Seed Enterprise Investment Scheme (SEIS)

On 6 April 2012, the Government introduced a new scheme aimed at incentivising investment into so-called 'seed-stage' companies.

This note covers the basics of how the scheme works, what tax relief is available and who is eligible for the scheme. It reflects the law and practice as applicable at April 2019.

How does the scheme work?

SEIS operates in a similar manner to the Enterprise Investment Scheme ("EIS"), providing income tax and capital gains tax reliefs for individual investors who subscribe in cash for qualifying shares in qualifying companies.

Qualifying shares include ordinary shares, but also shares that may have certain non-cumulative preferential dividend rights.

Income tax

For shares issued on or after 6 April 2012, an investor who qualifies for the relief can claim an income tax reduction equal to 50% of the money subscribed, subject to an annual subscription limit of £100,000 (so the maximum income tax saving is £50,000).

Relief can only be used to the extent that the individual has an income tax liability (it cannot create a loss or a repayment of tax) but investors can also use the tax reduction against their income tax liability for the previous tax year, or can split the reduction between the two tax years.

Capital gains tax

Where income tax relief is available for an investment in SEIS shares, broadly any capital gain realised on a disposal of the shares will be exempt from tax.

In addition, the scheme includes a partial exemption from capital gains tax for proceeds of disposals made in the relevant tax year that are ‘matched’ with investments in SEIS companies during the same period. There is no restriction on the type of capital asset to which this applies, but a gain that would be subject to capital gains tax must be realised on the disposal. It is not necessary to reinvest the entire proceeds of any disposal – only an amount of the proceeds equal to the gain (or part of the gain) to be exempted. An example is shown below.

When originally introduced (for tax year 2012/13) the reinvestment relief offered a 100% exemption for gains, but this was reduced to 50% of reinvested gains in 2013/14 and this continues.

Practical example

An individual earning £155,000 in taxable earnings during 2019/2020 will be liable to approximately £54,750 in income tax for the tax year.

An investment of £100,000 in a SEIS company would generate a tax saving of £50,000 against that tax liability, leaving a net income tax bill of approximately £4,750.

Furthermore, if the same individual disposed of a non-residential investment property (for example) for £200,000 in the same tax year, realising a gain of £100,000, they would be able to ‘match’ half of the gain to the SEIS investment and thereby save half of the 20% capital gains tax otherwise payable on that disposal (i.e. £10,000) in addition to the £50,000 income tax saving. If the gain was £120,000, but the individual still reinvested £100,000, the saving would remain £10,000.
Time limits

The scheme is only available to small ‘start-up’ companies. This, in effect, means that the company must not have been actively trading at any time before two years before the shares are issued.

As is the case under EIS, the shares must generally be held for three years from issue to benefit from the full income tax and capital gains tax reliefs above. If SEIS shares are disposed of within three years of their issue, then there is a potential claw-back of the income tax relief claimed (and no capital gains tax exemptions will be available, either on the disposal or in respect of any other disposal the proceeds of which were reinvested in the SEIS shares).

Note that SEIS relief can only be claimed by an investor (via their self-assessment return) once the company has either spent at least 70% of the SEIS monies invested or been actively trading for at least four months (as opposed to preparing to trade or conducting R&D in advance of trading). This marks the trigger-point for the company to issue a certificate of qualification to the investor, permitting the relief to be claimed. However, the previous requirement that 70% of any monies raised under SEIS had to be spent before a company could issue shares that qualify for EIS relief has now been withdrawn (so that ‘joint’ SEIS / EIS funding rounds can be implemented). Care must be taken with such arrangements to ensure that any shares intended for EIS relief are still issued at least one day after SEIS shares, and that investment monies for EIS shares are not received by the company before the SEIS shares are issued (as those monies may impact the “gross assets” threshold test referred to below).

Who can be a qualifying investor?

The SEIS has a number of similarities with EIS in relation to the requirements that have to be met for an individual investor to qualify.

One of the key requirements is that the investor must not hold (directly or indirectly) more than 30% of the company’s ordinary share capital, issued share capital or voting rights. There are no restrictions on how much loan capital in the company the investor can hold (although care must be taken with regard to convertible loan stock).

Investors who are employees of the company cannot benefit from SEIS. However, there is a distinction between SEIS and EIS in that with SEIS, existing or new directors in the company will be eligible (whereas for EIS, the scheme is not generally (subject to certain limited exceptions) available to directors). So, for example, an existing director of the company could invest and still qualify for SEIS relief.

Which companies can qualify for SEIS?

Similar to the other venture capital schemes, there are a number of qualifying conditions that the relevant company must meet in order for it to issue shares under SEIS.

One of the key conditions is that the company must exist wholly for the purpose of carrying on one or more ‘new’ qualifying trades. The scheme is limited to companies carrying on what is described as a ‘genuine new venture’. This would not include a situation where a company has, in the six months prior to commencing the new trade, carried on a different trade consisting of the same activities as the new trade. Subject to limited exceptions, the legislation also excludes situations where trades or activities that have previously been carried on are in effect transferred to the company. This is in part to prevent avoidance schemes of a type that have exploited the EIS regime through (for example) partitioning of existing non-qualifying businesses into new companies established specifically to enable investment to benefit from the tax reliefs.

In addition, as mentioned above, companies that had active trades more than two years before the investment do not qualify.

However, the company need not carry on a trade immediately – it can be engaged in research and development with the intention of trading. In addition, the monies raised under SEIS can be used in such R&D and there is no time limit placed on the company starting an actual trade.

Companies can only raise a maximum of £150,000 under the scheme – this is a lifetime limit. Monies raised under SEIS must also be used by the company in its qualifying activity within three years (but, as explained above, this can include R&D work preparatory to the carrying on of an actual trade).
In addition, the company must not have had any investment under EIS or the VCT scheme before any shares are issued under SEIS. However, it can raise EIS and/or VCT funding after an SEIS round, as noted above.

The other main conditions are:

a) the company’s gross assets must not exceed £200,000 immediately before the investment (although there is no gross assets test following the investment, as can be found for other venture capital schemes)

b) the company must have fewer than 25 full time employees

c) the company must have a UK permanent establishment

d) the company must not be listed on a recognised stock exchange (note that, although improbable, this means that AIM listed companies, if within the other limits, would qualify)

e) the company must not be controlled by another company (although there is an exception for shelf companies)

f) the company must not control another company (although the rules do permit the investee company to have certain qualifying subsidiaries), and

g) the company must not be a member of a partnership.

For investments made on or after 15 March 2018, a new ‘risk to capital’ condition applies. This requires that (broadly):

a) the company in which the investment is made has objectives to grow and develop over the long term, and

b) the investment should carry a real risk that the investor will lose more capital than they are likely to gain from a combination of income from dividends, interest and fees, capital growth and upfront tax relief. HMRC will decide whether an investor’s capital is at risk by looking at the company’s financial position, but if any arrangements have been put in place to reduce an investor’s risk (such as that investor receiving priority over other investors in payment waterfalls) these are likely to exclude that investor from the SEIS scheme.

The rules also contain a number of anti-avoidance provisions. These include the following:

a) a requirement that the investment be undertaken for genuine commercial reasons and not with a main purpose of avoiding tax, and

b) a prevention of the terms of issue of the shares including any form of protection against the ordinary risks of investment (e.g. ‘anti-dilution’ rights to protect against future fund raising at a lower price).

Practical observations

The launch of SEIS has broadly been heralded as a success, with provisional Government figures indicating £433m has been raised by over 4,775 companies between its launch in April 2012 and April 2015. In 2016-17, £175 million of funds were raised.

There are, however, some quirks in the scheme that have presented issues, particularly for the many businesses for whom funding rounds may by necessity exceed the maximum £150,000 available under SEIS. There, investors will typically seek a ‘blend’ of SEIS and EIS tax relief, but this was until late 2015 hampered by the requirement that at least 70% of the SEIS money raised needed to be spent before shares could be issued under EIS. Although the removal of that requirement is welcome, some complications remain, particularly around the potential for funds received for EIS investments to impact on the application of the £200,000 gross assets threshold for SEIS. It is generally recommended that joint SEIS/EIS funding rounds are conducted in two discrete tranches and care must be taken.

An advance assurance procedure is available from HMRC, which broadly allows a company to obtain some comfort for its investors that certain conditions for the relief are expected to be met, based on information supplied in the application (most notably the qualifying company conditions). If you are seeking advance assurance from HMRC under the SEIS, there are now mandatory forms that must be used, which are available on HMRC’s website.
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Key contacts

Peter Jackson
Partner,
Tax and Incentives
+44 (0)20 7300 4721
p.jackson@taylorwessing.com

Graham Samuel-Gibbon
Partner,
Tax and Incentives
+44 (0)20 7300 4916
g.samuel-gibbon@taylorwessing.com

James Stewart
Senior Counsel,
Tax and Incentives
+44 (0)20 7300 4865
j.stewart@taylorwessing.com

Harriet Revington
Senior Associate,
Tax and Incentives
+44 (0)20 7300 7109
h.revington@taylorwessing.com

Will Egan
Associate,
Tax and Incentives
+44 (0)20 7300 7105
w.egan@taylorwessing.com

Alice Thomas
Associate,
Tax and Incentives
+44 (0)20 7300 7149
a.thomas@taylorwessing.com

Madison Lawler
Associate,
Tax and Incentives
+44 (0)20 7300 4793
m.lawler@taylorwessing.com

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