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Client Briefing Note

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Seed Enterprise Investment Scheme

In Autumn 2011, the government announced plans to introduce a new scheme designed to encourage investment in small businesses. This scheme is known as the Seed Enterprise Investment Scheme (SEIS) and its provisions are to be included in the forthcoming Finance Act.

The scheme can allow investors to obtain tax relief of up to 78% on their investment and applies to businesses that are less than two years old. The relief is available to individuals who subscribe for qualifying shares in a company which meets the SEIS requirements.

To provide relief an investor's income tax liability is reduced by 50% of the amount invested in qualifying shares, up to a maximum of £100,000.

A 'carry-back' facility exists which allows all or part of the cost of shares acquired in one tax year to be treated as though the shares had been acquired in the preceding tax year. As SEIS did not exist prior to 2012-13 there is no scope for carrying relief back before that year.

There is also an opportunity for individuals, who make gains in 2012/13, to obtain relief from Capital Gains Tax. This provides an additional relief of up to 28% for investors if they invest the gain in the company. If the investment qualifies the gain will be exempt from Capital Gains Tax

Further reliefs are available to the investor in the form of Inheritance Tax Business Property relief and possible scope for loss relief against income, should the investment fail.

The shares must be held for a period of three years from the date of issue to avoid the withdrawal of relief and must be fully paid for at the time of issue.

The investor

In order to qualify for relief the investor or his associates must not be employees in the company, within a three year period, although there is no restriction for directors. In addition to this the investor or his associates must not have a substantial interest in the company. This is defined as owning more than 30% of the issued share capital, voting rights or rights to assets on winding up.

Associates for these purposes include business partners, lineal ancestors and descendants. It is interesting to note that relatives such as brothers and sisters are not included. There may therefore be good scope for less immediate family members to invest and receive the benefits of the tax reliefs alongside the traditional unconnected or 'business angel' type investor.

For example, subject to any challenge by HMRC that the investment is specifically for tax avoidance, there would seem scope for unmarried couples to qualify, or for investments by parents in law.

There must be no arrangements to protect the investor from the normal risks associated with investing in shares and no arrangements for the shares to be sold. In addition to this there must be no 'reciprocal' arrangements whereby investors agree to invest in each others companies for the purposes of obtaining tax relief.

The company

There are several rules that the company must satisfy in order for the investment to qualify. These include the requirement that the business must have fewer than 25 employees and assets of up to £200,000.

There are also requirements to ensure that the monies raised must be spent on qualifying business activities. This can include carrying on a qualifying trade, preparing to carry on a qualifying trade or carrying on research and development to lead to a qualifying trade. To qualify a trade must be conducted on a commercial basis with a view to the realisation of profit and trades do not qualify if they include a substantial amount of excluded activities. HMRC have published a list of sixteen excluded activities and these include dealing in land, farming, financial activities, leasing and property development

There is significant scope for the start up business to benefit from the scheme as investors will be incentivised and encouraged to invest by the available tax breaks. For the investor, 50% Income Tax relief and the scope to shelter gains from Capital Gains Tax, along with possible additional tax reliefs, may mean an increased commercial risk can be taken.

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