

For information on our EIS offerings please
contact your financial adviser or
call Octopus today on 0800 316 2298

GUIDE TO ENTERPRISE INVESTMENT SCHEMES (EIS)

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WHAT ARE ENTERPRISE INVESTMENT SCHEMES (EIS)?

An EIS is a Government initiative designed to encourage private individuals to invest in Britain's smaller companies. To achieve this, the Government offers EIS investors a range of compelling tax reliefs.

There are two types of EIS funds:

- Approved - these are pre-approved by HMRC, which means income tax relief can be claimed from the closure date of the fund
- Unapproved - income tax relief can only be claimed when the actual underlying investments are made

WELCOME

Enterprise Investment Schemes offer a simple and effective solution to individuals looking to defer (and potentially reduce) a capital gain whilst significantly reducing their income and inheritance tax liabilities.

Since its establishment in 2000, Octopus has built a reputation for creating innovative and successful investment solutions that meet the needs of individual investors. We now have over 18,000 customers across our range of products and we're doubling our funds under management every year.

I hope that you find this guide clear and easy to understand. We always recommend that you seek independent financial advice before you invest, but if you do have any questions - or if it would help to speak to one of the fund managers - please call us on **0800 316 2298**.

A handwritten signature in black ink that reads "Simon Rogerson".

Simon Rogerson
Chief Executive

TAX ADVANTAGES

The EIS tax advantages provide investors with a significant head start in comparison to more traditional investment products.

Provided the underlying investments made by the EIS are held for at least three years, there are four separate tax advantages:

- 100% capital gains tax deferral for the life of the investment
- 20% upfront income tax relief
- Up to 40% loss relief on any holdings that fall in value
- 100% inheritance tax relief after two years (provided the investments are held at time of death)
- Unlimited tax-free capital gains deferral on amount invested within three years of the original gain

Full use of these tax advantages will depend on individual circumstances. If you're unsure of your own potential tax liabilities, you should seek professional advice from a qualified tax adviser. Please remember that tax rules and regulations are subject to change.

TAX ADVANTAGE ONE - CAPITAL GAINS TAX DEFERRAL

If you've made a capital gain that is taxable, it can be invested into an EIS and the capital gains tax that was payable will, under current legislation, be deferred for the life of the investment. You should note that:

- For unapproved funds capital gains tax deferral will apply as and when the investments into qualifying companies are made
- The proceeds must be invested into qualifying companies within three years from the date the gain was realised (ie you can even reclaim tax you have already paid)
- If you die while your money is invested, the tax due on your capital gain will die with you

What's more, the recent change to capital gains tax rates announced by the Chancellor has made EIS structures even better for investors. So investors who have realised a capital gain at 40% during the last three years can now invest in an EIS, knowing that when they come to sell their EIS investment, the tax rate on this gain will have fallen from 40% to 18%. Combined with the 20% income tax relief, this provides investors with the potential for tax relief equal to 42% of the amount they invest.

FINANCIAL SCENARIOS

TAX ADVANTAGE TWO - INCOME TAX RELIEF

Under current legislation, 20% income tax relief is granted on qualifying investments made, up to a maximum of £500,000 per tax year. In order to retain this relief, the investment must be held for three years. This tax relief is available as and when the money is invested into portfolio companies, unless the investment is through an approved fund, in which case it is generated on the fund closure date.

TAX ADVANTAGE THREE - LOSS RELIEF

Loss relief is one of the most compelling features of an EIS and significantly improves the overall post-tax risk/return profile of the investment. The reason that loss relief is so beneficial is that each individual holding within a portfolio is assessed separately for this relief.

This means that any individual holding that has fallen in value at the time of sale will qualify for loss relief, irrespective of the overall portfolio performance. Even if only one holding within a portfolio of ten investments falls in value, you would be entitled to loss relief on that one holding. Loss relief is defined as the tax that you can claim back, should your investment fall below the 'effective' cost of that investment (the effective cost of your investment is equal to the amount invested less the upfront income tax relief). It is calculated at your marginal tax rate (ie up to 40%).

TAX ADVANTAGE FOUR - INHERITANCE TAX RELIEF

On death, investments made by the EIS will qualify for 100% exemption from inheritance tax under current legislation, provided the investments have been held for at least two years. This two-year period applies from the date the money is invested into qualifying companies.

TAX ADVANTAGE FIVE - TAX FREE GROWTH

Where gains arise from holdings within the portfolio, there is no capital gains tax (provided the investment has been held for at least three years).

The following case studies are designed to demonstrate how this product can be applied to a variety of client situations. In each scenario, we demonstrate the gain the client would have to make in an alternative structure to achieve the same result as the EIS.

All scenarios assume either a strong return on investment (60% growth over three years), moderate return (10% growth over three years) or poor return (20% fall over three years). Please note that for simplicity, the scenarios ignore fees and charges.

The scenarios are for illustrative purposes only and are not designed to be a forecast of the actual performance of any investment. You should remember that the value of shares can go down as well as up and you may not get back the full amount invested.

SCENARIO 1

An individual with capital gains tax to defer and an income tax liability and where a strong return on investment is achieved.

| CLIENT DETAILS | | | |
|--|--|----------|--|
| Amount invested | | £100,000 | |
| Capital gain on which client wants to defer tax (or reclaim if already paid) | | £100,000 | |
| Income tax bill per annum | | £20,000 | |
| Dies within three year holding period | | No | |

| ASSUMED INVESTMENT PERFORMANCE OVER THREE YEARS | | | |
|---|-------|-----------------|---------------|
| | | Realised Value | Loss Relief |
| Investment 1 | 160% | £26,000 | £0 |
| Investment 2 | 140% | £24,000 | £0 |
| Investment 3 | 110% | £21,000 | £0 |
| Investment 4 | 90% | £19,000 | £0 |
| Investment 5 | 80% | £18,000 | £0 |
| Investment 6 | 60% | £16,000 | £0 |
| Investment 7 | 40% | £14,000 | £0 |
| Investment 8 | (10%) | £9,000 | £0 |
| Investment 9 | (30%) | £7,000 | £400 |
| Investment 10 | (40%) | £6,000 | £800 |
| Final value of portfolio | | £160,000 | £1,200 |

| WITH EUREKA | |
|---|-----------|
| Amount required for investment (net of any initial income tax relief) | £80,000 |
| Initial income tax relief assumed to be invested in the product | £20,000 |
| Performance of portfolio constituents | £60,000 |
| Loss relief received within the portfolio | £1,200 |
| Capital gains tax at termination (at 18%) | - £18,000 |
| Total value at termination | £143,200 |

| WITHOUT EUREKA | |
|---|--------------|
| Same starting investment as above | £80,000 |
| Capital gains tax at 40% payable on gain of £100,000 | - £40,000 |
| Value now | £40,000 |
| Same total value as above to pass to beneficiaries | £143,200 |
| Required growth on an investment of £40,000 to reach £143,200 would be* | £103,200 |
| *Required growth is equivalent to a post tax annualised return of: | 53.0% |
| The equivalent pre-tax annualised return (assuming higher tax payer) is: | 88.3% |

This example includes: capital gains tax, income tax and loss relief

SCENARIO 2

An individual with capital gains tax to defer and both an inheritance and an income tax liability and where a strong return on investment is achieved. The client dies in the third year of holding the investment.

| CLIENT DETAILS | |
|--|----------|
| Amount invested | £100,000 |
| Capital gain on which client wants to defer tax (or reclaim if already paid) | £100,000 |
| Income tax bill per annum | £20,000 |
| Dies within three year holding period | Yes |

| ASSUMED INVESTMENT PERFORMANCE OVER THREE YEARS | |
|---|-----------------|
| | Realised Value |
| Investment 1 | 160% £26,000 |
| Investment 2 | 140% £24,000 |
| Investment 3 | 110% £21,000 |
| Investment 4 | 90% £19,000 |
| Investment 5 | 80% £18,000 |
| Investment 6 | 60% £16,000 |
| Investment 7 | 40% £14,000 |
| Investment 8 | (10%) £9,000 |
| Investment 9 | (30%) £7,000 |
| Investment 10 | (40%) £6,000 |
| Final value of portfolio | £160,000 |

| WITH EUREKA | |
|---|----------|
| Amount required for investment (net of any initial income tax relief) | £80,000 |
| Initial income tax relief assumed to be invested in the product | £20,000 |
| Performance of portfolio constituents | £60,000 |
| Total value at termination | £160,000 |
| Amount passed to beneficiaries | £160,000 |

| WITHOUT EUREKA | |
|---|---------------|
| Same starting investment as above | £80,000 |
| Capital gains tax at 40% payable on gain of £100,000 | - £40,000 |
| Value now | £40,000 |
| Same total value as above to pass to beneficiaries | £160,000 |
| Required pre Inheritance Tax value (£160,000 divided by 0.6) | £266,667 |
| Required growth on an investment of £40,000 to reach £266,677 would be* | £226,677 |
| *Required growth is equivalent to a post tax annualised return of: | 88.2% |
| The equivalent pre-tax annualised return (assuming higher tax payer) is: | 147.0% |

This example includes: capital gains tax, inheritance tax and income tax relief

SCENARIO 3

An individual with capital gains tax to defer and both an inheritance and an income tax liability and where a poor return on investment is achieved. The client dies in the third year of holding the investment.

| CLIENT DETAILS | |
|--|----------|
| Amount invested | £100,000 |
| Capital gain on which client wants to defer tax (or reclaim if already paid) | £100,000 |
| Income tax bill per annum | £20,000 |
| Dies within three year holding period | Yes |

| ASSUMED INVESTMENT PERFORMANCE OVER THREE YEARS | | |
|---|-------|----------------|
| | | Realised Value |
| Investment 1 | 50% | £15,000 |
| Investment 2 | 50% | £15,000 |
| Investment 3 | 40% | £14,000 |
| Investment 4 | (40%) | £6,000 |
| Investment 5 | (40%) | £6,000 |
| Investment 6 | (40%) | £6,000 |
| Investment 7 | (50%) | £5,000 |
| Investment 8 | (50%) | £5,000 |
| Investment 9 | (60%) | £4,000 |
| Investment 10 | (60%) | £4,000 |
| Final value of portfolio | | £80,000 |

| WITH EUREKA | |
|---|-----------|
| Amount required for investment (net of any initial income tax relief) | £80,000 |
| Initial income tax relief assumed to be invested in the product | £20,000 |
| Performance of portfolio constituents | - £20,000 |
| Total value at termination | £80,000 |
| Amount passed to beneficiaries | £80,000 |

| WITHOUT EUREKA | |
|---|--------------|
| Same starting investment as above | £80,000 |
| Capital gains tax at 40% payable on gain of £100,000 | - £40,000 |
| Value now | £40,000 |
| Same total value as above to pass to beneficiaries | £80,000 |
| Required pre Inheritance Tax value (£80,000 divided by 0.6) | £133,333 |
| Required growth on an investment of £40,000 to reach £133,333 would be* | £93,333 |
| *Required growth is equivalent to a post tax annualised return of: | 49.4% |
| The equivalent pre-tax annualised return (assuming higher tax payer) is: | 82.3% |

This example includes: capital gains tax, inheritance tax and income tax relief

SCENARIO 4

A client with capital gains tax to defer and an income tax liability and where a modest return on investment is achieved. The investments are held for at least three years.

| CLIENT DETAILS | |
|--|----------|
| Amount invested | £100,000 |
| Capital gain on which client wants to defer tax (or reclaim if already paid) | £100,000 |
| Income tax bill per annum | £20,000 |
| Dies within three year holding period | No |

| ASSUMED INVESTMENT PERFORMANCE OVER THREE YEARS | | |
|---|-------|-----------------|
| | | Realised Value |
| Investment 1 | 20% | £12,000 |
| Investment 2 | 20% | £12,000 |
| Investment 3 | 20% | £12,000 |
| Investment 4 | 20% | £12,000 |
| Investment 5 | 20% | £12,000 |
| Investment 6 | 20% | £12,000 |
| Investment 7 | 20% | £12,000 |
| Investment 8 | (10%) | £9,000 |
| Investment 9 | (10%) | £9,000 |
| Investment 10 | (20%) | £8,000 |
| Final value of portfolio | | £110,000 |

| WITH EUREKA | |
|---|-----------|
| Amount required for investment (net of any initial income tax relief) | £80,000 |
| Initial income tax relief assumed to be invested in the product | £20,000 |
| Performance of portfolio constituents | £10,000 |
| Capital gains tax payable at termination (at 18%) | - £18,000 |
| Total value at termination | £92,000 |

| WITHOUT EUREKA | |
|---|--------------|
| Same starting investment as above | £80,000 |
| Capital gains tax at 40% payable on gain of £100,000 | - £40,000 |
| Value now | £40,000 |
| Same total value as above to pass to beneficiaries | £92,000 |
| Required growth on an investment of £40,000 to reach £92,200 would be* | £52,000 |
| *Required growth is equivalent to a post tax annualised return of: | 32.0% |
| The equivalent pre-tax annualised return (assuming higher tax payer) is: | 53.3% |

This example includes: capital gains tax and income tax relief

INVESTMENT CRITERIA

The Government designed a set of rules for EIS to ensure that the funds are invested into certain types of companies. These include:

- The investment must be into new shares (therefore an investor can not simply buy existing shares)
- The company must trade wholly or mainly in the UK
- The company is an unquoted company at the time the shares are issued (this can include companies listed on AIM)
- The company is not controlled by another company
- The company has less than 50 employees
- The company has gross assets that do not exceed £7 million
- The investee company invests the money raised within 12 months
- Any investment does not exceed more than £2 million into any one company

INVESTMENT EXAMPLES

The following are examples of some typical investments that have been made by Octopus.



LoveFilm is Europe's leading online DVD rental and movie download company with nearly 500,000 active household subscribers. It is one of the top three most visited UK sites in Entertainment and Movies, with the UK's largest range of DVDs with over 65,000 titles. It is estimated that the company has over 20% of the total DVD rental market. In the last two years, Lovefilm launched in Sweden, Denmark, Norway, and Germany making it market leader in digital film delivery with the largest movie download catalogue in Europe.



ITM's aim is to be one of the key enablers of the hydrogen economy by using its low-cost patented materials and manufacturing processes. These should help overcome the key economic barrier to the use of hydrogen as a fuel. The company is developing near-term commercial applications which should facilitate the introduction of hydrogen to the consumer and pave the way towards this ultimate goal.



FSP is a Midlands based company set up with the aim of creating a major group of independent funeral businesses across the UK. FSP was founded in April 2007 by Phillip Greenfield, a former founder and director of the Fairways funeral business, which he grew to manage 6,000 funerals per year.

THE RISKS

As with many investments, there are risks associated with investing in EIS products. We've tried to explain these risks as clearly as possible.

PAST PERFORMANCE

Past performance is no guide to future performance. Fund Managers can make no guarantee of investment performance or the level of capital gains or income that will be generated. The value of investments and the income derived from them may go down as well as up and you may not get back the full amount invested.

INVESTMENTS

EIS investments, because they are private and AIM-listed companies, are likely to be higher risk than securities listed on the London Stock Exchange Official List. Investments in shares in private companies are not readily marketable and the timing of any realisation cannot be predicted. You should not invest in any EIS product unless you have carefully thought about whether you can afford it and whether it is right for you. You should be prepared to leave the investment intact for at least three years.

CURRENT LEGISLATION AND EIS FUND APPROVAL

Rates of tax, tax benefits and allowances described in this leaflet are based on current legislation and HM Revenue & Customs practice. These may change from time to time and are not guaranteed. Tax benefits will depend on individual circumstances. Octopus does not provide advice and potential investors are recommended to seek specialist independent tax and financial advice before investing. If you are not resident or ordinarily resident in the UK for tax purposes, it may not be appropriate or advantageous for you to invest in an EIS. Your obtaining income tax relief is subject to you making the proper filings with HM Revenue & Customs within the requisite time periods and you may lose such relief if not so filed.

QUALIFYING INVESTMENTS

Octopus will make investments which it reasonably believes to be qualifying at the time of investment (but please be aware that Octopus can give no commitment that any such investment will remain a qualifying investment at all times thereafter). Companies in which investments are made may cease to qualify. In this case, the relief available on that particular investment (and not on the whole portfolio) will be lost.

IMPORTANT INFORMATION

An EIS should be regarded as a longer-term investment. This guide is a short summary and is not intended to be comprehensive. This guide is not an invitation, or a solicitation of such an invitation, to invest in any EIS. An investment in an EIS should only be made on the basis of information contained in the relevant product brochure. The information in this guide should not be construed as investment advice on the merits of investing in any particular EIS. This document has been issued and approved by Octopus Investments Ltd, 8 Angel Court, London EC2R 7HP which is authorised and regulated by the Financial Services Authority, 25 The North Colonnade, London E14 5HS.

