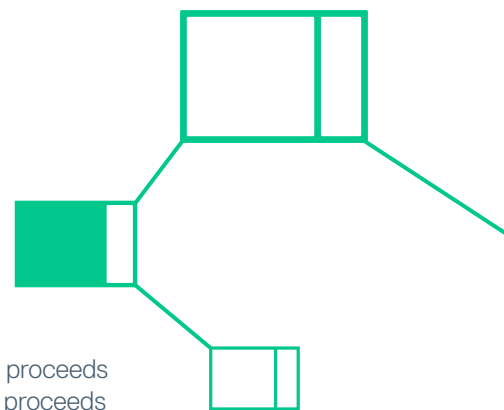


Seed Enterprise Investment Scheme (SEIS)



As of 6 April 2012, the Government has 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.

How does the scheme work?

SEIS operates in a similar manner to the Enterprise Investment Scheme, 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).

Naturally, 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. Note, however, that this “carry back” does not apply to any tax year before 2012/2013, so any SEIS investment in 2012/2013 would only be eligible for relief against income tax for that tax year.

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 “single year” exemption from capital gains tax for proceeds of disposals made in the 2012/2013 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.

Practical example

An individual earning £155,000 in taxable earnings during 2012/2013 will be liable to approximately £55,500 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 £5,500.

Furthermore, if the same individual disposed of an investment property (or other capital asset) for £200,000 in the same tax year, realising a gain of £100,000, they would be able to ‘match’ the gain to the SEIS investment and thereby save the 28% CGT otherwise payable on that disposal (i.e. £28,000) 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 £28,000.

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 CGT 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 CGT 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).

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.



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 employee could be appointed a director at the time of investment 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 6 months prior to commencing the new trade, carried on a different trade consisting of the same activities as the new trade. 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.

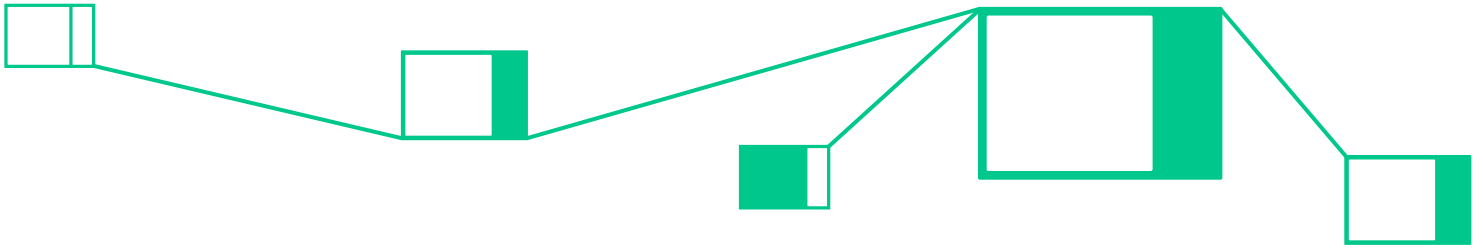
However, the company need **not** carry on a trade immediately – it can be engaged in research and development with the intention of trading. In addition, the monies raised under SEIS can be used in such R&D and there is no time limit placed on the company starting an actual trade.

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, provided at least 70% of the SEIS capital has been spent in the company's qualifying activity.

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 control or be controlled by another company (this is more restrictive than the equivalent provision under EIS, which allows the investee company to have certain qualifying subsidiaries); and



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Key Contacts



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



Robert Young
Partner, London
+44 (0)20 7300 4201
r.young@taylorwessing.com



James Meakin
Senior Associate, London
+44 (0)20 7300 4933
j.meakin@taylorwessing.com



James Stewart
Associate, London
+44 (0)20 7300 4865
j.stewart@taylorwessing.com