What EIS offers your clients.

EIS investment is only suited to clients with a high-risk appetite, who do not need the capital or to generate income from the investment and who are comfortable to wait over a period of several years for their investment to (potentially) provide returns.

There are five main tax benefits to EIS, including three main tax reasons to do an EIS, and another two features of an EIS:

1. Income tax relief,
2. Capital gains tax deferral,
3. Inheritance tax relief

An EIS investment also benefits from capital gains exemption and loss relief, which we will illustrate later in this guide.

When should you consider EIS for your clients?

Your clients should understand that EIS investments may entail gains and losses and is only suited to experienced individuals who are prepared to lose the money invested and have already have built a diverse portfolio.

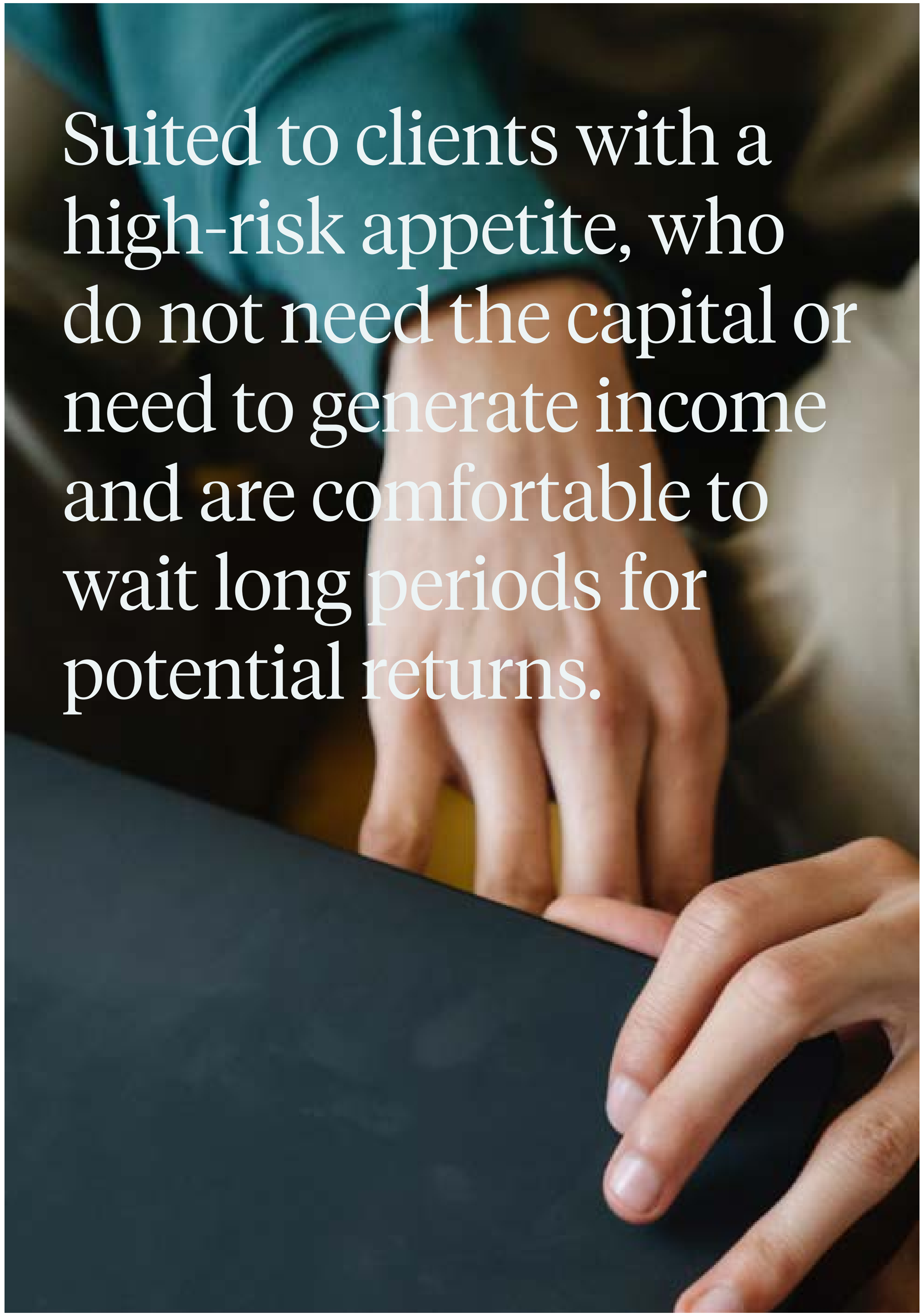
Tools like crowdfunding platforms can support your clients to construct diverse venture portfolios, providing autonomy to the individual. However, EIS funds run by experienced fund managers are a useful way of ameliorating the risk associated with investing in early-stage businesses for clients who do not have the in-depth knowledge required, time or inclination to construct a portfolio. There is also evidence that professionally managed EIS funds have significantly (4 times) higher likelihood of a positive exit*. [*Beauhurst, Following the Crowd, 2020].

Who is the EIS scheme appropriate for?

The EIS scheme is only appropriate for high net-worth and sophisticated investors who are comfortable with high-risk investments, held for the medium term, understand the potential capital loss and have any one (the more the better) of the below:

- Have income tax liability of at least £3,000
- Want to defer capital gains tax
- Wish to reduce their inheritance tax liability for their beneficiaries

In most situations, your clients will already have maximised other tax efficient investments, such as pensions and ISAs.



What are the EIS tax reliefs?

Income tax relief

When investing in EIS, if a client has paid enough income tax, 30% of their investment can be reclaimed against their income tax bill, either in the tax year the investment is made, or they can carry the relief back to the prior tax year. As long as the shares are held for a minimum of three years from the point of investment, and no qualifying conditions are breached, they will retain the income tax relief.

Capital gains tax deferral

When investing through EIS, your clients can defer a capital gain so that the capital gains tax is not yet payable, providing the underlying shares are issued between 12 months before, and three years after the gain occurred. The gain can be deferred by investing through EIS, but the gain does come back into charge and become payable once the shares are disposed of. However, if the gain is reinvested into an another qualifying company, that gain can be deferred yet again. There is actually no limit as to how much capital gain, or how long a gain can be deferred for, and the capital gain disappears upon death of the client.

Inheritance tax relief

Most businesses that qualify for EIS would also qualify for business property relief (BPR), meaning that if the client was to sadly pass away, the investment would not be subject to inheritance tax, providing that the shares have been held for more than two years. In addition, if a BPR qualifying asset is sold and reinvested into an EIS, the new investment is immediately outside of the estate through Replacement Property Relief.

Investing in early stage businesses is high risk, which is why these tax benefits are available when investing into qualifying companies. Some businesses will perform exceptionally well whilst some may fail. Each of these scenarios have different tax implications.

Although tax reliefs do not drive the value of an EIS investment, and the companies need to provide a substantive return to be successful, they enhance the overall return.

A positive example:

Capital Gain Tax Deferral case study - See page 22

If your client made a £100k capital gain, they may choose to buy £100k of EIS shares and get £30k income tax relief and defer paying the £20k capital gains tax.

If the acquired shares were sold after five years for £500k, £30k income tax relief would have already been claimed and there would be no capital gains tax to pay on the £400k gain, which would save £80k compared to a non-EIS investment. However, the £20k capital gains tax, which was previously deferred, would recrystalise and be payable, unless at least £100k was reinvested in EIS (minus the relevant capital gain allowance).

Example of a failure:

As we have already pointed out, investing in early-stage businesses is high risk, and sometimes a business may fail. In these cases, provided that no qualifying conditions are breached, the loss of the investment net of any income tax relief may be offset against the client's income tax.

For an additional rate income taxpayer, this means that 45% of the loss may be reclaimed. If both income tax relief is claimed when the initial investment is made, and loss relief is claimed in the event of a company failure, up to 61.5% of the investment is effectively reclaimed. So if £10k was invested into a business and it sadly fails, the loss may be reduced to £3,8k.

Some things to consider.

Diversifying an investment portfolio

EIS-qualifying businesses are often young companies which are striving to provide solutions to pervasive problems or create novel technology/products. Investment in EIS-qualifying companies provides an opportunity for portfolio diversification as these businesses are always unquoted and follow a different investment cycle compared to companies on the public market. Investing in early-stage companies is inherently high-risk but the risks are often distinct from those of other asset classes.

Long-term investment

EIS is a long-term and illiquid investment. Because your client's money is locked in for a minimum period after which point your shares are not easy to sell, you must weather the ups and downs of the more mainstream markets without selling your EIS shares, and, hopefully, maximise your return profile as a result. Long-term investment has its own risks and advantages and can complement pre-existing diverse investment portfolios which include ISAs, VCTs and pension funds.

Tax planning using HMRC approved Knowledge-intensive EIS funds

The government wants to encourage more investment into "Knowledge-intensive" EIS businesses, so it has made it even more attractive (see page 13). Clients can use the EIS tax reliefs to support intelligent tax planning. Investing in a HMRC approved EIS Fund provides further benefits for tax planning, as paperwork is reduced, and investors can carry back tax reliefs further.

What EIS offers investee companies.

The EIS scheme was founded to make funding accessible to start-ups and create a larger capital pool for entrepreneurs to access.

Benefits to entrepreneurs

EIS investment provides companies with the requisite capital they need to scale in exchange for equity. Other forms of financing, such as debt financing, can entail risks to entrepreneur's personal assets (like their property) if their start-up fails, whereas funding through the EIS scheme will not. This approach can embolden business leaders as they scale their enterprise.

How EIS funds support start-ups

Investee companies who receive investment from an EIS fund often benefit from support in addition to capital financing. Fund managers with strong expertise supporting start-ups can draw on their background and networks to help businesses scale in a variety of ways. Experienced investors can introduce expertise to the board, support businesses to implement good data collection to support marketing, facilitate strategy, such as expansion into new markets, and provide the right support at the right time to help portfolio businesses on their growth journey.

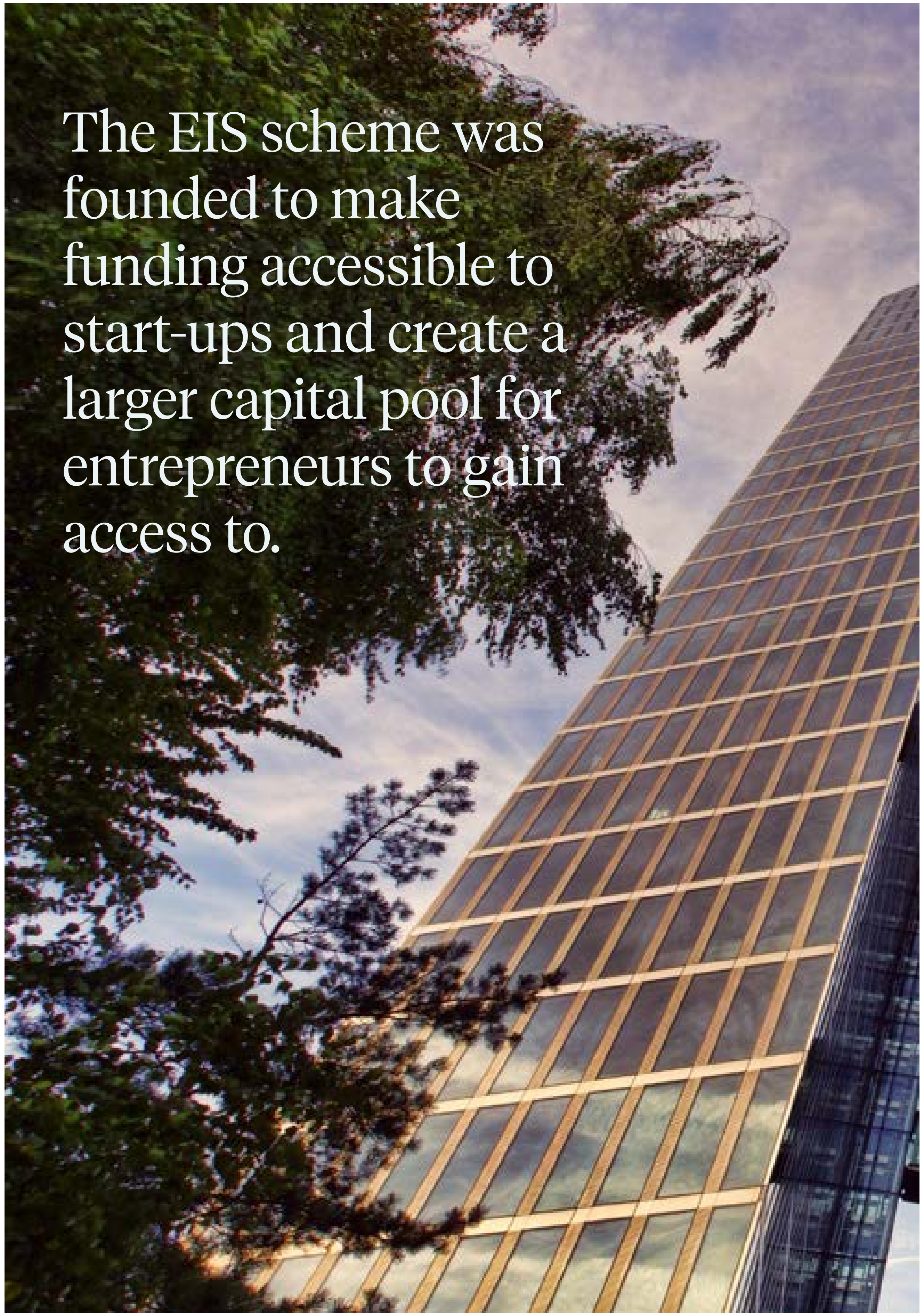
Companies that qualify for EIS investment

For the scheme to be effective, funding must be allocated in businesses that require the most support. That is why there are certain criteria that companies must meet to qualify for EIS investment. Businesses must be trading but cannot be listed on the London Stock Exchange – however, they can be listed on the AIM. EIS investment supports businesses with up to seven years' trading history and as many as 250 employees (and the limits are higher for knowledge intensive companies).

Some sectors are excluded from EIS funding:

- Land, property and leasing
- Currency, cheques and documents
- Human remains
- Financial activities and banking
- Loyalties and license fees
- Legal and accounting services
- Farming and gardening
- Forestry
- Residential homes and hotel operation/management
- Energy generation
- Coal production and steel production
- Shipbuilding

All companies interested in receiving EIS investment can receive Advance Assurance from HMRC that they are eligible. This isn't a necessity but provides an assurance to investors that the business is eligible for funding.



Risk rewarded

Innovative businesses in sectors with a high rate of start-up failure like Tech, Advanced Manufacturing and Healthcare benefit from EIS investment as they can prove investor capital is at risk and so qualify for the scheme. The tax reliefs associated with the EIS scheme incentivise high net worth individuals to fund these riskier ventures than they might do normally; rewarding risk-taking – for investors and investees – facilitates innovation in the UK business ecosystem.

What are the risks?

Investors must be comfortable with the inherent risk to capital that comes from supporting these early-stage companies with high-growth potential.

Capital at risk

Early-stage businesses are more likely to fail than established enterprises. Although these businesses have high-growth potential, there is also a substantial risk of failure and clients can potentially lose all of their investment.

Volatility

Shares in smaller businesses are more vulnerable to value depreciation and, conversely, value ascendance. These shares are inherently more volatile than those of listed businesses.

Liquidity

EIS investments are held for a long period and provide growth rather than income or opportunity to sell for liquidity, which can be a disadvantage for many clients and are entirely inappropriate for those who cannot withstand total capital loss.

Tax reliefs are not guaranteed

The tax reliefs associated with the EIS scheme are based on current legislation and, as a result, are subject to change in the future. Furthermore, the specific tax reliefs that investors benefit from vary depending on their current circumstances and tax status.

Companies that qualify for the EIS scheme can lose their qualification and, if they do, clients may be asked to return their tax relief to HMRC.

The mechanics of EIS

One of the biggest incentives for EIS investment is the attractive tax reliefs. All clients receive an EIS certificate when they have purchased shares. The time it takes to deploy capital varies depending on the EIS provider, but Mercia seeks to deploys within twelve months which has been recognised as one of the key strengths of the Funds.

Knowledge-intensive EIS rules in brief

The government wants more investment to go into Knowledge-intensive (KI) EIS businesses, so it has made it even more attractive:

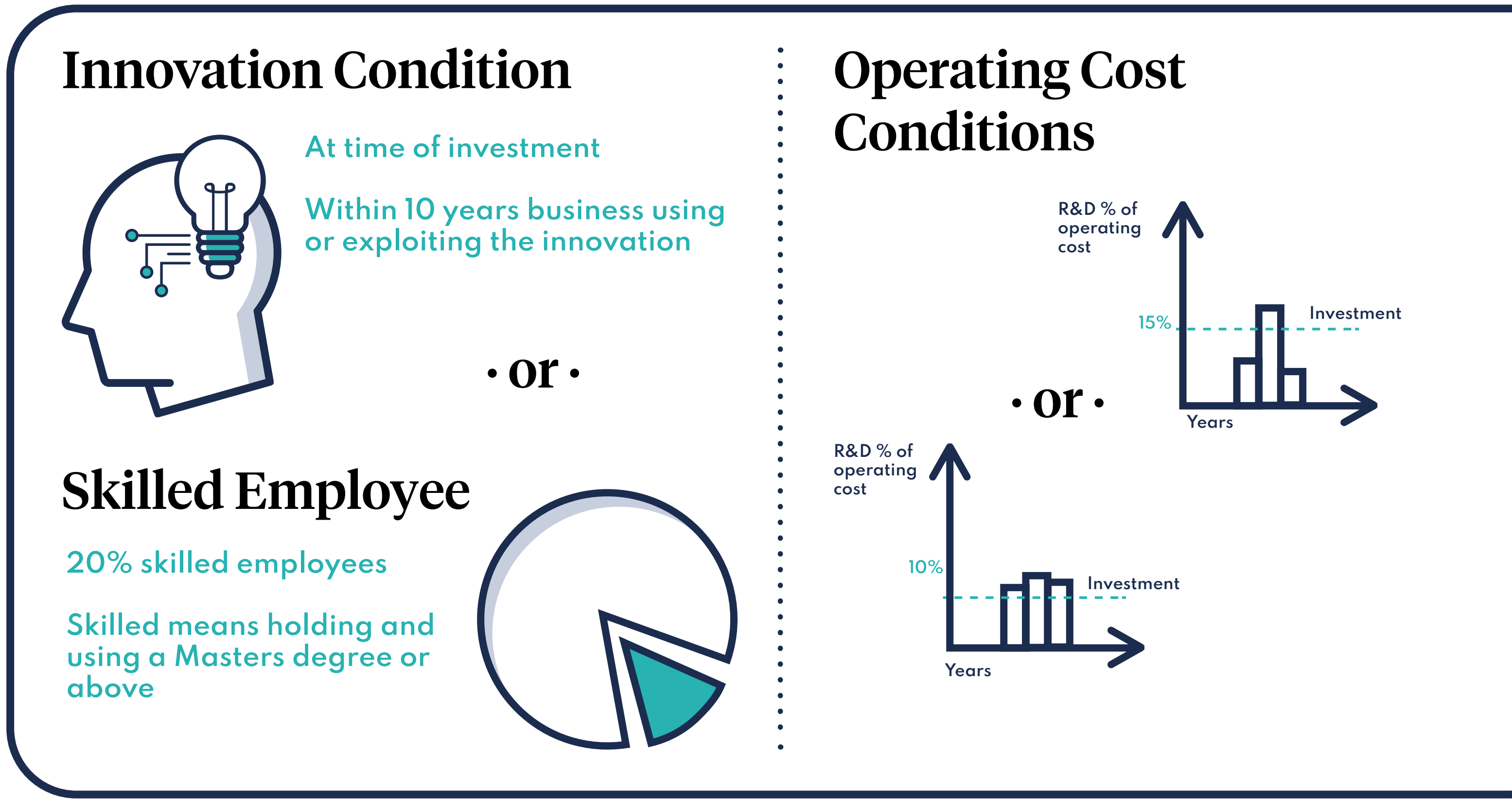
1) Simplified income tax planning, with one tax certificate (EIS5) and full qualification in a single tax year

2) An increased annual maximum of £2million for KI EIS funds means that your clients can effectively manage very large income tax, IHT and capital gains tax liabilities.

Many of the technical rules for qualifying EIS companies are the same as KI EIS, but there are some important differences:

- Money invested can only be used for new shares, not those which exist already
- Investments must be high-risk
- Raised funds must be used to deliver growth such as increase in revenue, customer base and employees, and not to provide cash flow to cover pre-existing expenses
- Companies cannot have been trading for more than seven years (extended to 10 years for KI companies)
- Companies cannot be controlled by another company
- Businesses must have a permanent establishment in the UK
- Companies can have a maximum of 250 employees (extended to 500 for KI companies)
- Gross assets cannot exceed £15million prior to investment or £16million immediately afterward
- KI EIS funds invested must be deployed within two years
- Companies cannot raise more than £5million in EIS investment annually or £12million overall (traised to £20million for KI companies)

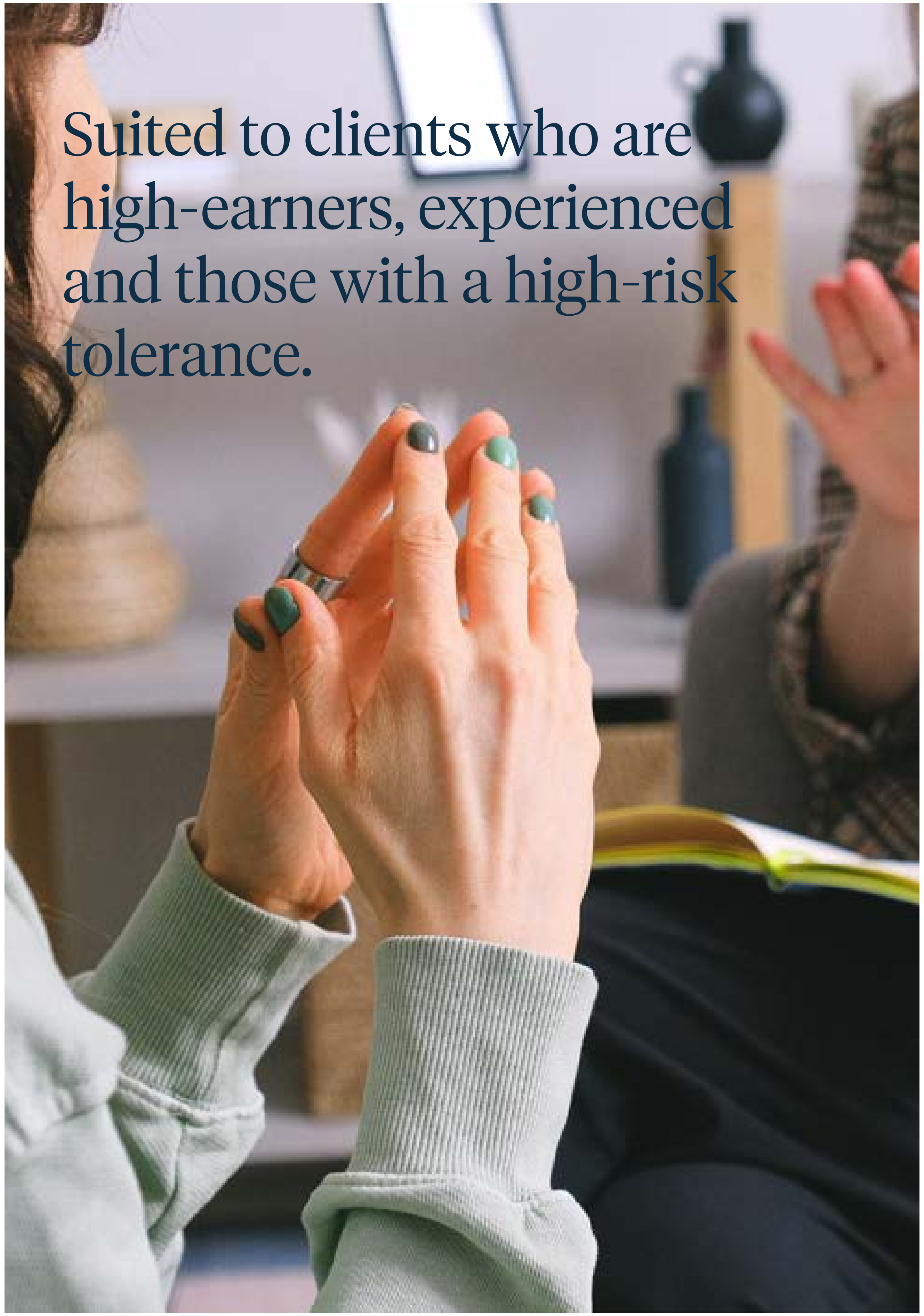
As standard, clients can fund up to £1million in an EIS fund or business each year. However, that amount can increase up to £2million if investment over £1million is made into knowledge intensive companies. Knowledge intensive companies are those which meet one of each of these sets of conditions:



2. WHO IS EIS FOR?

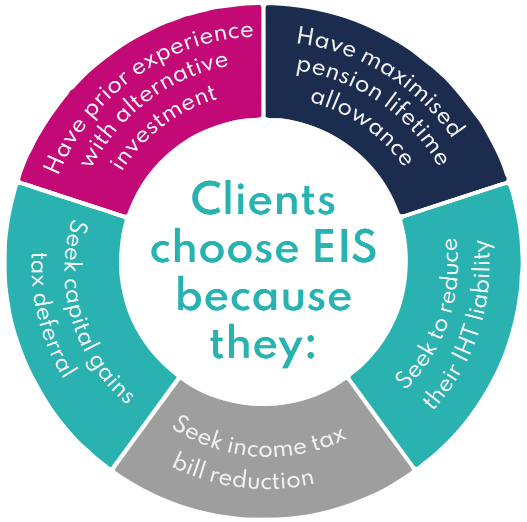
EIS investment is suitable for high net-worth, sophisticated investors with who do not need to generate income from this investment are able to sustain a loss of capital and are comfortable to wait over a long period for their investment to (potentially) provide returns.

Investors with a high-risk appetite, a long-term investment position and a desire to support British start-ups are best suited to EIS investment. Start-up investment provides many benefits to those who wish to defer capital gains tax, better manage their income taxes or re-invest in pension lump sums tax-free.



Suited to clients who are high-earners, experienced and those with a high-risk tolerance.

What does a typical EIS client/investor look like?



Motivations for EIS investment

One driver to make an EIS investment is a client with an income over £100k, who would like to defer a capital gain. Their appetite for risk would mean that they are likely to already have AIM/VCT investments in their portfolio, and hence an EIS might be suitable.

A further driver to make an EIS investment is a client who wishes to reduce their income tax, after having maximised their pension or ISA allowances, and are happy to commit to longer-term, illiquid investments.

3. Tax Relief

What makes EIS tax efficient?

EIS investment has attractive benefits in terms of tax planning which include an upfront relief on income tax. Some of the risk associated with funding these early-stage start-ups is ameliorated with substantial downside protection; loss relief protects as much as 61.5% of invested capital.

EIS investors benefit from:

- Tax-free upside profits without a taxation cap
- Loss relief to protect each investment (each investment is assessed individually)

30% Initial Income Tax Relief

Effective net cash outlay of 70p in the £1

CGT Freedom

No Capital Gains Tax to pay on any EIS gains after 3 years

CGT Deferral Relief

Potential unlimited indefinite deferral of an existing CGT bill

Loss Relief

Maximum exposure of 38.5p in the £1 for 45% Income Tax payer

Business Relief

Potential Inheritance tax saving of 40p in the £1 after 2 years

EIS tax reliefs:

Income tax relief

Clients can claim 30% income tax relief on investments of up to £1.0million for standard EIS-qualifying companies and £2.0million for those which are knowledge intensive each year.

Tax reliefs can be claimed for the year money is invested in companies; when investing into HMRC unapproved EIS funds or portfolios, that would be the year that the money is deployed, or the preceding tax year.

Investing in Knowledge-intensive EIS funds, approved by HMRC, allows investors to claim income tax relief for the tax year that the fund closes, or carry back the income tax relief to the prior tax year, which has benefits for tax planning.

Capital gains tax relief

Gains – not proceeds – made on asset sales can be reinvested in EIS investments and tax deferred for the entire lifecycle of the underlying investments, with no limit on gains deferred.
Reinvestment into EIS qualifying companies or portfolios must be made no more than three years after and no earlier than twelve months before the gain was made.

Gains are recrystalised in these instances:

- EIS shares sold
- The business loses EIS-qualifying status within three years
- Investors are no longer UK residents within three years of investment

Tax free capital gains

Disposed shares that were held in EIS companies for a minimum of three years and produced gains typically have no capital gains tax liability.

Inheritance tax exemption

EIS investments qualify for Business Property Relief ("BPR") which means they are 100% exempt from inheritance tax when passed to beneficiaries upon the death of the investor, as long as they have been held for a minimum of two years or qualify for Replacement Property Relief.

Loss relief

Loss relief can provide as much as a 61.5% tax relief as a form of downside protection for supporting these high-risk, early-stage companies. Investors can claim loss relief for any individual loss on an investment within an EIS portfolio, irrespective of the portfolio's overall performance. Loss relief can be claimed during the year of the loss or for the prior tax year, or against capital gains (including tax liability because of deferred gains) for the year of the loss and future years.

How and when to claim tax relief

Clients can claim tax relief on their EIS shares at the time tax reliefs are filed and will be asked to provide information included in EIS3/EIS5 certificates. EIS3 certificates are shared with clients shortly after each of their underlying investments are made into the underlying companies. Or, if the investment was made in a fund preapproved by HMRC, clients will be issued a single EIS5 certificate for all portfolio companies.

EIS3 and EIS5 certificates both include:

- The company's name
- The amount invested
- Number of shares issued
- Date shares were issued/date of investment
- Name and HMRC reference

Clients can include the specifics of their tax relief in their tax self-assessment to be submitted online or by post before the January submission deadline in each calendar year. Alternately, they can fill in pages 3 and 4 of their EIS3 or EIS5 tax certificate and submit it to their relevant HMRC office.

Qualification criteria

There are a number of factors that need to be considered to establish whether an individual qualifies, as follows:

- The client 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.

Tax-planning scenarios.

Capital gains tax deferral with EIS

Cameron the Company Director

- Company director, selling shares worth £500k (purchased at £400k).
- His annual salary is £150k and he is approaching his pension allowance.
- He has significant wealth within pension & ISA and uses the allowances for both each year.
- He has a significant capacity for loss, as he is saving in shares and cash (ISAs & other products).
- He is prepared to invest long-term as he does not need the capital.

Capital gains tax deferral with EIS

Lara the Private Landlord

- Lara is a buy-to-let landlord, selling a property for £500k (purchased at £400k).
- Her annual income is £90k.
- She has significant wealth within pension & ISA and uses the allowances for both each year.
- She has capacity for loss, as she has £500k of cash in savings.
- She is prepared to invest for the long-term as she does not need the capital.

Deferring a very large gain

Charlotte the Business Women

- Charlotte is a 55-year-old business woman wishing to tax-efficiently exit her company in the next few months.
- This will incur a £10m capital gain
- She earns a £250k annual salary and has £500k cash savings.
- Has maxed her ISAs and cannot contribute to a pension
- Wants to create an asset to pass on to her children.

Making EIS investments for Income Tax Relief

Ian the Doctor

- Ian would like to explore tax-efficient investments to mitigate his income tax bill, whilst saving for his retirement.
- Earns £100k per annum and has reached his pension allowance meaning any further contributions will be heavily taxed.
- Has significant wealth within pensions & ISA and uses the allowances for both each year.
- Has capacity for loss, as he has £500k of ISAs, savings and an emergency fund that exceeds six months' expenditure.
- Ian is an upper-medium risk investor on the risk spectrum and would benefit from balancing his conservative-leaning portfolio with venture capital.

Pension allowances

For pensions, there were until recently both an annual and a lifetime allowance for contributions. The annual allowance is the amount of pension contributions you can make each year without incurring a tax charge, and a lifetime allowance covers all years.

Although the lifetime allowance has recently been abolished, it is likely to be reintroduced. The annual allowance in combination with the tapered pension allowance for high earners effectively limits pension contributions.

If a client is a member of a defined benefit pension scheme, the amount of that scheme that counts towards their lifetime allowance may be less than the full amount of their pension benefits.

Investment in EIS can help to offset the effects of any pension limitations.

A pension may be limited by these allowances, your client may be able to invest in EIS and receive income tax relief of up to 30% on your investment.

Inheritance Tax

EIS is also a valuable tool for succession planning. Holding EIS shares for more than two years, typically reduces the inheritance tax bill for the EIS assets to 0%.

However, if your client dies their beneficiaries will have to pay income tax on the dividends from the EIS investment. Additionally, they will have to pay capital gains tax when shares are sold, based on the growth in value from when the shares are inherited.

Capital Gains Tax

If an individual has a capital gains tax liability, they may be able to use an EIS investment to defer that liability. There is no limit to the amount of capital gain that can be deferred, even if not all the income tax relief can be utilised.

Attitude to risk

The most suitable attitude to risk for an EIS investment is a high-risk tolerance. This is because EIS investments are generally high risk investments, and therefore your client should be prepared to lose some or all of their investment.

Income tax case study - See page 23

Income tax example:

Ian is a doctor with a taxable income of £100,000. He invests £40,000 in an EIS-qualifying company and receives tax relief of 30%, so his investment is worth £52,000.

If the investment increases in value by 20% over four years and the shares are sold, there will be a gain of £8,000, however, the growth has been within an EIS and so there is no Capital Gains Tax payable.

If the opposite happens, and the investment decreases in value by 20% over four years and the shares are sold, he will make a capital loss of £8,000. He can offset this loss against his other capital gains in the tax year, or carry it forward to offset against future gains.
If Ian dies, the investment will be exempt from inheritance tax.

4. How to select an EIS provider

The EIS fund manager.

Once a final shortlist of providers has been developed, it is essential to spend some time with any potential EIS provider to ensure their funds are a good fit for your clients.

A starting point is to look for third-party recommendations or reviews. Martin Churchill's Tax Efficient Review is completely independent and providers do not pay for the review. Equally, MICAP offers a range of balanced and insightful reviews of both the manager and the funds they offer. In addition, MJ Hudson's Tax Shelter Report is accurate and unbiased – Mercia's reviews can be downloaded here -

https://hub.mercia.co.uk/im-and-application-download

Spending time understanding the manager through its webinars, presentations and in-person events is critical. Additionally, the reporting and performance should be scrutinised, both in relation to successes and failures. Get insight into the manager's portfolio of companies – a granular view of the companies themselves as well as an appreciation of the portfolio in the context of the manager's other investment activities and thesis.

Once you have decided to invest in an EIS, you will need to choose an EIS fund manager. Here are five factors to consider:

1. Track record
Its widely accepted that although past performance does not indicate future returns, many investors choose an EIS manager according to their track record of cash returns to investors. Specifically, leading EIS funds can show that they have fully exited some of their previous EIS funds.

2. Investment focus
The first step is to decide which type of business your client may want to invest in. For example, they might want to invest in start-ups in a particular industry, such as renewable energy, biotechnology or healthcare. Or they may prefer to take a more generalist approach, to ensure a variety of sectors.

3. Experience of the investment team
The next step is to check how much experience the EIS fund manager has. For example, if you are looking to invest in a start-up, it's important that the fund manager has a good track record of investing in early stage businesses.

4. Investment strategy
It is also important to understand the fund manager's investment strategy. For example, some fund managers might focus on investing in businesses that have a clear exit strategy, such as businesses that are looking to list on a stock exchange. Or others may focus on a particular region, which if so, you should check how local they are to these areas.

5. Risk appetite
Finally, you need to consider your own risk appetite. For example, if they are looking for a high return, your client may be willing to invest in more risky businesses or sectors. However, they might prefer to invest in a fund that targets later stage businesses which are more established. Please note that EIS is inherently high risk, and to qualify for the EIS rules there should be sufficient risk involved.

The EIS fund

Ultimately, the best EIS provider is one that can offer you a comprehensive package of services that take advantage of all the benefits that the EIS has to offer and that is well aligned to your needs. The provider should also be able to provide the necessary support to ensure that your client's EIS investment is properly managed and operated.

When selecting an EIS fund, consider:

- The fund's investment strategy
- The fund's track record
- The fund's fees
- The fund's minimum investment amount
- The fund's liquidity
- The fund's tax benefits.

EIS funds typically have high fees and a high minimum investment amount. Be aware that EIS funds are illiquid, meaning your clients may not be able to sell their investment for several years.

Investing in EIS – the importance of diversification.

Tax efficiency, diversification and returns are three of the most important factors when constructing an investment portfolio. Diversification is of particular importance for EIS investment as it helps ameliorate some of the risks associated with supporting smaller start-ups that are more subject to value fluctuation.

Invest in portfolios, rather than single companies

Clients that back a single EIS company will see that company either fail or succeed. If the company succeeds, they could make a good return. In contrast, if that company fails, they will lose the entirety of their investment (except for loss relief).

Investment in an EIS portfolio or fund will enable clients to spread their risk and improve the chance of making good overall returns as a result.

Measured diversification

Over-diversification can jeopardise a client's chance of making a good overall return as backing a singular company can. The more businesses a client backs, the higher the likelihood the return will be around the median, as poor performers in the portfolio average out the return generated by exceptional businesses. Diversification should be measured and limited to benefit risk-reducing EIS investment.

Generalisation or specification

Investment in an EIS portfolio or fund can either be generalist or specialised. Generalist EIS portfolios include businesses across sectors and regions, for improved diversification. Specialised EIS portfolios are usually curated by fund managers who have expertise and/or a rich network in a particular region or sector. Although specialised portfolios are less diverse than generalist portfolios, risk is ameliorated as investors benefit from the expertise of fund managers, however they may be subject to a greater negative impact in the case where a sector is hit particularly hard due to the macroeconomic environment.

Manager diversification

Investing in portfolios with multiple fund managers can help reduce the risk posed by a portfolio managed by single fund manager. One fund manager may favour investment in businesses with similar characteristics which are therefore susceptible to similar fluctuations in value because of market volatility. Portfolios constructed by diverse fund managers are more likely to be composed of more companies which are distinct from each other, providing enhanced risk reduction.

Maturity diversification

A balanced EIS portfolio can include companies at different stages in their life cycle, such as early-stage businesses which are higher-risk, higher-reward, and companies which are at a late stage with a higher-valuation but are lower-risk investment opportunities.

How to mitigate EIS risk.

There are a number of ways to mitigate the risk associated with early stage investing, including:

1. **Diversification:** By investing in a number of different companies, a client can spread risk across a number of different sectors.
2. **Experience:** Look for experienced management teams who have a proven track record in building successful businesses.
3. **Thorough due diligence:** Make sure clients understand the business model, the market opportunity and the financial projections of the company before investing.
4. **Have a clear exit strategy:** A client can have a plan in place for how and when they will sell shares in the company.

Why is deployment speed important for EIS?

Some might determine that deployment speed is the primary investment driver for EIS funds. Being able to invest quickly and wisely is fundamental from a tax-planning perspective and this pressure can sometimes lead investment into late-stage businesses, which moves these funds into a lower return profile. A balance needs to be struck by the manager in terms of fundraising and deployment, which becomes really challenging for very large funds, inhibiting them from deploying within specific tax years that is tax-critical for unapproved funds.

The difference between 12 months deployment and in many instances the 24 months indicative of other funds, is substantial. This is also applicable to income tax, as a client can achieve double the amount of income tax relief if they are investing in the 12 months versus 24 months. If a client is considering estate planning, they have two years from the point of investment to qualify for inheritance tax relief, if there is a delay of two years, then it will be four years until the investment is qualified for business property relief.

5. Mercia's EIS Fund

Mercia Asset Management.

Mercia is one of the UK's most active regional investors supporting businesses and entrepreneurs across the UK. As a proactive specialist asset manager, Mercia provides capital solutions and active support from seed to growth with interlinked resources – its Complete Connected Capital solution. Mercia's private equity and debt teams focus on profitable businesses, whilst its regional venture and EIS funds provide seed to Series B funding.

Mercia Fund Management, is the FCA authorised and regulated fund manager for the EIS funds and is a direct subsidiary of Mercia Asset Management PLC. MFML was founded in 2010 with three employees and £12.0million in assets under management (AuM). Today Mercia, as a group, has over 140 employees and £1.4billion AuM and continues to expand throughout the UK regions.

Investment opportunity & investment strategy

Each Mercia EIS Fund aims to triple invested capital within five to seven years, including tax reliefs. Each Fund will invest into a range of companies within specialist sectors. There will be a mixture of pre-revenue generating companies and investments will be made into areas in which we feel there is a large addressable market, which can be accessed by the disruptive technology of the investee company. Each Mercia EIS Fund may invest up to £1.5million, either alone, or as part of a larger syndicated round. Before each investment is made, the opportunity is assessed by our investment panel.

Principal risks

Capital is at risk

We invest in early-stage trading companies. The companies we invest in and your client's investment could fall in value, potentially to nil. Your client may not get back the full amount they invested.

Tax rules could change in the future

This brochure is based on current tax legislation and interpretation. Tax rules could change in the future. The availability and value of tax relief will depend on your client's personal circumstances.

Companies could cease to qualify for EIS

A number of EIS tax reliefs depend on the portfolio companies maintaining their EIS-qualifying status for at least three years. Due to the nature of this investment, it is possible that a company and your client's investment itself might cease to be EIS-qualifying. EIS relief previously granted could be repayable to HMRC.

Client investments are illiquid

We will be investing into early-stage companies at the start of their journey. We expect investment in each company to last for at least five years. Shares in unquoted companies cannot easily be sold. This limited liquidity may make it difficult to action a transfer and/or withdraw from an investment before a company exit is achieved.

The investment could be volatile

Smaller companies are considered high-risk investments. The individual companies will not be listed on a stock exchange and their value can fall or rise much more sharply than shares in larger, more established companies. This means the value may also fall or rise more sharply than investments in more stable or established assets.

Why choose Mercia for your EIS investments?

Investment objectives

1. To offer the opportunity to invest in EIS- qualifying companies seeking expansion, development and early-stage capital which will not typically be traded on the Official List of the London Stock Exchange.

2. To generate capital gains and provide Tax Advantages associated with EIS Investments.

Sustainable growth

Mercia has continued to scale its platform and capabilities to meet the needs of its investors and entrepreneurs. Its proven hybrid business model allows Mercia to be proactive in supplying seed investment funding through to Series B. The intention is to help the most promising enterprises to scale up providing them with a range of Funds and different sources of capital that can work in synergy; EIS Funds can invest alongside other Mercia managed regional funds, the Northern VCTs, as well as Mercia's proprietary capital.

Operational excellence

Adding value is at the heart of what Mercia does. The operational expertise of its team and the support offered by 'Mercia Nucleus,' provides an infrastructure of knowledge and good governance, nurturing Mercia's portfolio businesses. Mercia has expanded its value-add offering to portfolio companies through the addition of other services that include talent search, growth partner counsel, non-executive appointments and knowledge sharing.

Engaged investment

Mercia is much more than the sum of its parts. Mercia's doctrine of interconnectivity delivers value beyond just the benefit derived from its Complete Connected Capital model. With eight regional offices, Mercia retains a strong presence across the UK. The company has digitally reenergised its systems and routines to offer both immediate engagement and in-person support. The majority of our portfolio companies are less than one hour away from one of our offices. Critically, prospective deals are equally within reach, typically coming from the strong regional ecosystem that its locality has cultivated.

Simplified deployment and streamlined digital processes support deal origination in today's competitive landscape. This enhances the speed of Mercia's response, expands the breadth of its coverage and increased its investment cadence.

EIS investment strategy

Mercia is one of the leading managers, independently recognised as working at scale across the UK. Our strength and expertise in regional investment is one of Mercia's biggest differentiators with 80% of its investment being outside of Greater London and the South East. This strategy can provide the fund with better entry prices and improved speed of deployment, with few managers or houses being able to compete for these deals. So not only are these deals less expensive, but also Mercia can move them across the line more quickly. The deal origination activity across all of Mercia's funds also provides visibility of a vast range of investees companies, providing substantial scale within the deal pipeline, many suitable for EIS investment.

Portfolio

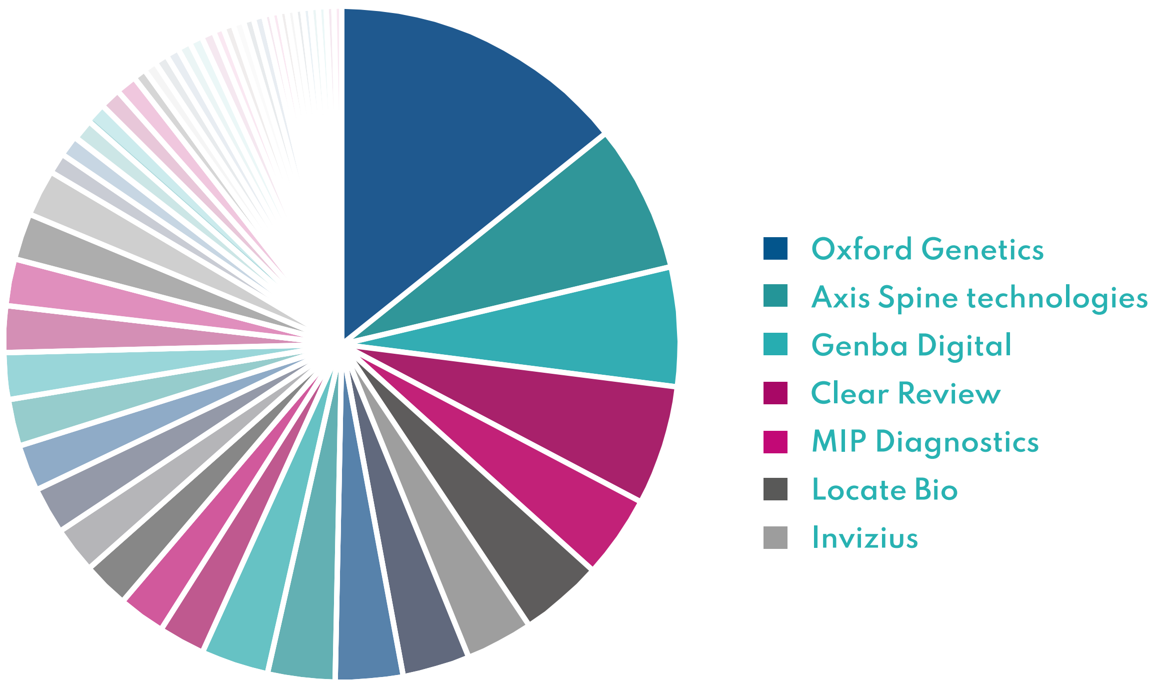
This pie chart shows the realised and unrealised valuations of our entire portfolio.

Very well diversified EIS Fund:

- Over 100 EIS investments
- Group has c.450 companies in its portfolio

Expect failures in any portfolio, but over time, we build up our position in companies that are doing well.

Repeat investors receive improved overall performance.



Companies we've backed

Mercia looks for regional businesses that have the potential for global impact. As a mission-led business ourselves – we address the regional funding gap – we seek businesses that also are led by purpose. We invest in businesses and management teams that know why they do what they do.

Our portfolio businesses typically provide a solution to a problem – which could be an environmental, social, health or business challenge – or have filled a market-gap, often by developing an innovative new technology.

To fulfil our mission to create value in the regions, we also look for regional businesses that will enrich the local economy through skilled job creation as they scale.

Dxcover

Dxcover is a spin-out from the University of Strathclyde, based on world leading research and fronted by an award-winning team dedicated to translating this technology into the clinic. Through the Dxcover® Cancer project, the company is targeting earlier detection of rare and common cancers. Earlier diagnosis results in significantly higher survival rates compared to late-stage diagnosis, with treatment options and the chances of recovery and quality of life hugely increased. The blood test developed by the project will allow doctors and clinicians to prioritise and fast-track patients for further treatment.

Mercia first invested in Dxcover in May 2019 with further EIS investment in 2020. Since spinout in 2019, the company has raised £5.1million in funding to date.

Adapttech

Adapttech was founded by CEO Frederico Carpinteiro to improve the lives of those with lower limb loss. Its initial product, the INSIGHT system, makes it easier for clinicians to fit lower limb prosthetics and monitor patient rehabilitation, offering cost savings and enhanced comfort.

New use cases for smart sensors and devices continue to play out across Healthcare capturing data into pathways that improve both existing, and often disruptive, technologies for improved end-to-end efficiencies. Smart sensors are a prime example of the role of enabling technology, seen in Adapttech and its INSIGHT system, which makes it faster and easier to fit lower-limb prostheses and monitor a patient's rehabilitation. The company was first backed by Mercia in 2016 with follow-on investments that this year saw the total investment in the business to £7.3m and followed its success in gaining FDA's proof of concept approval for its systems in the US and making initial sales to clinicians in America and Europe.

Mercia's EIS past successes

Our average deployment time from receiving funds to investing is 10.3 months.

We aim to exit all investments within five to seven years and our portfolios operate within the same timeframe.

Our MGF2 Fund, first funded in FY 2013/2014, has almost been fully exited with only some negligible value holdings remaining and has returned 4.7 times invested (excluding fees). We have also seen a growth in profitable exits within our target timeframe, as demonstrated below.

The Mercia group and our EIS have had many profitable exits – the returns quoted are excluding fees, include:

- Native Antigen Company, July 2020, at 8.6x
- Clear Review,October 2020 – at 8x
- Oxgene, March 2021 - up to 20x
- GENBA Digital, May 2021 - up to 8x (inc earn out)
- Snappy Shopper, July 2021 -circa 8x return & 218% IRR
- In-Part sold in December 2021 at 4.4x
- Kumulos sold in March 2022 at up to 3.5x (inc earn out)
- nDreams sold in March 2022 at 7.8x
- C7 Health sold in March 2022 at 14.1x

OXGENE®
A WuXi Advanced Therapies Company

OXGENE

OXGENE provides a fine example of how Mercia EIS goes above and beyond when supporting its portfolio companies to scale. As an asset manager, we sometimes engage in entrepreneurial VC activity and OXGENE's trajectory demonstrates the value of this.

Mercia CEO Mark Payton worked with Professor Len Seymour to found OXGENE by taking a discarded IP and spinning it out with the support of Mercia EIS funding to grow a profitable business. OXGENE is a socially impactful business that accelerates the development of new cell and gene therapies. During the COVID-19 pandemic, OXGENE worked with another Mercia portfolio company, The Native Antigen Company, on the large-scale production of high-quality COVID-19 antigens to support the creation of diagnostics and vaccines.

Mercia nurtured OXGENE for seven years. When it sold, Mercia EIS investors received up to 20x their original cost.

Mercia's Knowledge-Intensive EIS fund

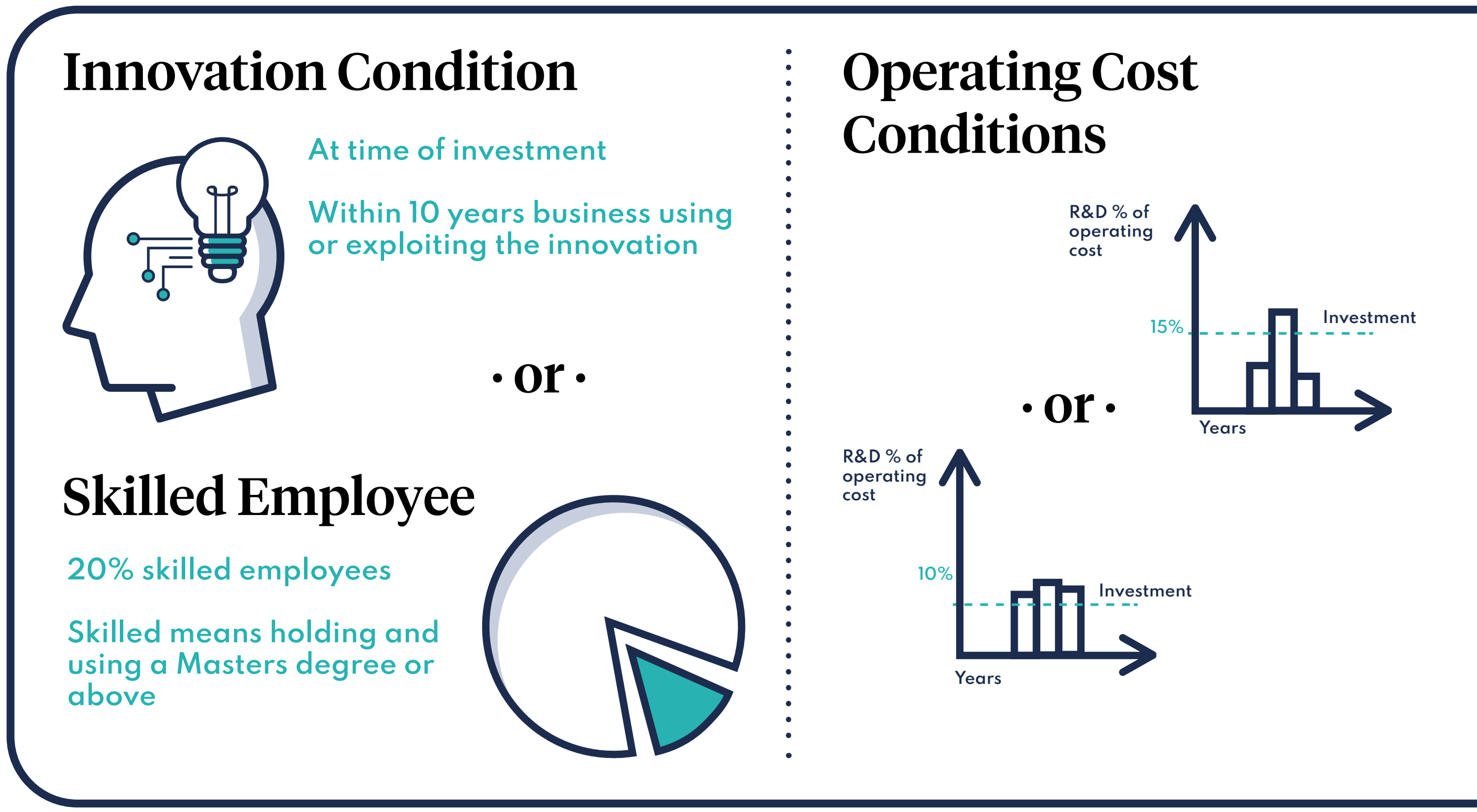
There are two types of EIS fund HMRC unapproved fund and HMRC knowledge intensive approved funds. Unapproved is purely a HMRC differentiation which determines when the initial income tax relief can be utilised and what type of tax certificate the investor will get. For an approved fund, the initial income tax relief can be claimed for either the tax year in which the fund closes, or the preceding tax year. For example, an investment of £100,000 is made into an EIS Fund, which closes on 5 April 2023. Tax Relief might either be claimed for the 2022/ 23 tax year, or the shares can be treated as being issued in the 2021 /22 tax year, even though the underlying shares will not actually be issued until the 23/24 tax year. The approved funds have a knowledge intensive requirement, meaning that more than 80% of the funds must be invested into knowledge intensive companies.

What is actually meant by a knowledge intensive company?

A knowledge-intensive company has to meet certain requirements. There are a number of technical conditions to each of these requirements but as a brief overview, the requirements are as follows.

The first requirement is all related to the proportion of research and development ("R&D") spend of the business and the company can make this in one of two ways. Either, the company must have spent more than 15% of its relevant operating costs on R&D in one of the last three financial years, or the company must have spent more than 10% on R&D in each of the last three financial years.

The second requirement is related to innovation and skill, and the company can make this in one of two ways. Either, it is expected that within 10 years of the investment, the company's activities will mostly consist of the use or exploitation of the intellectual property that it is creating, or at the time of the investment and for the next three years, 20% of the company's workforce is classed as being skilled employees, having a master's degree or above and engaging in certain activities of the business.



Responsible investment/ESG

To be a responsible investor is to act – internally and externally – in a manner which aligns with ESG principles in order to preserve the long-term health of society and the market.

Mercia has always aspired to be the first choice for investors, investees and employees. To do so, we create value in ways that exceed financial support, such as introducing experts into our portfolio companies to serve as non-executive directors in addition to implementing good governance measures. Mercia's commitment to responsible investing is a further method by which its proposes to create value beyond capital investment.

A responsible approach benefits people and the planet, as investors who adopt this methodology support impactful businesses that provide solutions to social and environmental challenges. Furthermore, this approach has strong remunerative potential. The kind of data analysis used to decide if an investment is responsible can also serve to identify risks and opportunities which would have otherwise gone unnoticed.

6. Next steps.

All EIS applications are received via email or our online portal. Our Client Services team checks the application to see if further information to support it is required. If so, we contact the applicant. Following that, our Custodian completes AML checks and processes the application.

Next, our clients and their advisers are set up on the Investor Centre platform which has fully personalised reporting, including valuations, contract notes, tax certificates, cash statements and loss relief letters.

All essential information is communicated by email through notifications from the Investor Centre. Our Client Services team is available to respond to queries by email and phone. We aim to respond to all queries within 48 hours.

Useful links

https://www.gov.uk/government/publications/income-tax-the-enterprise-investment-scheme-and-venture-capital-trusts-encouraging-investments-in-knowledge-intensive-companies/income-tax-the-enterprise-investment-scheme-and-venture-capital-trusts-encouraging-investments-in-knowledge-intensive-companies

This guide does not offer investment or tax advice and investing in EIS products is not suitable for everyone. We recommend you seek independent investment and tax advice before investing in any such products. Please note that investments made into the EIS Fund should be regarded as being of a long-term and illiquid nature, of significant and high-risk. Please read the full risk warnings in the Fund documentation before applying.

This guide is aimed at Investment Professionals only and should not be relied upon by Private Investors. Mercia does not offer any opinion on the suitability or appropriateness of any investment and this report is intended as general information only and does not constitute advice or recommendation. Information is sourced direct from fund managers and is therefore as current as is available at the time of production. The material provided by the any correspondent to this report is not intended to provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations.