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briefing

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Seed Enterprise Investment Scheme

The Government's Seed Enterprise Investment Scheme (SEIS) is aimed at encouraging investment in very small, new companies. Tax reliefs are available for qualifying investments. SEIS has many similarities with the Enterprise Investment Scheme (EIS), but there are significant differences.

This note provides a summary of the Seed Enterprise Investment Scheme and has been prepared based on the law up to and including the Finance (No 2) Act 2015.

Tax relief available under SEIS

Income tax relief

Individuals who make qualifying investments will benefit from income tax relief equal to **50 per cent** of the amount invested. However, the relief is subject to **an annual subscription limit of £100,000** (ie, a maximum income tax saving of £50,000). Investors can use the relief against their tax liability for the tax year in which they subscribe, the preceding tax year, or split the relief between the two years.

Capital gains tax (CGT) reliefs

Whenever an investment in shares benefits from income tax relief under SEIS, any disposal of those shares will also be exempt from CGT, provided that the shares have been held for at least three years and the SEIS conditions have been met throughout that period.

Half of any chargeable gains of up to £100,000 arising on the disposal of other capital assets during a tax year are exempt from CGT, if and to the extent that the investor makes, during the same tax year, a qualifying SEIS investment equal to all or part of the gain and claims SEIS reinvestment relief.

Where shares are sold at a loss, the allowable loss for CGT purposes is reduced to take account of any income tax received. In some circumstances, the allowable loss will be eligible to set against income.

Eligibility and conditions

Who can benefit?

SEIS tax reliefs apply to qualifying investors who subscribe for relevant shares in qualifying companies where all the applicable conditions are satisfied.

Who is a qualifying investor?

The investor must be an individual who is making the investment on his own behalf (though he may invest via a nominee).

Neither the investor, nor any of his associates, may be an employee of the investee company/group at any time during the period from the issue of the relevant shares to the third anniversary of that issue (referred to as "Period B" in the legislation).

However, where a person is a director of a company, he will not count as an employee for this purpose. Thus, an executive or non-executive director of a qualifying company can make SEIS investments. However, unless he is an unpaid director, he may be unable to make follow on investments under EIS; the rules are complex and, if this could be an issue, advice should be taken.

The investor must not have a "substantial interest" in the investee company at any time during the period from incorporation of the investee company to the third anniversary of the issue of the relevant shares (referred to as "Period A" in the legislation). In summary, the investor must not alone or with his associates hold directly or indirectly, or be entitled to acquire, more than 30 per cent of the ordinary share capital; issued share capital or voting rights of the investee company; or any of its subsidiaries or be entitled to more than 30 per cent of the assets on a winding up.

What are relevant shares?

Relevant shares are ordinary shares with no right to be redeemed, no preferential rights to assets on a winding up, and whose preferential rights to dividends (if any at all) comply with strict rules (such as not being dependent to any extent on a decision of the company, or the investor or any other person, and not being cumulative rights where unpaid dividends are carried forward for payment in a later year).

The shares must be:

- subscribed for wholly in cash and fully paid up when issued; and
- issued to raise money for a qualifying business activity to be carried on by the issuing company or a 90 per cent subsidiary. A qualifying business activity is carrying on a new qualifying trade (see below); or preparing to carry on a new qualifying trade; or undertaking research and development from which it is intended to derive a new qualifying trade or benefit a "new qualifying trade".

The concept of a "**new qualifying trade**" is central to SEIS and includes the following features:

- **the trade must be a qualifying trade** (ie, one which does not include, wholly or to a substantial extent, excluded activities). The definition of "excluded activities" is the same for EIS and SEIS and includes activities such as dealing in land, certain property-backed trades (such as property development and farming) and certain financial trades;

- **the trade must be less than two years old**. If the trade in question was carried on by the relevant **company**, or by any other person, more than two years prior before the date of issue of the relevant shares, it will not count as a new qualifying trade; and
- **the trade must be the company/group's first trade**. A trade will not be a new qualifying trade if, **prior** to its commencement, either the issuing company or one of its subsidiaries has carried on any other trade.

What is a qualifying company?

- The company must, if a single company, exist for the purpose of carrying on a new qualifying trade. If the company is the parent of a group, the group's business must not consist to a substantial extent (ie, 20 per cent or more) in non-qualifying activities, that is, trading activities which do not qualify for EIS or SEIS or non-trading activities.
- The company (or, if applicable, the group) must:
  - have **gross assets which do not exceed £200,000** immediately before the relevant shares are issued;
  - have fewer than 25 full-time equivalent employees when the relevant shares are issued.
- The company must not have raised funds under the EIS or Venture Capital Trust ("VCT") regimes before or on the day on which the relevant shares are issued for SEIS purposes.
- The company:
  - must not be controlled by any other company or any other company and any person connected with that other company (although this condition does not apply whilst only subscriber shares are in issue and no trade or business has been commenced);
  - must not have any subsidiary which is not a "qualifying subsidiary" (broadly, a genuine subsidiary);
  - must have a permanent UK establishment;
  - must be an unquoted company;
  - must not, when the relevant shares are issued, be in "financial difficulty", under applicable European Commission guidelines.

  For each of these conditions, the times for which they must be satisfied are slightly different.
- The qualifying business activity must be carried on by the issuing company, or a 90 per cent subsidiary and neither the company nor any of its 90 per cent subsidiaries may be a member of a partnership.

Additional applicable conditions

- Funds raised under SEIS must be **spent within 3 years** for a qualifying business activity.
- There is a maximum limit of **£150,000**, which may be raised by a company under SEIS; this is not an annual threshold but a maximum amount per company.
- SEIS reliefs must be claimed, and an investor will not be entitled to make a claim for relief, until the issuing company has provided him with a "compliance certificate". The issuing company is not permitted to apply to HM Revenue & Customs for a compliance certificate until:

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- o at least 70 per cent of the money invested has been spent; or
- o the new qualifying trade of the issuing company, or its 90 per cent subsidiary, has been carried on for at least four months.

o There are a number of anti-avoidance provisions (including a requirement that the investment be undertaken for genuine commercial reasons and a prohibition on terms of issue such as protection against the ordinary risks of investment including, for example, anti-dilution rights).

Loss of tax reliefs

o If the investor effects a disposal of the relevant shares (which includes granting a call option or receiving a put option) before the third anniversary of the date of issue, income tax relief may be clawed back in whole or in part and any chargeable gain will be subject to CGT in the normal way. If the investor secured exemption for another chargeable gain by way of SEIS reinvestment relief, that chargeable gain shall revive in whole or in part in the original year.

o Complex rules, similar to those in the EIS code in relation to “value received” by the investor, mean that where the investor receives value from the issuing company or one of its subsidiaries, unless the receipt is an “excluded payment” or an “insignificant” amount, income tax relief may be clawed back in whole or in part.

Comment

The Government wants SEIS to encourage the flow of "seed finance" to the smallest companies and, by implication, riskiest investment propositions. Investors are recommended to seek advice on whether potential investments will qualify for SEIS as the qualifying conditions are complex. Similarly, investors need to pay careful attention to documentation, such as shareholders’ agreements, to protect their interests in a risky investment arena.

Contacts

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