Enterprise Investment Scheme

A Private Investing Guide

Newable

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Introducing EIS

Investing in unquoted, early stage, technology-led businesses is inherently risky. The companies are typically small. Many may be pre-revenue. Most will not be turning a profit. The invested capital is tied up for many years. The eventual exit is uncertain.

As a result, this asset class tends to be outside the remit of institutional investors. Meanwhile banks find it all but impossible to support businesses with few tangible assets, a steady track record or recurring revenues.

The result is over and unsustainable reliance on funding from 'friends and family' with many potentially really exciting and innovative British businesses never going to realise their commercial potential. A pity for them and the wider UK economy.

This fundamental and very real funding problem has been termed 'the patient capital gap'. It is a gap long recognised by the UK Government. The Enterprise Investment Scheme (EIS) was introduced by the Government precisely with the goal of addressing it.

The premise is simple. The UK Government wants to boost investment in early stage businesses and encourages this through a combination of tax reliefs and tax-breaks.

The EIS fulfils a vital function, encouraging private investment into emerging and dynamic British businesses, fuelling the entrepreneurial heart of private enterprise. The premise is simple. Inevitably, with tax related matters, the application of the measures can seem complex to many. However, the fact remains that it is a highly successful long running scheme that works for both British businesses and British investors.

Over 26,000 companies have received investment through the scheme and over £16.2 billion of funds have been raised since its launch in 1994. HMRC data for 2015-16 shows that 3,470 companies raised a total of £1.88 billion under the EIS scheme. As a direct result of the scheme, the UK is the largest market for early stage investment in Europe, second only to the United States in the world.

Over 26,000 individual companies have received investment through the scheme, and over £15.9 billion of funds have been raised.

The Seed Enterprise Investment Scheme (SEIS) was introduced in 2012 to complement EIS and is intended to recognise the particular difficulties faced by very early stage companies in attracting investment. SEIS offers tax relief at a higher rate than that offered by EIS. HMRC rules govern which companies and investments qualify.

The Enterprise Investment Scheme has, over many years, become a cornerstone Government policy for stimulating enterprise and innovation.

New Rules.
New opportunities.

In 2017, the UK Government established a working group to examine the challenges faced by early stage businesses in accessing investment. It was called The Patient Capital Review. A broader, public consultation called Financing the Growth of Innovative Companies was also undertaken. Whilst the terms of reference for both initiatives were broader than simply the merits of EIS, both inevitably considered EIS closely as a key part of the funding mix. Newable provided considerable input into both work streams.

Following a consideration of the evidence presented, the Chancellor Philip Hammond announced a number of measures as part of the Autumn Budget. Firstly, and this turned out to be contrary to a number of rumours that were reported in the media, the Government made a clear statement in support for the role played by EIS. The scheme far from being under threat, is set to remain a key part of Government policy.

The Budget recognised the importance of the EIS to the funding of early stage technology businesses and announced measures designed to encourage more private investment into qualifying companies.

Investors and investees have been reassured both by the clarity provided by the Chancellor as to the future of the schemes and by a number of positive measures that have been introduced. The limit of EIS funding a company can raise has been doubled from £5m to £10m in a year. Individuals will now be able to invest up to £2m in EIS companies in a given tax year.

At the same time, The Treasury also renewed a focus on risk-taking investments. In his Budget Statement, the Chancellor said he would “ensure that EIS is not used as a shelter for low-risk capital preservation schemes”. This statement reflected a body of evidence that EIS investment vehicles were being used to support the launch of a range of enterprises such as coffee shop franchises, pubs and even crematoria. Each of these businesses are based on established and proven business models and should, all things being equal, attract investment without the need for additional tax incentives. Philip Hammond’s commitment was to return EIS to unlock support for businesses founded on new or emerging technologies, which was its original purpose. The Chancellor described this cohort as Knowledge Intensive Businesses.

Knowledge Intensive Businesses

As ever, the devil was left to the detail. Whilst the Chancellor described the cohort, the HM Treasury and HMRC is producing the working definitions. In January this year, Newable was invited to meet both HMT and HMRC to discuss the practicalities of the definitions at a roundtable along with the UK Business Angels Association and others. The challenge is to strike a balance between respecting the purpose of the EIS scheme and the practicalities of a workable and not overly restrictive definition.

Again, we have been encouraged by the reasonable approach adopted by all parties. There is a clear consensus around Knowledge Intensive Businesses. They may be companies that have recently created, are in process of creating, or preparing to create intellectual property that will form greater part of business activities within next 10 years. Companies where a significant proportion of cost can be identified as clearly being research and development. Companies where a significant proportion of staff is highly technically skilled or assigned to R&D activities. The final regulations will be published soon.

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Newable specialises in what are now called "4th Industrial Revolution" businesses. Businesses that have been enabled by the rapid advances in science and the confluence of technologies which is creating new opportunities in Artificial Intelligence, Space, Med Tech and so on. Being one of the most active and best established angel networks in the UK, Newable has developed deep sector experience as well as one of the most evolved deal flow ecosystems.

Understanding the potential of these businesses is, of course, a much more complex prospect than understanding a coffee shop franchise for example. This why Newable runs a number of investor workshops across the year featuring sector leading figures which provide investors with a strong grounding in these emerging sectors.

The Government has nailed the country's economic future firmly to the technology mast. The ongoing development of the Industrial Strategy recognises that technology will transform economies in the coming years. It identifies knowledge intensive sectors where the UK is already amongst the world leaders (Space tech for example) and made clear commitments to support the development of other sectors where we are highly competitive such as Med Tech and AI with sector deals.

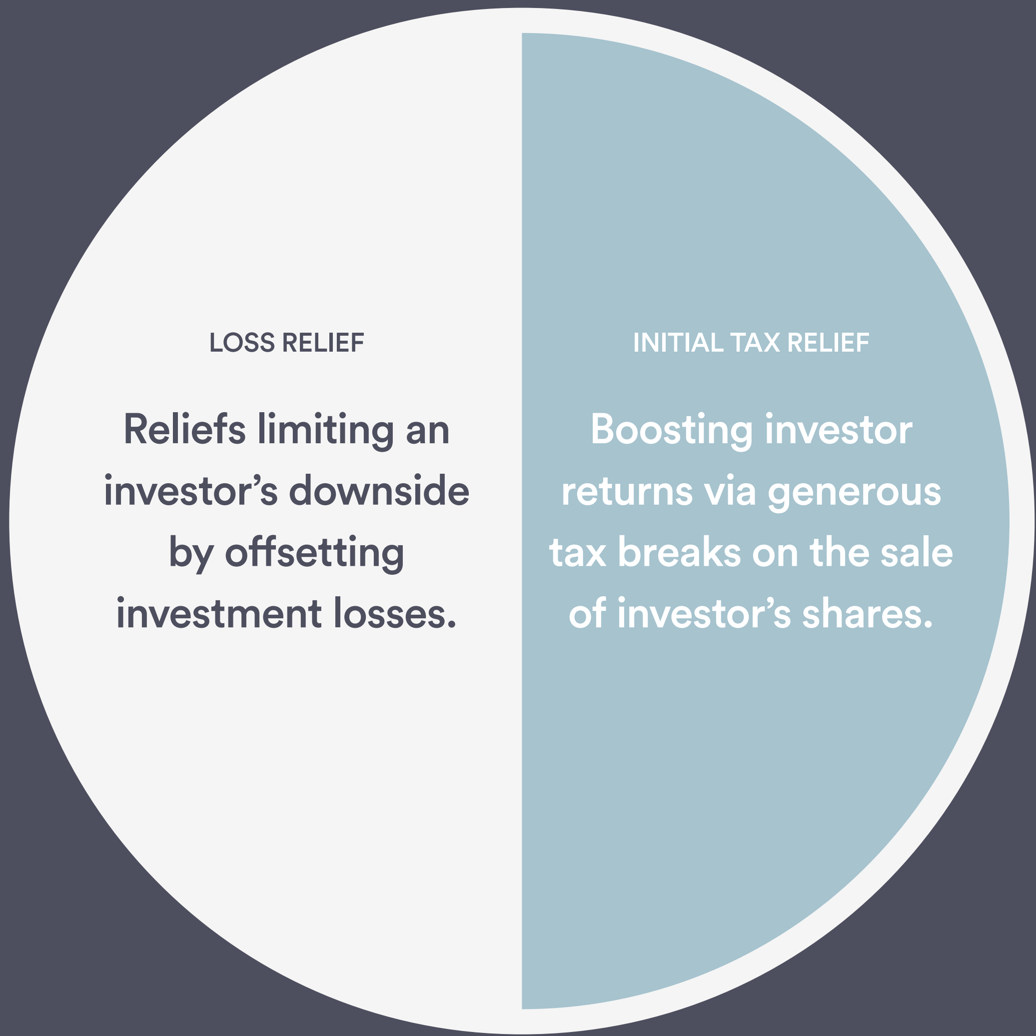
Early stage (angel) investors still have a vital role to play in providing Knowledge Intensive Businesses with the backing they need to help them realise their potential and scale. In so doing they make a contribution towards creating a globally competitive economy for the UK and rewarding and high quality jobs for people living here. In return for being prepared to take a risk and give something back, sophisticated high net worth investors can now potentially benefit from enhanced tax incentives. EIS is the catalyst.

How EIS works

EIS is designed to promote investment in risky early stage businesses. It does this by uncapping the upside gain and limiting the potential downside loss for investors.

If an EIS-qualifying company is sold for a profit, the gains should be tax-free. By contrast, if the company fails but EIS reliefs remain intact, a higher rate tax payer will only lose 38.5% of the amount they invested.

Therefore, EIS investors need to consider the following two key concepts; loss relief and initial tax relief.*



*EIS claims are subject to an individual's personal position and professional advice should be sought where necessary.

EIS investing promotes investment in exciting UK companies. However, investment in EIS-qualifying companies also brings UK taxpayers a range of tax benefits. Investors considering an EIS investment should take professional advice on all of the taxation matters set out below before deciding on whether to invest.

UNLIMITED CAPITAL GAINS DEFERRAL

Capital gains tax liabilities from other investments can be 100% deferred to the EIS investment for the life of the investment. This applies to gains arising within 36 months prior to and 12 months following an Investment in the Fund.

INCOME TAX RELIEF

Up to 30% of invested monies in EIS eligible investments can be claimed back provided the monies stay invested for at least three years. This is limited to £2,000,000 invested in a tax year. This relief may be carried back to the previous tax year.

LOSS RELIEF

Losses realised on EIS investments can in certain circumstance be offset at the highest income tax rate of the investor. This means that investors could potentially lose only 38.5% of initial capital inputted. That applies to either income subject to income tax or capital gains subject to capital gains tax rates.

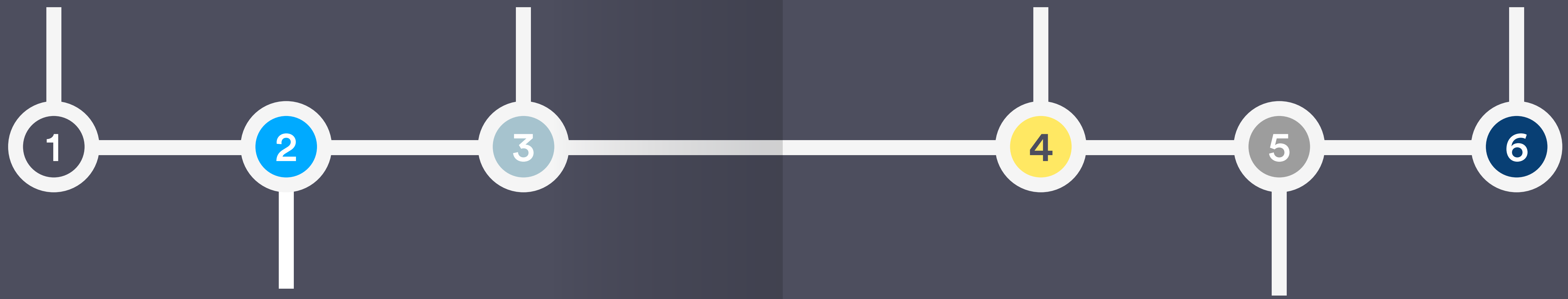
INHERITANCE TAX EXEMPTION

Money invested into EIS-qualifying companies will normally be exempt from inheritance tax as long as the EIS shares held at death have been owned for at least two years.

EIS relief can be claimed on your tax return or by writing to HMRC.

HOW EIS WORKS

Making an investment: Step by step



Application

You will need to complete the online application form via our Administrator and Custodian's portal. A custodial account will be created in your name and you will be able to transfer funds into your account.

Opportunies Shared

You will receive an investment pack for each company that we invest in, which will provide more information about the company, the transaction and our investment rationale.

EIS 3 certificates

We will complete the paperwork required for you to obtain an EIS3 certificate. This form is required by the HMRC in order to claim tax relief on your investment. The EIS3 Forms are usually issued out 2 to 4 months after each investment is made.

Claim tax relief

Once your EIS3 form is received, you will need to complete and submit to HMRC in order to defer Capital Gains tax payable on relevant gains and/or claim income tax relief against tax paid in the current or previous year.

Investment reported

The progress of the company in which you invested will be regularly reported to you. Additionally, the shares in your portfolio will be valued twice a year using International Private Equity and Venture Capital Valuation Guidelines. You will receive valuation and cash statements, and a performance report.

Investment exit

On exit all net proceeds will be transferred to your custodial account.

EIS investment tax illustrations

We have provided a simple overview of how the EIS scheme works for a higher rate tax payer (45%) under three returns scenarios. Ultimately, EIS investors need to consider the following two key concepts. For a 45% taxpayer, losses on eligible EIS investments are capped at 38.5%. In terms of gains, for Qualifying Investments there is no CGT payable upon exit once the shares have been held for three years. Investments are IHT exempt once they are held for a minimum of two years at the time of death.

HOW EIS WORKS

Investment	Fails	Break Even	Returns 3 x capital
Initial Investment	£10,000	£10,000	£10,000
30% initial tax relief (occurs in the year of investment)	£3,000	£3,000	£3,000
Net investment	£7,000	£7,000	£7,000
Investment Performance	Company fails at any point after investment	Company is sold after a three-year holding period for £10,000	Company is sold after a three-year holding period for £30,000
Loss relief (occurs in the year of failure only)	£3,150 additional tax relief on initial investment	None	None
Return breakdown	Loss of £3,850 after loss relief plus initial tax relief 30%	Profit on investment of £0 plus £3,000 from earlier tax relief	Profit on investment of £20,000 plus £3,000 from earlier tax relief
Total Invested	£10,000	£10,000	£10,000
Cash receipts from sale	£0	£10,000	£30,000
Total loss/profit	-£3,850	£3,000	£23,000
CGT Relief Min 3 year holding	n/a	n/a	100%
IHT relief Min 2 year holding	n/a	100%	100%

The above illustration assumes the investor is eligible to claim both the initial tax relief, loss relief and that the terms of the EIS are have been met.

Example EIS returns

Scenario 1

Portfolio Companies	A	B	C	D
Investment	£25,000	£25,000	£25,000	£25,000
Income tax relief (30%)	£7,500	£7,500	£7,500	£7,500
Net cost of Investment	£17,500	£17,500	£17,500	£17,500
Multiple	0x	0x	0x	2x
Return	-	-	-	£50,000
Loss relief*	£7,875	£7,875	£7,875	-
Return from Investment/Loss Relief	£7,875	£7,875	£7,875	£50,000
Portfolio				
Net cost of investment				(£70,000)
Total return				£73,625
Net profit				£3,625
Return as a% of capital outlay				5%

* Assumes a 45% tax rate and rules of HMRC EIS eligible investments are met

For example, an individual, who pays the highest marginal tax rate (45%), decides to invest £100,000 within a fund with four portfolio investee companies. These investments are held for the minimum three year period, and the individual receives a 30% income tax relief in respect of each investment.

Based on currently enacted tax rates and legislation, if three out of four companies fail, yet one returns a 2x, the overall portfolio returns 5%. For a 45% taxpayer, losses on investment are capped at 38.5%. In terms of gains, there is no CGT payable upon exit once the shares have been held for three years.

HOW EIS WORKS

Scenario 2

Portfolio Companies	A	B	C	D
Investment	£25,000	£25,000	£25,000	£25,000
Income tax relief (30%)	£7,500	£7,500	£7,500	£7,500
Net cost of Investment	£17,500	£17,500	£17,500	£17,500
Multiple	2x	3x	4x	0x
Return	£50,000	£75,000	£100,000	-
Loss relief*	-	-	-	£7,875
Return from Investment/Loss Relief	£50,000	£75,000	£100,00	£7,875
Portfolio				
Net cost of investment				(£70,000)
Total return				£232,875
Net profit				£162,875
Return as a% of capital outlay				233%

* Assumes a 45% tax rate and rules of HMRC EIS eligible investments are met

Following Scenario 1, if three of the four companies return, 2x, 3x and 4x respectively and one completely fails, the portfolio will return 233%. Again, there is no CGT payable upon exit once the shares have been held for three years. In both scenarios, Investments are IHT exempt once they are held for a minimum of two years at the time of death.

The Scenarios presented above are for purely illustrative purposes and based on currently enacted tax rates and legislation. They should not be relied on to predict actual returns. They should not be considered as an indication of the future performance of investee companies in which the Fund will invest. All fees expenses and carry have been excluded from the calculations for simplicity. Fees and carry will reduce the return on investment.

Managing risk

Investors should be fully aware of the highly risky nature of this type of investment. The taxation summary should not be viewed as constituting tax advice. If in any doubt whatsoever, Investors should not consider subscribing. In any case, it is strongly recommended that Investors seek the advice of their financial adviser or other appropriately qualified professional.

Early stage investing is risky. The risks arising from each EIS investment will be different, and should be explained to you in the marketing literature. However, there are a number of common risks that should be considered carefully.

EIS companies are often dependent on a few key executives. Any changes to the leadership team can have a big impact on the success of the company. The company may not, for whatever reason, be able to achieve its stated goal. Your investment is also at risk of risk of dilution if the investee company issues more shares in future funding rounds. Prevailing tax regimes may change which could lead to a loss of reliefs. As you will be investing in unquoted companies, the shares may be difficult to sell. It is always possible that your investments may fail or be sold at a substantial loss. Finally, past performance is not an indication of likely future performance.

It is therefore important to view an EIS as a medium to long-term investment.

In light of this, an investor may opt to create a diversified portfolio of EIS companies of their own choosing or invest in a Fund. Both approaches lays risk across a number of businesses.
The best way to demonstrate how Fund investment combined with the EIS scheme can bolster returns is to consider the following scenario where the Fund invests equal amounts in five companies. After three years, four of them fail with one company achieving an exit of 3x investment. Without the EIS scheme, such performance would result in a significant loss of £20k for a given Investor. However, once tax reliefs are considered, the total fund performance is a net return of £7,600 on a total investment of £50,000. In percentage terms, the EIS scheme is the difference between a 15% return and a 40% loss on Investment. Please contact us for more information about the Newable Ventures EIS Fund.

Many have recognised that by investing in a Fund, investors are able to diversify their risk through exposure to a wider portfolio of companies.

Summary

The Enterprise Investment Scheme is a genuine British success story. Running continuously since 1994, it has helped foster the larger early stage investment market in Europe, second only to the United Stated, globally.

It is good for British business – providing a source of vital capital and promoting the next generation of significantly economically productive enterprises. It is also good for investors for whilst such early stage investments always carry risk, the scheme provides for a number of reliefs and breaks that serve to offer some counterbalance.

The EIS is a successful scheme encouraging long term equity funding in early stage, British knowledge intensive companies by offering significant tax incentives to investors.

Newable is a long term, leading and innovating player in early stage investment with access to one of the UK's most comprehensive deal flow ecosystem. Newable has over thirty years experience of helping companies start out and scale up through a range of business services.

Should, after careful consideration, you feel that EIS Investment could play a role in your personal investment strategy, then we look forward to the opportunity of helping you meet your goals.

For more information about our funds visit www.newable.co.uk/private-investing.

Investment Key Risks

Your capital is at risk. Investing in early stage companies involves risks including loss of capital, illiquidity, lack of dividends and dilution. Equity investments made via Newable Capital, Newable Ventures, and Newable Private Investing should be considered as part of a diversified portfolio. Past performance is not a predictor of future performance. Neither Newable Capital, Newable Ventures, or Newable Private Investing give tax or investment advice. The availability of tax relief depends on individual investors' circumstances, and on investee companies' qualifying status, both of which may be subject to change.

Investment Risks

Investing in shares, especially shares in small and early stage companies, is an inherently risky process. Below we provide a summary of the major risks and considerations you should be aware of:

Potential for Loss

An investment in shares (equity) does not guarantee that your money will be returned to you. Many small, early stage businesses fail, and if a business you invest in fails, neither that company nor Newable Ventures or Newable Private Investing will pay you back your investment. You are strongly advised not to invest more than you can afford to lose.

Diversification

Diversification – which means spreading your money across a wide variety of investment types – is an important way to reduce the overall risk of investing. Don't put all your eggs in one basket. Investors should not invest more than 10% of their investable assets in shares in early stage companies.

Lack of Liquidity

It is highly unlikely that you will be able to sell your shares quickly or easily. Shares in companies marketed via Newable Private Investing or invested in through Newable Ventures' EIS and/or SEIS Funds are unlikely to be traded on stock markets. You should be prepared to wait until, if it is, the whole company is sold, or floated on a stock market to sell your shares.

No Regular Income

Businesses marketed at Newable Private Investing events or invested in by Newable Ventures' EIS and/or SEIS Funds, are generally not yet profit-making, or will choose to spend all their profits on growing the business. This means that you are unlikely to receive regular distributions of profits through dividends, so you are unlikely to receive any return on your investment unless you are able to sell your shares.

Uncertain performance

The majority of companies marketed at Newable Private Investing events or invested in by Newable Ventures' EIS and/or SEIS Funds are early stage companies, which lack significant trading or operating history. The success of these companies is uncertain and depends upon the ability of their management team to implement a strategy for growing the business. A company's campaign page may contain estimates of anticipated performance, which are based on assumptions which may or may not prove to be correct.

Conflicts of Interest

Newable Ventures, Newable Private Investing or one of their Directors or employees may already hold shares in a company being marketed at one of Newable Private Investing's events, or being considered for investment by one of Newable Ventures' EIS and/or SEIS Funds. In addition, they or one of its Directors may also have a previously existing business relationship with a company being either considered for investment by a Newable Ventures Fund or presenting at a Newable Private Investing investment Event

Dilution

Any investment you make may be subject to dilution in the future. This happens when a company needs to issue more shares, in order to raise more money or incentivise staff. This means that the proportion of the company you own may be reduced, or 'diluted' over time. New shares issued by the company may also carry preferential rights to those acquired by you, meaning that payments such as dividends might get made to them first. (often the shares you purchase will come with 'pre-emption rights', which allow you to purchase more shares before they are made available to new investors, to reduce the effects of dilution.)

Tax Treatment of Shares

The UK government provides certain types of tax relief for investments in small businesses. While Newable Ventures and Newable Private Investing encourage businesses to apply for these tax reliefs (such as EIS and SEIS reliefs) where appropriate, the final decision on whether the company and investment is eligible is made by HMRC after the investment is completed. Eligibility for tax relief may also be lost due to your personal circumstances, or due to changes in the company's activities or circumstances. If you are unsure about any of the risks or warnings set out above, we recommend you seek advice from an Independent Financial Advisor.

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