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SEIS and EIS

Presentation to Tech Hub

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Agenda

- **Compare SEIS and EIS – overview**

- **What is SEIS relief?**
  - Company requirements
  - Investor requirements

- **What is EIS relief?**
  - Company requirements
  - Investor requirements

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Compare SEIS & EIS - overview

- SEIS for smaller start up companies – EIS for more established companies
- SEIS new relief; applies from 6 April 2012 – EIS established in 1994
- SEIS higher rates of relief; 50% income tax relief – EIS maximum 30% income tax relief; SEIS exemption capital gains tax, EIS deferral
- SEIS cannot be granted if EIS status has been approved – order important
- Can be a director of SEIS but not EIS – relevant business angels

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What is SEIS relief

- Seed Enterprise Investment Scheme
- Small, early-stage companies
- Raise equity finance on share subscription
- Income tax and capital gains tax reliefs for investors
- Introduced for 2012/13 but extended

SEIS - Company requirements

At time of share subscription

- Unquoted (AIM OK)
- < 25 employees within company or group
- Gross assets < £200,000
- No other Venture Capital investment including EIS, VCT
- Raise up to £150,000 (inclusive of State Aid – excess doesn’t qualify)

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SEIS - Company requirements

Continued (at time of subscription)

- Qualifying trade intended
- Trade < 2 years old and no other trade by company previously

To be met continuously for 3 years

- Must not be controlled by another company (except restricted circumstances)
- Cannot be a member of a partnership
- Company can have subsidiaries > 50% owned (‘qualifying’)

SEIS - Company use of funds

- **Used within 3 years for 'qualifying business activity'**

- **Qualifying business activity**
  - Carrying on qualifying trade
  - Preparing to carry on the qualifying trade
  - Research and development to benefit qualifying trade

- **Cannot use to pay dividends, buy investments etc.**

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SEIS – Qualifying trade

- **Commercial basis – view to realisation of profit**
- **Most trades qualify except 'excluded trades'**
- **Excluded trades (not exhaustive)**
  - Relating to land, development, dealing or investment
  - Financial activities including accountancy, banking, insurance
  - Receiving royalties or licence fees except where intangible asset created by the company
  - Others: hotel management, farming, coal or steel production

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SEIS – Procedure

- **HMRC Small Companies Enterprise Centre (SCEC)**

- **Advance clearance – 6 weeks, usually 3 weeks** – accounts, articles, business plan, nature of trade etc.

- **Formal clearance – SEIS1 form**
- Requirement to have traded for at least 4 months, or
- It has spent at least 70% of monies from SEIS share subscriptions

- **Issue SEIS2 and SEIS3 for the investors**

SEIS - Investor requirements

- Subscribe for full risk ordinary shares – no preferential rights
- Fully paid in cash – cannot be partly paid shares
- Do not hold > 30% issued share capital/voting rights/rights to winding up (including associates)
- Take care with associates : linear relatives, business partners
- Not employed by company for 3 years – *can be director*
- No beneficial loan to acquire the shares
- No reciprocal arrangements – cross investment
- Stricter than EIS but for greater tax savings

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SEIS – Tax reliefs on subscription

Income tax

- Income tax - 50% of amount invested
- Maximum £100,000 (maximum £50,000 income tax relief)
- Year of subscription or carry back i.e. 2013/14 to 2012/13

Capital gains

- Exemption chargeable gains - 28% tax relief – 2012/13
- Maximum £100,000 in 2012/13
- Extension in Budget 2013 - gains in 2013/14 - 50% relief
- Invest in 2013/14 or 2014/15
- Year of subscription or carry back

SEIS – How to claim relief

Subscription

- On tax return
- Amendment to tax return up to 5 years after 31 January of the tax year
- SEIS3 submission for earlier adjustment – claim on return still needed
- Must have paid sufficient tax to cover the relief

Ultimate disposal

- Disposal after 3 qualifying years – otherwise income tax relief withdrawn
- Tax free profits on exit if attracted income tax relief
- If no income tax relief – disposal is chargeable to capital gains tax
- ER maybe available
- Loss relief – capital loss – convert to income loss

SEIS – Example of tax relief

Mary disposes of an asset in 2012/13 with a gain of £25,000. In May 2013 she subscribes £10,000 for shares into a new SEIS company that is currently undertaking research and development into web based design. This is owned as to 60% by her brother and 30% his wife. Mary will own 10% of the shares. She has paid £63,000 income tax in 2012/13.

Tax relief on subscription:

- **Elect to carry back the tax relief to 2012/13**
- **Capital gains tax relief on the full £10,000 invested (28% x £10,000 = £2,800)**
- **Income tax relief of £5,000 (£10,000 x 50%)**

Total tax relief on subscription - £7,800 - £0.78 in the £1 relief

SEIS – Example of tax relief (continued)

Assume holds the shares for 3 years and then sells. Provided the company continues to qualify as an SEIS company:

- If a gain arises on disposal – free of tax
- If a loss arises – further tax relief - capital loss @ 28% or income tax relief with carry back if required
- Example – if the shares are sold for £3,000, a loss of £7,000 arises but income tax relief of £5,000 has been claimed already on subscription. The loss available either as a capital loss or income loss is £2,000 (£7,000 - £5,000). If Mary is a 45% income taxpayer – relief of £900.
- **Total income tax relief £5,900 and capital gains tax relief of £2,800 on effective 124% relief on £7,000 lost - £1.24 in the £1 relief**

SEIS - Summary of tax reliefs

Tax Relief	Unconnected	Connected
Income tax relief	✓	×
Capital gains tax exemption on subscription	✓	×
Capital gains tax deferral on subscription	N/A	N/A
Capital gains tax exemption on disposal	✓	×

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Withdrawal or reduction of tax relief

Within 3 year period from share issue

Withdrawal:

- Become employed without being a director
- Holding increases to > 30% with associates
- The company loses qualifying status (liquidation for genuine commercial reasons – OK)

Withdrawal or reduced relief:

- Dispose of the shares except to spouse
- Receive value from the company/person connected with company

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What is EIS relief

- Similar to SEIS, but bigger companies
- Encourage investment into trading companies
- Subscription into ordinary full-risk shares in unquoted trading company
- Established scheme – capital gains and income tax reliefs
- Can claim EIS after SEIS, provided 70% of SEIS funds used in trade

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EIS – Company requirements

At date of subscription

- UK permanent establishment
- < 250 full-time employees
- Gross assets < £15m before share issue and £16m afterwards

To be met continuously for 3 years

- Cannot be controlled by another company (restricted exceptions) so usually EIS company is 'Top Co'
- Subsidiaries where > 50% shares held
- Parent company issuing shares must have 90% trading subsidiary

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EIS – Company use of funds

- **Maximum of £5m - 12 month period from VC schemes and state aid – otherwise withdrawal**

- **For existing trade/preparation to carry on a trade/research and development**

- **From 6 April 2011 trade does not have to be in the UK**

- **Used within 2 years of later of:**
  - share issue, or
  - trade carried on

- **Can acquire a 90% qualifying subsidiary (provided subsidiary uses funds)**

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EIS – Qualifying trade

- **Commercial basis – view to a profits**
- **Same as SEIS**
- **Can carry on 'insubstantial' excluded activities - 20% test**
- **Onus on company to disclose to SCEC if breach conditions (60 days)**

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EIS – Procedure

- **SCEC**
- **Advance then formal clearance -** accounts, business plan, articles, details of trade etc.
- **Must have been trading/preparing to trade for 4 months**
- **No more than 2 years since end of year in which shares issued**
- **EIS 2 and EIS3 issued**

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EIS - Investor requirements

- Subscribe for full risk ordinary shares – no preferential rights
- Fully paid shares
- Do not hold > 30% issued share capital/voting rights/rights to winding up (including associates) – income tax relief only
- Take care with associates – linear
- Not employed by company for 3 years, nor a director (*business angels exemption*)
- No beneficial loan to acquire the shares
- No reciprocal arrangements – cross investment

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EIS – Tax reliefs on subscription

Income tax

- Income tax - 30% of amount invested
- Maximum £1m
- Year of investment or carry back i.e. 2013/14 to 2012/13 at that rate

Capital gains

- Deferral chargeable gains - no maximum
- Time limit – 1 year prior or 3 years after chargeable disposal
- No ER on deferral
- Year of disposal or carry back

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EIS – How to claim relief

Subscription

- On tax return
- Amendment to tax return up to 5 years after 31 January of the tax year
- EIS3 submission for earlier adjustment – claim on return still needed
- Must have paid sufficient tax to cover the relief

Ultimate disposal

- Disposal after 3 qualifying years – otherwise income tax relief withdrawn
- Tax free profits on exit if attracted income tax relief
- If no income tax relief – disposal is chargeable to capital gains tax
- ER maybe available
- Deferred gain becomes chargeable at rate in year becomes chargeable
- Loss relief – capital loss – convert to income loss

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EIS - Summary of tax reliefs

Tax Relief	Unconnected	Connected
Income tax relief	✓	×
Capital gains tax exemption on subscription	N/A	N/A
Capital gains tax deferral on subscription (unlimited)	✓	✓
Capital gains tax exemption on disposal	✓	×
Loss relief on disposal at a loss	✓	In some cases

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EIS – Example of tax relief

Mary disposes of an asset in 2012/13 with a gain of £25,000. In May 2013 she subscribes £10,000 for shares into a new EIS company that is currently undertaking research and development into web based design. This is owned as to 60% by her brother and 30% his wife. Mary will own 10% of the shares. She has paid £63,000 income tax in 2012/13.

Tax relief on subscription:

- **Elect to carry back the tax relief to 2012/13**
- **Capital gains tax *deferral* on the £10,000 invested (28% x £10,000 = £2,800)**
- **Income tax relief of £3,000 (£10,000 x 30%)**

Total tax relief on subscription - £3,000, and £2,800 deferred until sale of shares

EIS – Example of tax relief (continued)

Assume holds the shares for 3 years and then sells. Provided the company continues to qualify as an EIS company:

- If a gain arises on disposal – free of tax
- Deferred gain of £2,800 becomes chargeable
- If a loss arises – further tax relief - capital loss @ 28% or income tax relief with carry back if required
- Example – if the shares are sold for £3,000, a loss of £7,000 arises but income tax relief of £3,000 has been claimed already on subscription. The loss available either as a capital loss or income loss is £4,000 (£7,000 - £3,000). If Mary is a 45% income taxpayer – relief of £1,800.

- **Total income tax relief £4,800 means losing only £0.31 in the £1**

Withdrawal or reduction of tax relief

Within 3 year period from share issue

Withdrawal:

- Become employed or a director (not a business angel)
- Holding increases to > 30% with associates
- The company loses qualifying status (liquidation for genuine commercial reasons – OK)

Withdrawal or reduced relief:

- Dispose of the shares except to spouse
- Receive value from the company/person connected with company

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- **Apply for advance clearance, formal clearance**
- **Advice on the structure of the company**
- **Tax advice to investors**
- **Annual tax compliance for companies**
- **Any other tax issues including VAT, corporate tax, personal tax etc.**