eisa
enterprise investment scheme association

EIS: under the bonnet

About the EIS Association

The EIS Association (EISA) is the official trade body for the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) industry. EISA is a highly effective not-for-profit organisation that exists to aid the provision of capital to UK small and medium-sized enterprises (SMEs) through these two schemes.

EISA works closely with HM Treasury, HM Revenue and Customs, government ministers, MPs and the FCA to enhance EISs and SEISs and promote the benefits of using them to investors, companies and their respective advisers.

EISA collaborates with other trade bodies that support investment into SMEs, including the British Venture Capital Association (BVCA), the Association of Investment Companies (AIC), the Institute of Chartered Accountants in England and Wales (ICAEW) and the UK Business Angels Association (UKBAA). The EISA Director General sits on the BVCA Venture Capital Working Group, which aims to present a unified voice from all sections of the SME and venture finance industries to the UK government and the EU.

EISA's membership is drawn from all areas of the EIS/SEIS industry and includes EIS/SEIS fund managers, lawyers, accountants, tax advisers, corporate financiers, IFAs and wealth managers throughout the UK. Details of our members and membership categories can be found on our website, www.eisa.org.uk, under the 'Membership' section.

Please contact Mary Rodgers at mary.rodgers@eisa.org.uk if you are interested in learning more about EISA and becoming a member.

About this guide

The Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) support the UK economy by encouraging the flow of private capital from taxpaying individuals to some of the country's brightest companies – those that show the most promise and the highest growth potential. These companies use investors' money to help finance expansion and development at a time when the impact of growth can be most positively felt. In exchange for providing capital, investors are granted a series of generous tax reliefs by the UK government, helping them to mitigate the risks and enhance the returns that can be generated from investing in growing companies.

The main purpose of this guide is to get 'under the bonnet' of EIS and SEIS. Our aim is to delve a little more into the detail of these schemes, look at the component parts that make them tick and illustrate how they work in practice.

EIS and SEIS investing is becoming more and more popular. The investor demographic is broadening to encompass a wider range of people, some of whom may be less familiar with this exciting, vital and rewarding area of UK equity investing. This is why we have produced this guide. We want to help educate investors and their advisers about EIS and SEIS and what to expect from investing in this sector. Along with the sponsors of this guide (see page 18), we hope to provide interesting and practical insights into investing in UK companies through EIS and SEIS and to raise awareness of these schemes so that even more investors can benefit from them.

Mark Brownridge

Director General
The Enterprise Investment Scheme Association (EISA)

In this guide

What is the difference between EIS and SEIS?

EIS and SEIS are very similar in many respects, but there are some important differences.

EIS and SEIS serve the same essential purpose – to be a conduit for early-stage investment into high-growth-potential, smaller and younger UK companies, for which there is widely regarded to be a 'finance gap', meaning many promising businesses can struggle to obtain growth funding.

The key difference between the two is that SEIS is explicitly targeted at start-ups and very early-stage companies, while EIS can be used by larger and more mature companies – though these are still relatively small and young in the context of the UK's business and corporate landscape.

SEIS funding criteria for companies:	Fewer than 25 employees	Trading for less than two years	Gross assets valued at no more than £200,000	No previous investment from a Venture Capital Trust or EIS Subject to a lifetime SEIS funding limit of £150,000
The comparable requirements for EIS:	Fewer than 250 employees	Trading for less than seven years (or less than 10 years for 'knowledge-intensive' companies – typically those with high research and development costs/requirements)	Gross assets valued at no more than £15m	Maximum lifetime amount that can be raised under SEIS, EIS and Venture Capital Trusts is £12m (or £20m for 'knowledge-intensive' companies)

For simplicity, in the remainder of this guide references to 'EIS' can be taken to mean both EIS and SEIS, unless the context indicates otherwise.

How do I invest in EIS?

The one thing that all EIS investors have in common is that they are UK taxpayers, which is a requirement of the scheme. The routes by which they invest in EIS may vary, though.

Among the most common routes to invest are:

Through a financial adviser or wealth manager, who will recommend an EIS fund, portfolio or other form of investing in EIS.

Directly with an EIS investment manager (more common if an investor already has a relationship with them and/or considers themselves to be sufficiently sophisticated and experienced to not require professional advice).

Direct purchase of an EIS-qualifying company's shares – this may be an approach followed by 'business angels', who tend to be experienced entrepreneurs and serial investors who often provide expertise and contacts as well as capital. This route may also be taken by people within the network of the owners of the company that is raising finance through EIS.

Through a crowdfunding or investment platform. Increasingly, EIS-qualifying companies are seeking to raise money directly from investors through an investment platform in addition to or instead of other distribution channels.

Depending on the route investors take, there may be varying levels of support in making and processing their investment, though all follow the same fundamental underlying process laid down by the UK government, which created and administers the schemes.

For the purposes of this guide, we will generally assume that individuals are investing in EIS via an investment manager into an EIS fund or portfolio, which is one of the most widely used routes.

EIS 'funds', 'portfolios' and single company investments

Despite the term being in common usage, there is no such thing, in a legal or regulatory sense, as an EIS 'fund'. 'Fund' is used as an easily understood shorthand denoting an investment portfolio of single investments in individual companies, professionally managed on an investor's behalf in an arrangement akin to a discretionary managed portfolio. It is a requirement that investors are owners of an EIS-qualifying company's shares for tax relief purposes.

This contrasts with a mutual fund or unit trust, where the individual investor owns shares in the fund and the fund, as a legal entity itself – into which all investors' capital is pooled – owns the shares in the underlying companies in which it invests. For all practical purposes, an investor is unlikely to notice any difference between an EIS fund and a traditional pooled subscription fund.

Some EIS investment managers also offer 'portfolio services', through which investors can choose EIS-qualifying companies that have been assessed and approved by the investment manager as credible investment opportunities. However, for the purposes of this guide, the terms 'portfolio' and 'fund' are interchangeable and neither denote the type of portfolio service mentioned above.

It is also quite common to invest in single EIS company investments. These are typically accessed directly by investors through investment platforms and crowdfunding websites, though some investment managers, wealth managers and financial intermediaries may also offer them.

How do investment managers source EIS-qualifying investments?

There is no stock market for EIS companies and so a big part of the challenge in EIS investing is finding great companies. Investment managers do this in a variety of ways.

When thinking about EIS investing, it can be useful to compare it with investing in stock-market-listed companies. These tend to be very visible: they have a daily share price, they publish results and trading statements, and they are often the subject of independent research and analysis by brokers who assess whether they might or might not make a good investment. For fund managers who invest in listed equities it is therefore relatively easy to find potential investments (the skill is picking the ones that will rise in price the most, or fall the least, from the thousands of companies available).

There is no stock market for EIS-qualifying investments* and analyst coverage for EIS-qualifying companies does not really exist – though, as the market for these investments evolves and matures, analysts are beginning to take more interest. This means EIS investment managers rely heavily on contacts they have developed during their careers investing in this specialist area of UK equities.

Some EIS managers focus on specialist areas – for example, technology or healthcare – and so will have extensive contacts within them.

Typical sources of deal flow

University professors and academics, who might be aware of the most exciting and commercially promising ideas and technologies emerging from their institutions.

Experienced professionals and senior executives in different industries and sectors, who know where the new talent is within their fields.

Accountants, lawyers, corporate financiers and professional service providers, who are working with new businesses and entrepreneurs. Part of their role may be to help companies raise money through external EIS investment.

Successful serial entrepreneurs and investors, who have made it their business to try to find and support the most exciting companies and entrepreneurial talent the UK has to offer. Such individuals are sometimes known as 'business angels' or 'angel investors' (think of the inhabitants of TV's 'Dragons' Den'). They often share investment opportunities to reduce their investment risk, while making it easier for companies to get the money they need.

It is relatively common for a company seeking EIS funding to make a **direct approach to a fund manager**. Many companies now also use **crowdfunding and investment platforms**.

An EIS manager may consider hundreds of companies every year but perhaps invest only in a handful of them. The number of companies and how much money is invested in each will depend on a fund manager's investment strategy and approach, coupled with the perceived risk and return profile of the investment opportunity.

**EIS-qualifying companies cannot be listed on major stock markets, though listing on the Alternative Investment Market (AIM) is allowed.*

Supporting an investee company to aid its success

EIS managers usually take a direct and active role in helping to build a company's value in order to make finding potential buyers – and therefore a profitable exit – more achievable.

Investing in EIS-qualifying companies requires specialist skills and expertise not generally necessary for a fund manager investing in, for example, FTSE 100 companies. Young companies cannot afford the raft of board members and senior managers that a listed company will have.

From an investment manager's perspective, EIS investing is highly resource-intensive at almost every step of the way. Finding perspective companies in which to invest, carrying out analysis and due diligence on them, providing significant levels of support throughout the investment period, securing an exit – all of these demand large amounts of time and expertise.

This is why EIS portfolios and funds might consist of only 10 companies or fewer – compared to a typical UK equity fund, which may feature between 30 and 50 companies.

Helping to build value through a hands-on approach, specialist advice and access to professional networks

EIS companies are often approaching a stage where, with the right support, they can take a major step forward in their development. This may result in a multiple increase in their valuation – and therefore the potential of a significant shareholder gain when the investment is exited.

Investment managers will look to provide this support in some or all of the following ways:

Appointing a representative to a company's board

It is common for an investment manager to take a seat on the board of an investee company so they can closely monitor and advise the company, often adopting a hands-on approach and perhaps even being involved on a day-to-day, operational level during key periods.

Personnel changes

EIS fund managers' expertise and experience in knowing how to help build value within portfolio companies often extends to recommending personnel changes, suggesting replacements for existing (sometimes senior) roles or the creation of new roles and helping to recruit for these positions.

Informal and formal mentoring

To provide the level of support many EIS investee companies require, investment managers will often have advisory boards of senior professionals, academics, successful entrepreneurs and investors, whose expertise, experience and access to networks of contacts will be available to investee companies on an on-going basis.

Particularly in the more start-up-focused SEIS sector, investment managers may offer dedicated and structured mentoring programmes to investee companies to help equip their managements with the skills and knowledge they will need as they grow their business. This could involve help with financial management, operational efficiency, marketing, PR and commercial management.

What if a company needs more investment before it can be made ready for exit?

It is often the case that a company will not raise all the capital it requires in just the one round. Most start-ups go through a series of follow-on fundraisings before they become capable of supporting themselves from their own cashflows.

Follow-on investing is very common in the EIS sector, though how likely it is may depend on the nature of the company in question and its stage of development. In general, earlier-stage businesses are more likely to require it than later-stage businesses.

An EIS manager will try to assess how likely it is that further investment may be needed before an exit can happen and what that could mean for the investment. Further rounds of investment will dilute existing shareholders' proportion of ownership but may result in an increase in the overall value of the company, either mitigating or outweighing the dilution – think about the size of the cake as well as the angle of the slice. Even if there is significant dilution, further rounds of investment may be essential if a company is going to reach the stage at which a profitable exit can be achieved for EIS investors – something that is ultimately in all investors' interests.

The legal and due diligence process

In most cases, before seriously considering a company for investment, an investment manager will want to see evidence that the company is likely to be EIS-qualifying.

An investee company will normally apply to HMRC for 'advance assurance', which is an indication that it appears to meet EIS-qualifying criteria, based on the information provided to HMRC. It is important to be aware that advance assurance does not guarantee that a company will be determined EIS-qualifying once a full application is made to issue shares under the EIS scheme.

Once advance assurance is provided, an investment manager will complete further due diligence and detailed assessment of the investment potential of a company. If it decides that it wants to invest in a company and terms have been agreed then a third party, often a corporate law firm or accountancy firm, may be employed to go through further detailed due diligence to ensure the company satisfies EIS-qualifying criteria, as laid down by HMRC, and any other requirements, whether regulatory, legal or per the terms that have been agreed between the investee company and the investment manager. If any issues are identified, the law/accountancy firm will advise on how to remedy them so that the deal can proceed. It is possible that more serious issues, which could lead to questions about the viability or desirability of making the investment, could be identified. In this case the law firm may advise that the deal should not or cannot proceed under the initially agreed terms – or that it should not proceed at all.

It is also often the role of law firms involved in this process to prepare legal documentation and contracts relating to the investment being made and to prepare and make applications to HMRC on behalf of the company raising money to ensure that the eligibility requirements of receiving investment under EIS are met.

OK, I've decided I'd like to invest. What happens now?

EIS investing involves a bit more paperwork than is usually the case with other common forms of investing, such as in stock-market-listed companies.

The application process

For their money to be invested in EIS-qualifying companies via an EIS fund, investors will typically complete an application form provided by their investment manager. Depending on whether a financial adviser has advised the investor, the form may involve the provision of information about the investor's investment experience and circumstances. The investor will also have to provide evidence of identity for anti-money-laundering purposes.

Once this form is processed, the investment sum will be transferred from the investor to the investment manager's **custodian and nominee**, usually a third-party company regulated by the **Financial Conduct Authority**.

The custodian receives and holds investors' money safely until it is ready to be invested into EIS-qualifying companies. On instruction from the investment manager, the custodian will invest the money into the specified companies and the nominee will become the owner of the shares on behalf of the investors. The custodian will receive the share certificates in the name of the nominee company, which it will hold for the life of the investment until it is instructed by the investment manager to sell the shares and return the proceeds to investors. (To qualify for EIS tax relief, the shares must have been held for a minimum of three years after the investment was made, unless the investor is claiming loss relief.)

Additional roles carried out by the custodian include investor reporting, manager communications, administration and fund accounting.

The investment process and claiming tax relief

How long will it take for my money to be invested by my investment manager and does this affect the timing of tax relief?

Most EIS fund managers aim to deploy an investor's subscription within 12 months, although a small number may take a little longer.

A small minority of EIS funds are classed as **'Approved'** by HMRC, which allows investors to claim 30% income tax relief with effect from the fund's inception date (the date on which the fundraising ends). To be classed as Approved, a fund must meet certain criteria, including that it will invest 90% of its assets within 12 months of inception. Being granted **Approved status in no way relates to the quality of the investments or investment manager and should not be taken to mean Approved funds are in any way superior in the eyes of HMRC**. It simply relates to the timing of when tax relief can be received. An investor will be able to claim EIS relief once the 90% investment threshold has been reached, and EIS relief is backdated to the fund's inception date (as opposed to the date on which individual companies in the portfolio issue shares).

‘Unapproved’ EIS funds represent the vast majority of fund options available to investors. The primary distinction between these and Approved funds is that tax relief is granted when shares are issued following an investment being made in an underlying EIS-qualifying company. Some EIS fund managers may take longer than 12 months from the point an investor subscribes to deploy all that investor’s subscription to the fund.

This gives investment managers flexibility to select investments purely on merit, because they are not under a time constraint to invest 90% of their assets within 12 months of fundraising closing. In practice, most EIS managers will seek to invest within that period, but the length of time will vary from manager to manager and from year to year, essentially based on the quality of prospective investments (deal flow) they are able to source. Somewhere between six and 18 months is a common target time period during which money will be invested, though in some cases it could take longer. When choosing an investment manager, it is advisable to ask them how long they anticipate it will take them to invest the money they have raised.

It is also worth noting that investments are unlikely to happen all at once. They are likely to be staggered and this means that tax relief in respect of Unapproved funds will generally begin to be available earlier than would be the case for Approved funds, where EIS reliefs are available only once the 90% minimum deployment threshold is reached. For example, the first 50% of their investment may be invested within 12 months of investing, with subsequent 10% sums (or greater or lesser amounts) being invested at intervals over the next six months or so. As each investment is made, investors will be able to claim income tax relief on that portion of their total investment.

The practical differences between Approved and Unapproved EIS funds are subtle and complex, so this may be an area where specialist tax advice should be sought.

When will I get the tax relief and what is the process for receiving it?

Whichever way you invest in an EIS fund or companies, it may take anything from several months to more than a year to receive the initial income tax relief on your investments.

As we have seen, if you invest in an **Approved EIS fund**, tax relief can technically be claimed with effect from the fund’s inception date, once at least 90% of the fund’s capital has been invested in EIS-qualifying companies. This may be within the year in which you invest your money, but this is in no way guaranteed. In order for investors to be able to claim tax relief, an Approved fund will issue investors with **a single certificate called EIS5**. Once this is received, an investor can make a claim to HMRC for an income tax rebate equal to the tax relief they are owed on their total investment.

The process for receiving tax relief through investing in an **Unapproved EIS fund** is similar, but there are some important differences. Instead of an EIS5 certificate, investors receive **EIS3 certificates for each of the individual companies their EIS fund subscription has been invested in**. As soon as they receive one of these, tax relief can be claimed for that particular investment. EIS3 forms will typically be sent to investors by the fund manager or their administrator.

Although the above may sound complicated, the administration process need not be a burden for anyone investing in a professionally managed fund or portfolio. Intermediaries such as financial advisers, wealth managers or accountants will be able to advise on, assist with and even undertake much of the process.

Claiming other reliefs

Capital gains relief

Provided that shares have been held for at least three years from the point of issue (or the company's commencement of trade, if later) and that income tax relief has been claimed on them, any gains arising from a disposal of those shares will be free of capital gains tax.

Capital gains deferral

EIS investments also allow investors to **defer any capital gains tax liabilities** they have accrued elsewhere in the past three years. As with EIS income tax relief, they can do this once they have received their EIS3 or EIS5 certificates.

Loss relief

Loss relief can be claimed where EIS company shares have been disposed of at a loss. This is done on an investor's personal tax return. The relief can be claimed for the tax year in which the loss was incurred or, using the 'carry back' facility available on EIS tax reliefs, for the previous tax year.

EIS tax efficiency generally

It is possible to **reduce your annual income tax liability to zero** through EIS investments, and there are ways in which the timing of investments can be managed to make EIS investing as tax-efficient as possible within the context of a wider investment portfolio and tax liabilities. These are best discussed with a financial adviser, accountant, tax professional or other suitably qualified individual.

The benefits for individuals of investing through EIS and SEIS

EIS	**30% initial income tax relief** Actual net cash outlay of 70p in the £	**CGT freedom** No capital gains tax to pay	**CGT deferral relief** Potential unlimited and indefinite deferral of an existing CGT bill	**Loss relief** Maximum exposure of 38.5p in the £ for a 45% income tax payer	**Inheritance tax relief** Potential saving of 40p in the £
SEIS	**50% initial income tax relief** Actual net cash outlay of 50p in the £	**CGT freedom** No capital gains tax to pay	**CGT deferral relief** Potential exemption of 50% of an existing CGT bill	**Loss relief** Maximum exposure of 27.5p in the £ for a 45% income tax payer	**Inheritance tax relief** Potential saving of 40p in the £

Staying on top of your investments

Once you have invested in an EIS fund, you can expect regular communications from the investment manager about how your portfolio is performing.

You are likely to receive an update each time a new investment is made, providing you with information about the company and explaining the rationale for the decision. You are also likely to receive periodic information from your investment manager about the overall progress of investing the total sum of money you have committed.

Most investment managers will provide six-monthly or annual progress reports on the underlying investments, covering notable developments and news about the portfolio companies. Typically, these will be accompanied by portfolio statements and valuation reports, which may come directly from the fund manager or via the fund administrator.

If there is a major development with a portfolio company, you may expect a one-off communication providing details and describing its significance for your investment.

Some fund managers may hold events at which investors are able to meet representatives from portfolio companies, as well as their investment managers.

In most cases, investment managers will also be able to respond to queries and questions you have after you have invested. If you use a financial adviser or wealth manager, you can expect them to be your first point of contact in such instances. If you do not use an intermediary, you can directly contact the fund manager or the company in which you have invested.

Exits

Investors can also expect communication when investments are ‘exited’. This will usually happen through a trade sale (where an acquirer buys all the company’s shares from investors, management and any other shareholders) but may be in the form of a buy-out or, more rarely, a stock market listing. In the vast majority of cases, this will be after the minimum three-year EIS holding period has passed.

EIS is a relatively high-risk area of investing, and it is likely that some investments within a fund or portfolio will fail completely or the shares will be sold at a loss. Investors will be kept fully informed of all exits, positive or negative, when they occur. As indicated on the previous page, EIS has a unique feature called loss relief, which can reduce exposure to loss to as little as 38.5p for every pound invested in an EIS company and to as little as 27.5p for SEIS companies (in both cases, assuming the value of the investment fell to £0.00 and the investor is able to relieve their loss against income taxed entirely at a marginal rate of 45%).

Planning a route to exit

When deciding whether to invest in a company, most EIS investment managers will be thinking about the most viable – and profitable – ways of selling out of it.

There is no liquid, tradeable market for EIS companies or independent or objective means of valuing them – as a stock market could arguably be described for listed companies. So finding a buyer and agreeing a price for the shares is not as simple as calling a broker or executing a trade at the push of a button.

Instead, EIS managers must carefully plan for an exit, looking at a range of possible scenarios and outcomes, and then consider what a company would need to do in order to achieve them. They will assess the sectors from which potential buyers might come, such as a trade sale to a company that operates in a similar or complementary sector or to a private equity firm or other professional or institutional investor. They will also consider which specific companies from within these sectors could be potential buyers, even though the actual sale is envisaged for several years in the future. They will also assess if a stock market flotation could be a realistic route to exit.

Preparing for exit

EIS managers will generally seek to exit an investment as soon as it is commercially viable to do so after the three-year minimum holding period for the EIS tax reliefs has passed. However, target time horizons will vary and may depend on a range of factors, including the level of return being sought, the overall economic climate and the nature of the companies in which a fund manager invests. A tech start-up with intensive research and development needed before its product or service could become commercially viable will probably take longer to exit profitably than a more mature business with a better-established product or service – though the tech start-up, if successful, may generate better returns for investors.

Preparing a portfolio company for exit will typically be one of the busiest, most time-consuming and resource-intensive periods for EIS managers since making the initial investment.

The process can in some ways be considered akin to preparing a house for sale. When a house is being sold, the vendor will take all steps necessary to maximise the chances of selling their home at the desired price. These might include redecorating it, making repairs, cleaning and tidying, preparing all the essential documentation and any other actions that will make the property as attractive as possible to potential buyers. EIS portfolio companies will be subject to a similar deep clean and tidying. Key parts of this process will include preparing the selling documents, completing legal paperwork and anticipating and making the company ready for the prospective acquirer's due diligence process. These steps are essential to help to minimise the likelihood of any issues that could result in a reduced offer price or derail the purchase completely.

Case study

pathxl
cancer detection software

Anatomy of an EIS investment

Sector: Health tech/software

Products and/or service: PathXL has developed a range of software tools intended for use in digital pathology. In particular, TissueMark analyses digitised images of tissue samples and uses algorithms to identify tumours and tumour 'hot-spots' (areas of particular concern). Presently confined to non-diagnostic applications, such as drug discovery, the software has significant potential (subject to regulatory direction of travel) to be used in diagnosing cancer.

Investment manager Par Equity invested in PathXL in 2012, having identified the investment opportunity through contacts in the life sciences and biotech sector. Par Equity supported the company through one planned and two smaller, unplanned follow-on rounds.

The investment manager's role

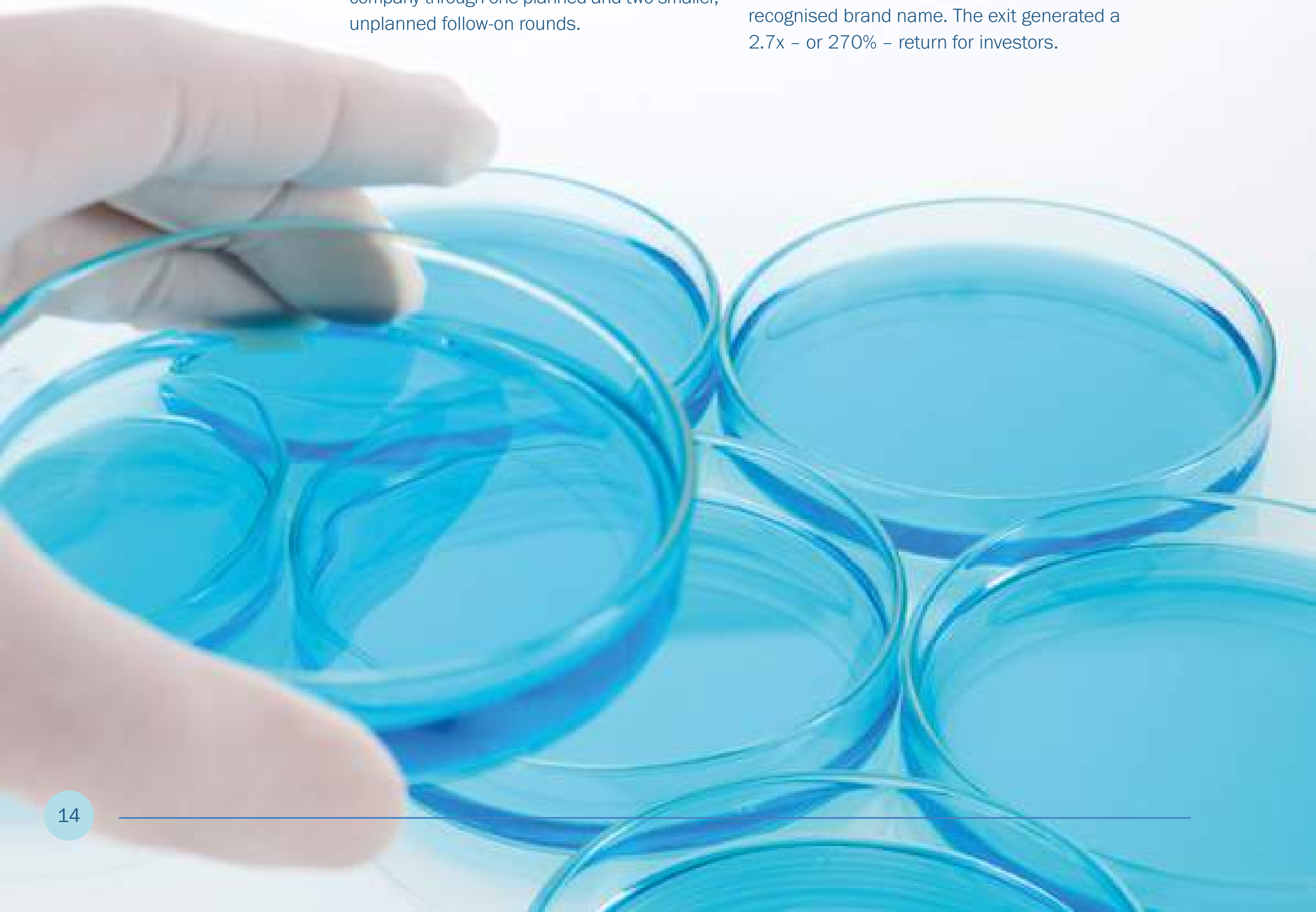
In addition to the funding it provided, Par Equity played a major part in the commercialisation process of PathXL's TissueMark software. This included providing:

- significant input at board level, including appointment of non-executive directors
- industry connections on a global basis
- technical expertise in other areas of application for PathXL's technology (e.g. the veterinary market)
- funding at key steps to bridge short-term issues and lengthen runway during exit negotiation

Par Equity's industry connections also produced the exit opportunity.

Outcome

PathXL was acquired by Dutch health technology company Philips in June 2016, providing its technology with a platform to be developed further as part of a powerful and globally recognised brand name. The exit generated a 2.7x – or 270% – return for investors.



What happens after an exit?

Once an exit occurs, investors should receive their money back relatively quickly.

After an exit occurs, an investor's EIS investment manager will write to them to confirm the terms of the exit (which will most likely have already been communicated prior to exit) and outline the process for receiving the money. Normally the fund **administrator** will arrange for the proceeds of the exit to be paid into an investor's nominated bank account.

The minimum holding period for which an investor must hold EIS shares in order to be eligible for income tax relief is three years, which usually runs from the date of issue of the shares. Exits will almost always occur only after this period is over. If an exit occurs before this time then an investor will have to repay the income tax relief they have received on the investment (loss relief will still be available if the exit results in a loss, however).

Usually exits occurring before the three-year period has been reached involve an investment that has failed, often meaning the portfolio company has gone out of business. Exceptionally, however, an EIS manager may conclude that a bird in the hand is better than two in the bush, even taking loss of EIS relief into account. For example, an opportunity to sell a company may arise where the alternative is for the company to seek significant follow-on investment to support it through a further growth phase. This follow-on investment may be difficult to attract and/or come on terms that are less than compelling to existing investors and will not in any event guarantee a successful exit at a valuation sufficiently increased as to compensate existing investors for the additional risk and elapsed time.

Reinvestment options

Should an investor wish to reinvest some or all of the proceeds of the sale of an EIS investment into another EIS fund, portfolio or individual company shares, their investment manager is likely to have further investment opportunities available. Alternatively, the investor may want to consider using another EIS investment manager or investment option. The more adventurous investor may even wish to select their own EIS-qualifying companies in which to invest, perhaps via a crowdfunding platform.

Those who are considering reinvesting may benefit from professional financial and tax advice to make them aware of the tax implications, if any, of making – or not making – further EIS investments.

EIS example

£10,000 investment split equally across 10 companies

Net cost of investment after intial EIS income tax relief = £7,000

Two companies perform very well and quadruple their value
£8,000

Two companies perform reasonably well and double their value
£4,000

Two companies return the money invested
£2,000

Four companies fail completely and the investment is worthless – loss relief can be claimed on the £4,000 invested

Assuming the investor is a 45% tax payer, loss relief amounts to £1,260

Total return to investor is £15,260, for a net investment of £7,000

**This is purely for illustrative purposes and should in no way be viewed as representative of how a real EIS fund investment is likely to perform. Some portfolios may perform better and some may perform worse than in this example.*

Questions to ask your EIS manager

Most people will invest using an EIS investment manager. As when choosing any provider, it is useful to identify a number of prospective candidates and ask them questions about their service, track record and cost, so you can make a more informed choice about which one to use. Several companies now provide independent reviews, which may also be useful.

Below are some suggested questions that you might wish to ask in obtaining information from an EIS investment manager. They may help you in making a decision about whether to invest.

- ☐ Has the manager and/or fund been reviewed by an independent analyst?
- ☐ Is the scheme operated as a fund, in which the investment manager has total discretion over the investments made on behalf of investors, or does it take more of a portfolio-style approach, where the investor and/or adviser can choose from a list of potential investments?
- ☐ Can the manager give you aggregate performance figures, net of fees?
- ☐ Do they have details of past individual exits, holding periods, the gains and losses generated and the proportion of successes/failures?
- ☐ In what time period would the manager aim to invest your money?
- ☐ What is their average holding period for an S/EIS investment?
- ☐ How common is follow-on investment in their portfolio companies?
- ☐ What is the fee structure?
- ☐ Can they outline their investment process, philosophy and investment selection criteria?
- ☐ Does the manager specialise by sector or geographic region or focus particularly on start-ups or more mature, established businesses?
- ☐ Do the investment team members invest their own money into portfolio companies?
- ☐ What is the team's background and experience in the sector?
- ☐ What is the manager's corporate history?

If you would like to know more about investing through the Enterprise Investment Scheme or Seed Enterprise Investment Scheme you can visit the EIS Association's website, www.eisa.org.uk, where you will be able to find a wide range of information and contact details for the association and its members, including investment managers.

This guide's sponsors

A number of EIS Association members have sponsored the production of this guide. We have acknowledged their contributions here by way of thanks and to highlight the breadth and depth of expertise offered by our membership.

Hardman & Co.

Founded over 20 years ago, Hardman & Co provides research, analysis, valuation and advisory services to public and private companies.

A few years ago, at the suggestion of EIS Association, we expanded into the tax enhanced market, undertaking reviews to enable advisers to select products for their clients with confidence. The sector expertise of our team of over 15 analysts enables us to offer a unique insight into specialist markets.

We have developed our service to include education for advisers on tax enhanced products and the production of product panels that are geared to the client profile of advisory firms.

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Mainspring

Mainspring provides dependable, high-quality fund services to EIS funds and small-to-medium-sized private equity and venture capital managers in the UK. We are regulated to provide nominee and custodian services for EIS fund managers and authorised to handle the cash and assets of EIS fund investors.

Our service is designed to grow with our clients' offering and adapt to their evolving requirements. We take care of the time-consuming administrative components of fund management and fit in with our clients' schedule to allow them to focus on their own growth. Our administration infrastructure is built upon industry-standard software that is a proven tool for managing and recording business and accounting transactions of funds and enables us to provide our clients and their investors with accurate, timely and well-presented information.

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Par Equity

Par Equity, founded in 2008, is an Edinburgh-based venture capital firm formed specifically to address the particular requirements of investment in small, high-growth-potential companies. Our focus is on innovation, and we seek out companies that are doing things in new and better ways. This could be doing business more quickly, more efficiently or in a new context.

Through the Par Syndicate and the Par Syndicate EIS Fund, Par Equity aims to be a leading investor in its market niche, capitalising on its network of industry experts. Specifically, we are able to access people within our network who can add valuable perspective to our assessment of the commercial rationale for our investments. This resource adds significant value to investee companies and is a major factor in mitigating the risk associated with this stage of investment.

Contact:
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Shoosmiths

'Highly Commended' in the Best EIS/SEIS Legal or Regulatory Adviser category at the 2016 EISA Awards, Shoosmiths LLP has an extremely strong track record in advising all types of investors and investee companies on EIS and SEIS-qualifying investments and has dedicated teams of tax and corporate lawyers who advise on EIS investments week in, week out.

Shoosmiths is one of the most active UK law firms in the area of tech start-ups, acting for founders, investors, funders and research organisations that look to the firm for advice on EIS and SEIS tax, intellectual property and commercialisation.

The firm is one of the few full-service law firms in this sector to have a national presence in the major markets of London and the South East, Thames Valley, the Midlands and the North-West, giving its clients the benefits of accessibility, strong market connections and fresh thinking.

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