Seed Enterprise Investment Scheme

Introduction

There are a number of provisions within the UK tax legislation which provide tax reliefs for taxpayers who invest in qualifying companies.

This Briefing Note deals with Seed Enterprise Investment Schemes ("SEISs") with a further Briefing Note dealing with the Enterprise Investment Scheme ("EIS") legislation. There is a wealth of detail in each case so only the main points are covered in the Briefing Notes.

Detailed provisions

The SEIS legislation was introduced in the Finance Act 2012.

The rules are summarised as follows:

- In order to qualify a company must be undertaking, or planning to undertake, a new business (see below) which has fewer than 25 full-time employees and with gross assets of less than £200,000 at the time of the SEIS investment.
- Qualifying companies are able to raise up to £150,000. The funds raised must be used within three years. Once 70% of the funds have been used, the company may raise funds under the EIS or from Venture Capital Trusts.
- Income tax relief of 50% of the investment amount is available to investors for subscriptions of shares with a value of up to £100,000. An investor can include a director.
- A claim for relief under SEIS may not be made until at least 70% of the money raised by the issue has been spent by the issuing company for the purposes of its trade.
- The investor must not own more than 30% of the ordinary or issued share capital, or the voting power. Holdings of 'associates' are included - parents and children and remoter issue are associates but brothers and sisters are not.
- The investor limit for SEIS is £100,000 per tax year across all investments.
- There is no CGT payable on the disposal of SEIS shares if they have been held for at least three years at the date of sale.
- There is an exemption from CGT on gains realised from disposals of other assets where the gains are reinvested in SEIS shares. The exemption is capped at 50% of the SEIS investment.

Other matters:

- Companies can qualify even if they have subsidiaries.
- Eligibility is determined by reference to the age of the trade, rather than the company - any trade being carried on by the company at the date of the relevant share issue must be less than two years old at that date, whether the trade was carried on by the company or another person.
- The rules allow past (but not current) employees to qualify for relief.
- The rules allow directors who qualify under SEIS to continue to qualify under EIS (provided the EIS shares are issued before the third anniversary of the date of issue of SEIS shares).

Income tax relief on investment/dividends

The rate of income tax relief is 50%.

The maximum annual investment is £100,000 per tax year and relief can be carried back to the tax year prior to that in which the investment is made.

Income tax relief is given as a credit against an individual's income tax liability for the year of subscription or in the previous year if the appropriate carry back claim is made.

Income tax relief will be withdrawn if within three years of the date of issue the SEIS shares are disposed of or the investor receives value before that date and if the relief is subsequently found not to have been due. Transfers between spouses and civil partners are permitted without prejudicing the relief.

Dividends on SEIS shares are taxable in the normal way.

The tax relief is not affected by the income tax loss relief capping rules.

Capital Gains Tax ("CGT") relief on the sale of shares

Gains on disposals of SEIS shares are exempt from CGT if held for at least three years from the date of issue.

CGT deferral relief

CGT deferral relief (see EIS Briefing Note) is not available for SEIS investments.

However, subject to certain conditions, gains realised on any asset disposed of with the proceeds reinvested in SEIS qualifying shares will be exempt if the SEIS shares are held for at least three years from the date of issue. The exemption is capped at 50% of the qualifying SEIS investment.

Losses

Similar rules apply to losses realised on SEIS shares as apply under the EIS scheme (although the rate of income tax relief to restrict the amount of the loss is 50% rather than 30%). For a 45% taxpayer, this currently limits the maximum economic loss to 27.5%, ignoring the effect of any CGT exemption obtained for gains reinvested in SEIS qualifying shares.

Practical issues

- ALL the conditions must be examined.
- The conditions with regard to ‘connection’ need to be carefully reviewed.
- An investor must claim relief within five years from the 31 January following the tax year in which the subscription was made.
- Shares should not be issued as part of the company formation process with payment made later.
- The shares must be paid for immediately in full and for cash.
- Shares should only be issued, and funds taken, if the company has a bank account to take the funds.
- The company’s share register should be updated contemporaneously with the share issue - i.e. not before the issue but immediately after the issue so that there is no dispute as to when the shares are issued.
- The SEIS money raised should only be used for the purposes of the trade. Great care is needed if an immediate use is not apparent and the SEIS funds need to be ‘parked’ pending use.
- The period of time, three years from the issue of the shares, within which the funds must be used is very important.
- Compliance certificates cannot be issued until 70% of the SEIS funds have been used or the company has been trading for four months. The SEIS company may therefore need to ‘ring fence’ the SEIS investment monies so that these can be used in advance of other funds.

- The individuals must not be connected with the business. Employees and individuals with controlling holdings are not able to invest. Watch indirect holdings and family connections. The rules on connection are primarily disadvantageous for income tax relief.
- The SEIS1 needs to be completed as comprehensively as possible. If there is doubt as to whether a company will qualify (there are a number of non-qualifying activities) advance assurance can be secured from HMRC and is advisable.
- Investors cannot claim relief until they have form SEIS 3 issued by the company. In year relief can be secured in relevant situations with a change to a PAYE notice of coding.

Inheritance tax considerations

The same IHT considerations apply to SEIS shares as apply to EIS shares.

Further advice

The rules are complex and only the main points have been set out in this Briefing Note. Please contact us if you require any more information or specific advice.

If you have any questions regarding this Briefing Note please contact:

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