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BLACKFINCH
VENTURES

Using EIS Carry Back to Reduce Previous Income Tax Bills

Please note: *Benefits of tax-efficient investments are subject to change and personal circumstances.*

Scenario

A key aim for many high-earning clients is to reduce their income tax bill. A tax-efficient investment such as an Enterprise Investment Scheme (EIS) enables an individual to reduce their income tax for both the current and/or previous tax year.

Take a look at Alan's situation. He's a self-employed business coach who on average, pays £30,000 income tax every year. Alan has a lump sum of £150,000 that he would be comfortable investing in a tax-efficient product to mitigate his income tax bill. As a sophisticated investor, Alan is prepared to assume a higher level of risk on his investment. As a result, he's comfortable with investing in EIS-qualifying companies, when his adviser suggests it.

Income Tax Bill
£30,000

Solution

Alan and his adviser plan for him to invest £150,000 into a portfolio of EIS-qualifying companies. This will allow Alan to claim income tax relief on 30% of the initial investment. Moreover, investors can 'carry back' this relief to the previous tax year. In Alan's case, it means he can claim 100% income tax relief on last year's bill and also significantly reduce his current bill.

Investment into an EIS Portfolio
£150,000

Steps

Alan's adviser selects an EIS portfolio from an established provider. The provider charges a portfolio establishment fee of 3%, and invests in ten companies. The establishment fee for his £150,000 EIS investment will be £4,500, which is not eligible for income tax relief. Alan can claim income tax relief of 30% on the remaining £145,500, which equals £43,650. Once Alan receives the EIS3 certificates from the EIS provider, he can contact his local HMRC office and claim income tax relief or use the form to complete his Self Assessment tax return.

Income Tax Relief
£43,650

By using the 'carry back' available, Alan can claim full income tax relief on the £30,000 paid in the previous tax year. He can then use the remaining available income tax relief (£13,650) to reduce his current year's income tax bill from £30,000 to just £16,350.

	Previous Tax Year	**Current Tax Year**
Income Tax	£30,000	£30,000
EIS Investment	£0	£150,000
Fees (3% of investment)	£0	£4,500
Investment after Fees	£0	£145,500
Income Tax Relief	£30,000	£13,650
Adjusted Income Tax	£0	£16,350

The example is for illustration purposes only.
Income tax relief is subject to HMRC approval of each underlying investee company.
There is no guarantee that the investee company will remain EIS qualifying at all times after the initial investment, or that EIS tax reliefs will continue to be available to investors.

IMPORTANT INFORMATION

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Risks

Due to the potential for losses, the Financial Conduct Authority (FCA) considers this investment to be high risk.

What are the FCA key risks?

1 - You could lose all the money you invest
If the business you invest in fails, you are likely to lose 100% of the money you invested. Most start-up businesses fail.

2 - You are unlikely to be protected if something goes wrong
Protection from the Financial Services Compensation Scheme (FSCS), in relation to claims against failed regulated firms, does not cover poor investment performance. Try the FSCS investment protection checker (https://www.fscs.org.uk/check/investment-protection-checker).

Protection from the Financial Ombudsman Service (FOS) does not cover poor investment performance. If you have a complaint against an FCA-regulated firm, FOS may be able to consider it. Learn more about FOS protection (https://www.financial-ombudsman.org.uk/consumers).

3 - You won't get your money back quickly
Even if the business you invest in is successful, it may take several years to get your money back. You are unlikely to be able to sell your investment early.

The most likely way to get your money back is if the business is bought by another business or lists its shares on an exchange such as the London Stock Exchange. These events are not common.

If you are investing in a start-up business, you should not expect to get your money back through dividends. Start-up businesses rarely pay these (https://www.financial-ombudsman.org.uk/consumers).

4 - Don't put all your eggs in one basket
Putting all your money into a single business or type of investment for example, is risky. Spreading your money across different investments makes you less dependent on any one to do well.

A good rule of thumb is not to invest more than 10% of your money in high-risk investments (https://www.fca.org.uk/investsmart/5-questions-ask-you-invest).

5 - The value of your investment can be reduced
The percentage of the business that you own will decrease if the business issues more shares. This could mean that the value of your investment reduces, depending on how much the business grows. Most start-up businesses issue multiple rounds of shares.

These new shares could have additional rights that your shares don't have, such as the right to receive a fixed dividend, which could further reduce your chances of getting a return on your investment.

If you are interested in learning more about how to protect yourself, visit the FCA's website (https://www.fca.org.uk/investsmart).