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A fresh approach to accounting

SEED ENTERPRISE INVESTMENT SCHEME

The Seed Enterprise Investment Scheme (SEIS) provides tax relief for individuals prepared to invest in new and growing companies. It is the junior version of the Enterprise Investment Scheme (EIS). Investors can obtain generous income tax and capital gains tax (CGT) breaks for their investment and companies can use the relief to attract additional investment to develop their business.

Key features

The key features of the relief can be summarised as follows (figures are those applicable from 6 April 2024):

- a qualifying investor will be able to invest up to £200,000 into qualifying companies in a tax year
- they will receive income tax relief of up to 50% of the sum invested
- unused relief in one tax year can be carried back to the preceding tax year if there is unused relief available for that year
- the maximum amount that a company can attract in investment qualifying for the SEIS is £250,000 in total
- the company must not have assets of more than £350,000 before any SEIS investment
- an individual who makes a capital gain on another asset and uses the amount of the gain in making a SEIS investment will not pay tax on 50% of the liability, subject to certain conditions
- there is a huge amount of anti-avoidance legislation to prevent exploitation for tax avoidance purposes.

Who can invest?

The official term is a 'qualifying investor'. The primary requirement is that the investor or someone who is associated with them must not be an employee of the company in which the investment is being made. They can however be a director. They must also ensure that they do not have (directly or indirectly) a substantial interest in the company. This is defined by reference to holding more than 30% of any of the following (in either the company itself or a 51% subsidiary of the company):

- ordinary shares
- issued shares
- voting rights
- assets in a winding up.

Which shares qualify?

The shares must be ordinary shares which have been subscribed for wholly in cash and are fully paid up. They must be held for a three-year period from the date of issue. The company must have issued the shares for the purpose of raising money to fund a qualifying business activity which either involves the carrying on or preparations to carry on a new trade. Using the funds to meet the costs of research and development intended to create or benefit a new qualifying trade will also be acceptable. The money must be spent within three years of the date of issue of the shares. The anti-avoidance requirement is that there must be no pre-arranged exit for the investor involving the purchase of the shares, or the disposal of assets.

Which companies qualify?

The rules are intended to benefit new companies. The basic requirements are that the company must be unquoted. The trade must be a 'new' qualifying trade. This is one not carried out by either the company or any other person for longer than three years at the date the shares are issued. The company must exist wholly for the purpose of carrying out one or more qualifying trades throughout the three-year period from the date of issue of the shares. If the company goes into receivership or administration or is wound

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up during this period, this will not prevent the relief being given, provided there was a commercial justification for the action.

The other main conditions relating to the company can be summarised as follows:

- the company must have a permanent establishment in the UK
- the company must be effectively solvent at the date of issue of the shares
- the company may have a qualifying subsidiary
- the company must not be a member of a partnership
- immediately before the investment, the gross assets of the company plus the value of any related entity (one that holds more than 25% of the capital or voting power in the issuing company) must not exceed £350,000
- there are fewer than 25 full-time employee equivalents in the company and any related entity
- the company must not have had EIS or Venture Capital Trust (VCT) investment before the SEIS shares are issued
- the total amount of investment made under the SEIS in the company must not exceed an aggregate of £250,000.

Which trades qualify?

The primary requirement is that the company must carry on a genuine new trading venture. There may be a problem if the same activities had been carried on as part of another trade. Basically, any trading activity will qualify unless it is an excluded activity within the definitions used for the EIS. This means that activities such as property development, retail distribution, hotels, nursing homes and farming will not qualify. The trade must be carried out on a commercial basis.

How is relief obtained?

The relief is given as a reduction against the total tax liability for the year but cannot turn a tax liability into a tax repayment. In that situation the individual would be able to carry back the unused relief to the preceding tax year for use if there was any tax unrelieved for that year.

Examples

Samantha invests £60,000 under the SEIS. Potentially her tax relief is 50% of her investment which is therefore worth £30,000. As her tax liability for the year is £45,000, the maximum relief is available to reduce her tax liability to £15,000.

Richard also invests £60,000 under the SEIS. His forecast tax liability is only £20,000 so the claim to relief under the SEIS will be limited to £20,000 for that tax year. However, Richard can in addition make a claim to carry back the unused relief of £10,000 (£30,000 less £20,000 relieved) to the preceding tax year.

The relief must be claimed and requires a certificate from the company issuing the shares.

Can the relief be withdrawn?

The short answer is yes if certain events happen within three years of the date on which the shares are issued. The most obvious event is the disposal of the shares in that period. There are complex rules that will cause the relief to be withdrawn if the investor receives value from the company during this period.

What about the CGT position?

Where shares are sold more than three years after the date on which they are issued, then any resulting gain is free of CGT. Shares sold within three years would be chargeable but may qualify for Business Asset Disposal Relief (BADR) if the various conditions are met.

Where a disposal is exempt for gains purposes, this would normally mean that a loss would not be allowable for CGT purposes, but an allowable loss is available under the scheme. Where SEIS income tax relief has been obtained and is not withdrawn then the capital loss is reduced so that tax relief is not duplicated.

Example

Murat invested £25,000 in the SEIS for which he received £12,500 relief against his income tax liability of £35,000. If four years later the company is unsuccessful and is liquidated with no value returned to the shareholders then his allowable

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capital loss will be £12,500, being the amount invested of £25,000 less the income tax relief obtained of £12,500.

Clearly investors will hope that they are not in a capital loss position but where this does happen, the allowable loss qualifies for relief against either gains or income. The facility to use a capital loss against income is only available in certain specified circumstances which include a capital loss on the SEIS. It can be used in the year of the loss and/or the preceding year to relieve net income and can therefore potentially save tax at the individual's highest rate of tax.

A bonus exemption

There is also an additional exemption where assets are disposed of at a gain in that year and funds equal to the amount of the gain are invested in SEIS shares. Reinvestment relief is available at 50% of the matched gain where the proceeds are invested in SEIS shares.

Where only part of the gain is invested in such shares then only that part is exempt. The maximum gain to be relieved is capped at £200,000. Further, this relief will only be allowed where the investment also qualifies for income tax relief and a claim is made. If for any reason the SEIS relief is withdrawn on the shares then the gain will be reinstated.

Example

Isaac sells some more quoted shares for £200,000, making a gain of £80,000. He invests £80,000 of the proceeds in new shares which qualify under the SEIS. He will be able to claim a reduction of £40,000 (being 50% of the amount invested in the SEIS) in the chargeable gain on the shares.

Comparison to EIS

The SEIS supplements the EIS. Some aspects of both schemes are similar but there are also key differences. These are not considered in detail here, however, consider the position of the individual investor. Under the EIS those investing up to £1 million receive income tax relief at up to 30%. From a tax relief perspective on investments up to £200,000, the SEIS is more favourable but it clearly cannot be used for larger investments.

How we can help

SEIS compliments the EIS and related Venture Capital Trust investment schemes as it may be an alternative way of attracting funds at a time when it is still difficult to obtain finance from traditional sources such as banks. Great care will be required to ensure that all opportunities to use it are obtained for investor and qualifying company alike. Please do contact us if this is an area of interest.

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