STEVENS&BOLTON

ENTERPRISE INVESTMENT SCHEME (EIS) AND SEED ENTERPRISE INVESTMENT SCHEME (SEIS) OVERVIEW

INTRODUCTION

This note outlines the key conditions which need to be met and the tax treatment of the investment under both the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS). It is not designed to be a definitive statement of the qualifying conditions and tax treatment but instead is intended to provide an overview for discussion. It is based on the laws and judicial interpretation in force at the date of writing and is therefore subject to any changes in applicable tax laws and HMRC interpretations occurring after the date of this document.

If, having considered this guide, you would like to know more or to discuss your own circumstances in greater detail, please speak to your usual contact at Stevens & Bolton or a contact listed at the end of this guide.

TAX RELIEFS

Income Tax

Investors can claim relief from income tax up to the annual investment limit for funds used to subscribe for new ordinary shares issued by qualifying companies. The investment limit is £200,000 for SEIS and £1 million (with a further £1 million for investment into knowledge-intensive companies) for EIS.

The income tax liability of the investor is reduced by 50% (for SEIS) and/or 30% (for EIS) of the sums invested provided that the shares are held for 3 years. Where SEIS/EIS relief is claimed, interest relief is not available in relation to money borrowed to invest in the qualifying company.

It is possible to elect for SEIS and/or EIS shares acquired in one tax year to be treated as if they had been acquired in the preceding tax year (carry-back).

Capital Gains Tax (CGT)

If an investor obtains income tax relief on the investment, they are also entitled to exemption from CGT on a disposal of those shares provided income tax relief has not been withdrawn (i.e.. the shares are held for at least three years and no disqualifying event occurs). Relief is also given for any allowable losses arising on the disposal of the shares (less any income tax relief already claimed on those shares) against either income or chargeable gains.

The investor may also benefit from unlimited CGT deferral (of disposals from other assets) available for EIS subscriptions made within 1 year before, and 3 years after, the chargeable gain on the disposal of the asset is realised. If gains from a disposal are reinvested under a SEIS scheme in the same tax year, 50% of that gain is exempt from tax up to £200,000.

INVESTOR REQUIREMENTS

The investor must:

- not be (nor have been) connected with the investee company (or any subsidiary of the investee company) throughout Period B (for SEIS) or Period A (for EIS) (*see definitions below for meanings of "connected", "Period A" and "Period B"*)
- not grant a call option over shares in the company within Period B or be granted a put option over shares in the company at any time within Period A
- subscribe for shares for genuine commercial reasons, not tax avoidance
- for EIS only, not hold any shares in the investee company other than subscriber shares (i.e. shares held continuously by the investor since incorporation of the investee company) or other risk finance investment shares (i.e. shares acquired through VCT, SEIS or EIS)

Other considerations

There may be other points that can impact eligibility which should be considered if you are looking to issue, or subscribe for, SEIS/EIS shares, such as any value received by the investor from the company (e.g. conversion of a convertible loan note to shares, any lending arrangements between the investor and the company, and any repurchase of share capital by the company), as well as any other reciprocal or linked arrangements.

SHARE REQUIREMENTS

The shares must be non-redeemable "ordinary shares" which carry no present or future preferential rights to assets on a winding-up, certain dividends or redemption, throughout Period B.

The subscription for the shares must be wholly in cash and the shares must be fully paid up (i.e. you cannot undertake to pay cash in the future or capitalise a loan).

There must also be no arrangements in place that are designed to reduce the investment risk.

Advance subscription agreements (ASA)

It is possible to use an ASA to raise funds quickly, particularly at a time when the value of the shares in the issuing company cannot be easily ascertained (e.g. outside of a funding round/as a bridging round).

ASAs allow investors to pay their subscription funds to the issuing company, with the shares issued at a later date (within 6 months), typically on an anticipated future fundraising round or by a long-stop date. The value of the shares is specified at the time of issue (e.g. at the price of the issuing company's next fundraising round), with the number of shares issued based on that value.

Care must be taken to ensure that the ASA is kept simple, does not confer other benefits to the investor (e.g. investor consents or preferences) and is not effectively a loan in order to qualify under SEIS/EIS. In particular, the company must demonstrate how the timing and terms of any ASA fit into its business plan and planned expenditure on growth and development, and the ASA must not bear an interest charge or allow the refund of the monies paid or be capable of variation, cancellation or assignment.

COMPANY REQUIREMENTS

The investee company must:

- have a permanent establishment in the UK throughout Period B
- be unquoted when the shares are issued and there must be no arrangements for it to become quoted (AIM listed companies are not regarded as quoted)
- not be in 'financial difficulties' when the shares are issued
- have fewer than 25 (for SEIS) or 250 (for EIS, or less than 500 for knowledge intensive companies) full-time employees (or part-time equivalent) when the shares are issued – in the case of a group this is applied to the group as a whole
- be independent (i.e. not a 51% subsidiary or under the control of another company, nor have arrangements in place to that effect) throughout Period B
- only have qualifying (51%) subsidiaries (non-qualifying subsidiaries are treated as investments; care must be taken with joint venture companies), with property managing subsidiaries being 90% subsidiaries
- exist wholly for the purpose of carrying on a qualifying trade, i.e. conducted on a commercial basis with a view to making profits without a substantial amount (20%) of non-qualifying activities (being investment activities and excluded activities, e.g. property development, financial activities, energy generation and hotel/nursing home management) – in the case of a group this is looked at holistically across the group
- not have gross assets (or in the case of a group, the assets of the group, as set out in each company balance sheet rather than the group consolidated balance sheet) with a value exceeding £350,000 immediately before the share issue (for SEIS) or £15 million immediately before the share issue and £16 million immediately after (for EIS)
- not be in a partnership (itself or through a 90% subsidiary) throughout Period A (for SEIS only)

Maximum permitted age

For SEIS, the investment shares must be issued by the investee company within three years from the commencement of the qualifying trade (by the investee company or any other person), and neither the investee company nor any 51% subsidiary carried on another trade before the commencement of the qualifying trade.

For EIS, the investment shares must be issued by the investee company within 7 years from the relevant first commercial sale (or, for knowledge intensive companies, within 10 years from either the relevant first commercial sale or the date on which its annual turnover exceeded £200,000) (the "initial investment period") unless:

- an investment through VCT, social investment tax relief (SITR), SEIS or EIS was made in the investee company within the initial investment period and the further investment was anticipated in the company's business plan at the time of the previous investment;
- the investment is for at least half of the average turnover for the last five years and is used to enter into a new product or geographic market; or
- the investment is a follow-on round after a new product/geographic market fundraising round and the further investment was anticipated in the company's business plan at the time of the previous investment.

The relevant first commercial sale is the earliest first commercial sale (excluding limited sales to test the market) by the investee company, its subsidiaries or any person who previously carried on a trade that was subsequently carried on by the investee company's group.

Use of Funds

The shares must be issued:

- in order to raise money for the growth and development of the investee company or a 90% subsidiary (for EIS, the 90% subsidiary must remain a 90% subsidiary of the issuing company throughout Period B and must not carry on the trade in partnership, nor must the trade be carried on by a limited liability partnership of which a 90% subsidiary is a member) with a significant risk to the investor of loss of capital
- for the purpose of a qualifying business activity (i.e. a new qualifying trade or R&D activity towards a new qualifying trade), which is carried on by the investee company or a 90% subsidiary throughout the period of three years from the date of the share issue
- for genuine commercial reasons and not for tax avoidance purposes
- without any arrangements being in place for the cessation of trade or disposal of assets by the investee company (or a connected person) or other pre-arranged exit

The funds raised must be used within 3 years (for SEIS) or 2 years (for EIS) for the purpose of the qualifying trade. Please note that the acquisition of shares in another company or a trade/assets does not amount to employing the money raised for the purposes of a qualifying business activity.

Investment Limits

The investee company (or group if the holding company of a trading group) must take care not to exceed the investment limits, being:

- total investment of £250,000 under SEIS (or other de minimis aid)
- total investment of £12 million (£20 million for knowledge intensive companies) under SEIS, EIS, VCT or other state aid, including any investment made into a company that has at any time been a 51% subsidiary (including investments in such a company prior to it becoming such a subsidiary)
- annual investment of £5 million (£10 million for knowledge intensive companies) under SEIS, EIS, VCT or other state aid, including any investment made into a company that has been (within that 12-month period) a 51% subsidiary (including investments in such a company prior to it becoming such a subsidiary)

It is also important to note that, for SEIS, the issuing company (or group) must not have received any EIS or other venture capital trust investment on or before the day of issue of the relevant shares. For EIS, there is a further investment limit where the relevant qualifying business activity was carried on before such business was part of the investee company's group.

ADVANCE ASSURANCE

Companies are encouraged to seek advance assurance from HMRC that they meet the conditions for SEIS/EIS, and the same application can be used for both SEIS and EIS investments. This is not mandatory, although the company will need to provide the same information to HMRC when submitting their compliance statement if advance assurance is not sought. Applications for advance assurance should be made before the shares are issued or any ASA is entered into.

DEFINITIONS

Connected Persons

An individual is "connected" with a company if they (or their associate):

- are an employee or paid director of the company or a subsidiary or any company which is a partner of them (although, for SEIS only, investors can be directors (paid or unpaid) of the investee company and, for EIS, there is an exemption for certain business angel arrangements);
- directly or indirectly possesses or are entitled to acquire, in the company or any subsidiary, more than 30% of:

    - the ordinary share capital (being all issued share capital save for shares which are entitled to a fixed rate dividend only); or
    - the issued share capital; or
    - the voting power; or
    - the assets on a winding-up;
- have the power to secure that the affairs of the company are conducted in accordance with their wishes (whether through share or voting power, or through other powers conferred by the articles or other document, in the company or any other entity); or
- subscribes for shares under certain anti-avoidance arrangements

Knowledge-intensive Companies

A "knowledge-intensive company":

- has research and development or innovation costs which are at least 15% of their operating costs in at least one of the previous 3 years or at least 10% of the operating costs in each of the previous 3 years; and either:
- the company has created, is creating or is intending to create, intellectual property as the greater part of its business; or
- the company's employees with a relevant Masters or higher degree who are engaged in research and development or innovation comprise at least 20% of the company's total workforce for the period of three years from the date of the share issue.

Period A

- For SEIS, the period from the date of incorporation of the investee company to the third anniversary of the share issue
- For EIS, the period from either the date of incorporation of the investee company (or, if the investee company was incorporated more than 2 years prior to the date of the share issue, 2 years before that date) to the third anniversary of the share issue (unless the investee company (or its 90% subsidiary) had not commenced trading on the date of the share issue in which case the period ends 3 years after the commencement of trade)

Period B

- For SEIS, the period from the date of the share issue to the third anniversary of the share issue
- For EIS, the period from the date of the share issue to the third anniversary of the share issue (unless the investee company (or its 90% subsidiary) had not commenced trading on the date of the share issue in which case the period ends 3 years after the commencement of trade)

KEY CONTACTS

For further information about any of the issues raised in this guide, please contact:

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