Making EIS investments for income tax relief

Ian is a doctor earning over £100k per annum and has reached his pension lifetime allowance, meaning any further contributions will be heavily taxed.

- He has significant wealth within pension & ISA and uses the allowances for both each year.
- He has a significant 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 an allocation of venture capital growth assets.

Ian would like to explore tax-efficient investments to mitigate his income tax bill, whilst saving for his retirement.

After assessing Ian's attitude to risk, investment goals and capacity for risk, Ian's financial adviser suggests EIS to manage his income tax liability

The adviser lays out the following approach, which aims to reduce Ian's income tax bill and create a significant tax-efficient asset to supplement his pension.

Ian realises with EIS there may be significant falls in the value of these investments, but nonetheless would like his capital to outpace inflation and with the potential to achieve better long-term returns.

After five years, he should expect a regular flow of sale proceeds, which he could reinvest and create a self-perpetuating investment, with additional tax benefits.

This investment strategy would reduce Ian's income tax liability by £60k over five years, and create a rapidly growing asset, which after ten to twelve years could be valued at £600k* including tax reliefs.

Year 1	Year 2	Year 3	Year 4	Year 5
£40,000 Mercia EIS investment	£40,000 Mercia EIS investment	£40,000 Mercia EIS investment	£40,000 Mercia EIS investment	£40,000 Mercia EIS investment
+	+	+	+	+
£12k tax relief @ 30%	£12k tax relief @ 30%	£12k tax relief @ 30%	£12k tax relief @ 30%	£12k tax relief @ 30%

A total EIS investment of £200k creates a portfolio valued at £600k* after 10-12 years, including income tax and loss relief, but excluding any reinvestment.

EIS and income tax

The maximum investment for income tax is £1m in any tax year or £2m if the additional goes into Knowledge-intensive companies.

The investment must be deployed in either the current or the subsequent tax year to the income tax.

E.g. For income tax incurred in the tax year 2022/23, the EIS investment must be deployed in the 2023/24 tax year or 2022/23.

To use an EIS for income tax relief, investors must hold their shares for a minimum of three years.

Mercia aims to triple invested capital, including tax reliefs, over five to seven years.

* assuming 3x Mercia growth target is achieved

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

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

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

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

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

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

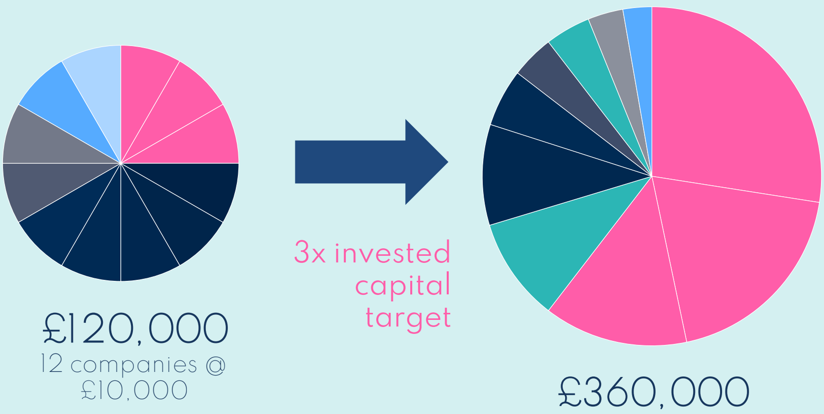
Tax incentives available

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

Tax-free growth and downside protection

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

Mercia EIS model portfolio*



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

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

Risk warnings

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