The Seed Enterprise Scheme

an introduction for entrepreneurs and investors

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OVERVIEW

The Seed Enterprise Scheme (SEIS) is designed to help smaller companies raise money when they start to trade.

SEIS was introduced on 6 April 2012 and is modelled on the long standing Enterprise Investment Scheme (EIS), but offers more generous tax breaks to incentivise investors to invest in very early-stage companies - with all the additional risk that entails.

At the time of writing, the tax breaks are worth up to 64% of the amount invested, this includes income tax relief and capital gains tax relief.

A summary of the tax breaks:

- Income tax relief for the investor of up to 50% of the amount invested;
- Exemption from capital gains tax on the disposal of SEIS shares;
- Losses on disposal of SEIS shares are allowable for capital gains tax purposes;
- Capital gains tax reinvestment relief for chargeable gains reinvested into SEIS shares; and
- Inheritance tax business property relief once the shares have been held for two years.

A maximum of £150,000 can be raised by a company (or group of companies) through SEIS investments. This maximum is however reduced by any other de minimis state aid the company received in the three years up to and including the date of investment.

It is, of course, perfectly possible for a small company to raise more than £150,000 from a single share issue; however only £150,000 of the amount raised can qualify for SEIS.

To qualify for the SEIS scheme, and realise the tax advantages associated with the scheme, there are many complex conditions that need to be met both by the company and the investor, at various stages before, during and after the share issue.

The tax advantages available under SEIS can be withheld or withdrawn from investors if the detailed rules are not followed for at least three years after an investment is made.

A word about risk

Investing in the type of companies that qualify for SEIS is invariably a high-risk activity, which is one of the reasons why the tax reliefs are available in the first place.

Shares in unquoted companies can be difficult to sell should investors wish or need to liquidate their investment.

SEIS scheme rules are very complex and the consequences of failing to comply with those rules can be very expensive for investors. Consequently, expert professional advice MUST be sought by any company contemplating a share issue that is intended to qualify for SEIS, and by any individual thinking about investing in SEIS shares.

THE COMPANY PERSPECTIVE

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What companies can qualify

A company seeking to use SEIS must:

- Not have gross assets over £200k when the shares are issued (for a parent company this is the sum of the gross assets of all members of the group, ignoring rights of shares in or loans to another member);
- Not be a member of a partnership; and
- Have less than 25 full-time equivalent employees in total when the shares are issued.

Throughout the three year period starting with the date of issue of the shares, the company must:

- Have a permanent establishment in the UK;
- Exist for the purpose of carrying out one or more "new qualifying trades"; and
- Be the only party to carry out the activities of the new qualifying trade (unless the trade is acquired by an unconnected party or undertaken by a qualifying 90% subsidiary).

Throughout the period starting with the date of incorporation and ending three years after the date of the share issue, the company must not:

- Be controlled or under the control of another company (ignoring any "off the shelf" period from 2013/14 onwards); or
- Be a party to arrangements that would result in it becoming controlled by another company; or
- Control any other company unless it is a qualifying subsidiary (eg. a 51% subsidiary that is not controlled by any other company).

Failure to comply with these conditions throughout the three year holding period will result in the various tax reliefs being withdrawn.

Companies which at the time of the share issue are trading on a recognised stock exchange or have arrangements in place to become a quoted company (or subsidiary of a quoted company) cannot use SEIS.

Companies that have previously raised money under the EIS or Venture Capital Trust (VCT) schemes cannot use SEIS. However, companies that raise money under SEIS can go on to raise money from EIS or VCT investors.

How much money can be raised under SEIS

The maximum amount that can be raised by a company (or group) through an issue of SEIS shares is £150,000, but this is reduced by the amount of any money previously raised under SEIS and by any other de minimis aid that the company has received in the three-year period prior to the share issue.

De minimis aid

Any de minimis aid the company has received in the three years prior to the share issue is deducted from the maximum qualifying investment of £150,000.

De minimis aid includes not only grants, loans and subsidies, but also training, licences, and other free supplies from local enterprise partnerships or regional development agencies. Normally a company will be informed when they receive de minimis state aid.

When completing an advance assurance application (see later on), details of any de mimimIs state aid received by the company should be provided.

How the money must be used

The money raised must be spent within three years of the share issue on:

- A “new qualifying trade”; and/ or
- Preparing to carry out a qualifying trade; and/ or
- Research and development that is expected to lead to a qualifying trade.

The investment cannot be used to buy shares, unless the shares are in a qualifying 90% subsidiary that uses the money for a qualifying business activity.

New qualifying trade

To be a “new qualifying trade”, the activities of the trade must not have been carried on by the company, or any other person, for more than two years before the date of the share issue.

The company, and any 51% subsidiary, must not have carried out any other trade before it started the new trade. In other words a long-established company cannot qualify for SEIS by starting a new trade.

The trade must be treated as a commercial business run with a view to making profits. Companies will not qualify for SEIS if their trade consists mostly of one or more “excluded activities”.

Excluded activities

Excluded activities include certain financial activities and “passive” or “investment activities” such as plant hire, property letting, and receiving royalties.

Some land-backed trades are also excluded, including hotels, nursing homes, property development, farming, and forestry. Other excluded activities include shipbuilding, coal mining, steel production, legal and accounting services, and the subsidised generation of electricity, power, fuel or gas.

Here is the full list of excluded activities (at the time of writing):

- Dealing in land, commodities, shares, futures and other financial instruments;
- Dealing in goods other than in the normal course of a retail or wholesale trade;
- Banking, insurance, money lending or other financial activities;
- Leasing or letting assets on hire;
- Receiving royalties or license fees, unless the company has created the intangible asset itself;
- Providing legal or accountancy services;
- Farming, market gardening, woodlands and timber production;
- Property development;
- Shipbuilding;
- Operating hotels, nursing homes and similar establishments;
- The subsidised generation or export of electricity;
- The subsidised generation of heat or subsidised production of gas or fuel;
- Coal and steel production;
- Making reserve electricity generating capacity available; and
- Providing services to a connected party conducting one of the above trades.

For SEIS purposes, the company can undertake *some* excluded activities, but only to the extent they are not “substantial”. Substantial in this context means no more than 20% of the turnover or capital employed, as a proportion of the total activities.

Advance assurance

It is possible to apply to HMRC for “advance assurance” about whether or not a share issue is likely to qualify for SEIS and many investors will insist on this, even though it is not a mandatory requirement to qualify for SEIS.

The form is called form SEIS (AA) and it would normally be prepared by the company’s professional advisers who would simultaneously carry out a review of whether the qualifying conditions are met.

There are no guarantees since the company has to satisfy certain requirements for three years after the share issue. Advance assurance is not a guarantee that a share issue will qualify, but it can be helpful both to attract investors and to identify and resolve potential problems before it is too late.

Initially, clearance is given provisionally.

Issuing the shares

The shares must be full risk, ordinary shares subscribed for in cash and fully paid up at the time they are issued.

Shares are generally regarded as “issued” when the details of the share issue are entered into the company’s register of members.

Extreme care must be taken about the timing of payment and share issue. Shares should be issued *as soon as* – but not before - the monies are received from the investors. The shares should not be issued in advance or in arrears of the receipt of the money (in the latter case they would then be issued in consideration for the capitalisation of an existing debt, rather than for cash, and could therefore fail to qualify for SEIS).

If raising money under both EIS and SEIS, the company should raise the money under the SEIS share issue first, then separately raise the money under an EIS share issue at least a day later. This is because an SEIS share issue cannot be made after an EIS share issue. Note also that it is not possible to raise money under both SEIS and EIS schemes on a single share issue.

Applying for SEIS

Once the shares have been issued, a “compliance statement” (form SEIS 1) should be completed and sent to HMRC.

If advance assurance has previously been obtained on a provisional basis, copies of any documents that have changed since advance assurance was granted should be supplied to HMRC along with the completed SEIS 1.

If advance assurance was not obtained, the following information must be provided to HMRC about the company and any subsidiaries:

- Company name;
- Registered address;

- Company registration number;
- Amount and intended use of funds raised;
- The business plan and financial forecasts;
- The latest financial accounts;
- How the business will meet the “risk to capital” condition;
- Details of all trading and activities to be carried out;
- Details of which company(ies) will use the money raised by the share issue;
- The up-to-date memorandum and articles of association with details of any changes to be made;
- The information memorandum, prospectus and any other documents used in the fundraising proposal to investors;
- Details of any subscription of other side agreements between the company and shareholders;
- Details of any previous investments under venture capital schemes;
- Details of any de minimis aid received in the three years prior to the share issue; and
- Any other documents of relevance to the application.

The compliance statement may only be submitted once:

- The qualifying activity has been undertaken by the company (or a qualifying 90% subsidiary) for at least four months; or
- At least 70% of the amount raised by the share issue has been spent for qualifying purposes.

A separate application must be prepared for each share issue.

Clearance is given by HMRC based on the accuracy and completeness of the information included in the application; it is therefore *essential* that professional advice and assistance is obtained when completing the compliance statement.

What happens after the application is submitted

If the application is successful, HMRC will send a letter and compliance certificates (forms SEIS 3) for the company to give to each individual investor.

The letter includes a unique investment reference number which must be included on the compliance certificates that are given to the investors. The investors will need the compliance certificate and reference number to be able to claim their tax relief.

If the application is unsuccessful, HMRC will write to explain their decision. The company can ask them to review the decision or appeal against it.

Investor prospectus and SEIS

An investor prospectus will normally include detailed information about the proposed activities; financial forecasts; and an explanation of the tax implications of the investment for the investor. The section on tax implications would normally explain the procedures and risks associated with SEIS investment, including the potential financial consequences for investors of failing to secure, or maintain, SEIS qualifying status.

THE INVESTOR PERSPECTIVE

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To qualify for the tax advantages available under SEIS, there are conditions that the investor needs to meet and conditions that the company needs to meet. Some of those conditions apply at the time of investment; others must be met during periods before and up to three years after the share issue.

The company that is seeking investment might have an "advance assurance" letter from HMRC that shows the company and the share issue is likely to meet some of the conditions, at least at the time of the proposed share issue.

An advance assurance letter is not, however, a guarantee that all the appropriate conditions are met, nor a guarantee that events after the date of investment will not lead to SEIS status (and the associated tax reliefs) being reduced or withdrawn altogether.

Tax reliefs - overview

The tax reliefs available to the investor under SEIS are:

- Income tax relief of up to 50% of the amount invested, for up to £100,000 of qualifying investments annually (income tax relief can also be carried back one tax year);
- Gains on the disposal of SEIS shares after more than three years may be exempt from capital gains tax;
- Losses on the disposal of SEIS shares are allowable for capital gains tax purposes;
- Half of chargeable gains on the disposal of any asset may be reinvested into SEIS shares and attract an exemption of up to 50% of the amount invested; and
- SEIS investments should qualify for inheritance tax business property relief once held for two years.

Since the company may not immediately meet the SEIS conditions at the time of the investment (for example because it has not yet traded for at least four months), the investor may need sufficient resources to pay their tax liabilities in full, only claiming tax relief when (and if) it becomes available at a later date.

Income tax relief

Under SEIS, relief can be claimed by an investor for qualifying investments totalling up to £100,000 (the permitted maximum) in any tax year.

The investor can offset up to 50% of the value of the investment(s) up to the permitted maximum against their income tax liability for the tax year in which the investment was made.

The investor can also choose to treat some or all of the investment as being made in the previous tax year for the purposes of income tax relief, and offset 50% of the value of the investment against their income tax liability for the tax year immediately previous to the tax year in which the investment was made. The permitted maximum of that earlier year must take into account both any subscriptions made in that year (and not carried back) and those carried back to that year.

Relief can only be claimed against the amount of income tax the investor is due to pay in the UK; any unused income tax relief from an SEIS investment cannot be carried forward to future tax years or repaid to the investor.

In income tax computations, "tax reducers" like SEIS (and also EIS and VCT) are deducted from the tax liability before giving relief for any tax deducted at source, such as PAYE. Reductions for SEIS

investments are given in priority to those for VCT and EIS. The reduction may reduce the tax liability to nil, which may in turn result in a repayment of any tax that has been deducted at source.

There is no income tax relief for dividend income arising from investments in SEIS shares.

Example 1 – income tax relief

In 2019/20 Mary expects to have an income tax liability of £40,000.

In March 2020 Mary makes a qualifying SEIS investment of £20,000.

Mary can choose to claim a "tax reducer" of 50% of £20,000 = £10,000.

Mary's income tax liability is reduced by £10,000 from £40,000 to £30,000.

Mary's £20,000 SEIS investment has, in effect, cost her only £10,000.

Example 2 – with carry-back and unused relief

In 2018/ 19 Joe had an income tax liability of £35,000.

In 2019/ 20 Joe expects his income tax liability to be rather lower, around £25,000.

Joe decides to make a series of qualifying SEIS investments totalling £130,000 which he completes between December 2019 and February 2020 (ie. In the 2019/20 tax year).

Joe made no qualifying SEIS investments in the previous (2018/19) tax year.

The maximum investment that Joe can claim SEIS relief on in relation to any one tax year is £100,000. However, Joe can claim to treat a proportion of his SEIS investments as being made in the previous tax year, where it is beneficial to do so.

Joe can (for example) claim to treat £70,000 of his £130,000 2019/20 SEIS investments as having been made in the previous tax year, 2018/19. He can then claim a tax reducer of 50% x £70,000 = £35,000 against his 2018/19 tax bill.

Joe can also claim a tax reducer for the balance of his 2019/20 SEIS investments, £60,000, against his 2019/20 tax bill. That would be a reducer of 50% x £60,000 = £30,000.

After his claims to SEIS income tax relief his tax liabilities would then be:

2018/19: £35,000 - £35,000 = £nil

2019/20: £25,000 - £25,000* = £nil

* for 2019/20, Joe is entitled to a tax reducer of up to £30,000, however his 19/20 tax bill is only £25,000, so the balance, £5,000, is lost – it cannot be carried forward to the next tax year or repaid to Joe by HMRC.

Making a claim to income tax relief

Entitlement to SEIS income tax relief is not automatic; a claim must be made, and to be able to claim the investor must have received form SEIS 3 from the company. The claim is made by entering onto the investor's tax return the amount subscribed – limited to the permitted maximum - and details of

the investment (company name, total amount subscribed, date of issue, name of the HMRC office authorising the SEIS 3, and the HMRC reference).

A claim to carry back the relief to the previous tax year can be made on the investor's tax return for that earlier year, or, if the tax return has already been filed, by writing to HMRC with full details of the claim and a calculation of the tax repayment due.

Capital gains tax reinvestment relief

Under SEIS, the investor can also claim relief against capital gains tax.

An investor who makes a capital gain on the sale of any asset and makes a qualifying SEIS investment in the same tax year can claim relief from capital gains tax. Relief is available for 50% of the gain invested into SEIS shares, on a qualifying investment up to £100,000. In other words up to £50,000 of chargeable gains can be relieved in any one tax year.

Reinvestment relief is available in addition to, and not instead of, income tax relief, so both reliefs can be claimed in respect of the same SEIS investment.

The asset does not have to be sold before the SEIS investment is made, but if it is, it must be sold in the same tax year that the SEIS investment is treated as being made for income tax relief purposes.

It is not possible to claim income tax relief and capital gains tax relief for the same investment in *different* tax years, so if a carry-back claim is made for income tax relief, then capital gains tax reinvestment relief can be claimed only in respect of a disposal arising in the earlier tax year.

Where a carry-back claim is made for income tax relief, it is understood that HMRC will accept a claim to capital gains tax reinvestment relief in relation to a chargeable gain arising in the earlier year - even though this appears to contravene the legislation. Caution is advised when making such a claim.

Example 1 – reinvestment relief

Fred sells a residential property in March 2020 giving rise to a chargeable gain of £140,000. In the same tax year he subscribes for £100,000 of SEIS shares. Fred can claim reinvestment relief of £50,000 and his chargeable gain is then reduced to £90,000.

Example 2 – reinvestment relief (limited to 50% of gain)

Sally sells a painting in December 2019 realising a chargeable gain of £30,000. The same tax year she subscribes for £40,000 of SEIS shares. Sally can claim reinvestment relief of £15,000 and her chargeable gain is then reduced to £15,000.

Capital gains tax exemption on sale of SEIS shares

Gains on the sale of SEIS qualifying shares are exempt from capital gains tax provided that:

- The investor received income tax relief on the investment that was not subsequently withdrawn or reduced; and
- The shares were held for at least three years prior to disposal.

Therefore a chargeable gain arising on the sale of SEIS shares within three years of issue, or where SEIS income tax relief in respect of those shares has at some point been reduced or withdrawn, will receive no SEIS capital gains tax exemption.

Loss relief

If SEIS shares are sold at a loss, the loss amount, net of any income tax relief already given and not withdrawn, can be offset against taxable income for the tax year in which the shares were sold – or the tax year before.

Example 1

In March 2020 Joanna sells some SEIS shares for £20,000. She had bought them for £50,000 four years ago and obtained income tax relief of £25,000 at the time which was not subsequently withdrawn.

Joanna's loss is calculated as the loss on sale, £30,000, less the income tax received and not withdrawn, £25,000, ie. £5,000. She can claim to offset the loss of £5,000 against her taxable income for 2019/20 – or the previous tax year 2018/19.

Inheritance tax relief

Provided SEIS shares are held for at least two years they will normally qualify for inheritance tax business property relief and therefore be exempt from inheritance tax.

Interaction with tax relief for investments in other venture capital schemes

Investors can invest in different companies through different venture capital schemes (eg. EIS, VCT) in any tax year and receive the appropriate reliefs, provided the qualifying conditions under those schemes are met.

Income tax relief for SEIS investments is given in priority to that for investments in VCTs and EIS.

Qualifying investors

To be a qualifying investor:

- For a three year period starting from the date of the share issue, neither the investor nor their "associates" may be employees of the company (directors are not employees for this purpose);
- For a period starting with the date of incorporation of the company and ending three years after the date of the share issue, the investor may not have a "substantial interest" in the company; and
- For a period starting with the date of incorporation of the company and ending three years after the date of the share issue, neither the investor nor their associates may receive a loan as a result of the investment.

And in addition:

- The investor may not subscribe for the shares as part of a reciprocal arrangement whereby another person subscribes for shares in a company that he has a substantial interest in; and
- The investor must not have a tax avoidance motive.

"Associates" include:

- Parents, grandparents and great-grandparents;
- Children, grandchildren and great-grandchildren;
- Spouses and civil partners;

- Business partners; and
- Trustees of settlements where the investor is a settlor or beneficiary.

Siblings are not considered to be associates for the purposes of SEIS.

A “substantial interest” exists where the investor holds an effective 30% holding of the ordinary share capital, issued share capital, or voting power of the company or a 51% subsidiary, or a right to receive more than 30% of the assets of the company or subsidiary in the event of a winding up. Effective holdings include those which the investor enjoys as a result of holdings through companies.

SEIS is available to directors investing in their own companies, even if they are paid for their services, subject to the substantial interest test described above.

The substantial interest test is a “once and for all test” – an investor who fails the test cannot qualify for SEIS in relation to the same company at a later date, even if a new share issue dilutes their holding below 30%.

There is an exception to the substantial interest test – an individual is not disqualified if they hold more than 30% at a time when the company has not issued any shares other than subscriber shares, and the company has not yet begun to trade or make preparations for carrying on any trade or business.

Qualifying shares

The shares must be subscribed for wholly in cash and be fully paid-up at the time of issue.

Throughout the three year period from the date of issue, the shares must be full risk, ordinary shares which are not redeemable and carry no special rights to dividends or assets on a winding up.

It is possible for SEIS shares to have *limited* preferential rights to dividends, but these cannot be cumulative or allow the dividend to be varied; and the amount and date of payment must not be dependent on a decision by the company, the shareholder or any other person.

The money raised by the share issue must be used for a qualifying business activity and all spent for that purpose within three years of the share issue (insignificant amounts unspent, or spent for another purpose may be ignored).

When the shares are issued, there can be no arrangements in place:

- To protect the investor’s investment;
- To sell the shares at the end of, or during the three year period; or
- To structure the company’s activities to benefit the investor in a way not intended by the SEIS scheme.

An investor can transfer their SEIS shares to a spouse or civil partner who is then treated as being the investor for the purposes of determining whether the SEIS conditions are met on an ongoing basis.

Selling SEIS shares and clawback

An investor needs to keep their whole investment in the SEIS qualifying company for at least three years to be able to claim the full tax reliefs available.

The investor will lose tax relief (via “clawback”) if during the three year period:

- They sell some or all of the shares;
- They form a connection with the company;
- They receive money or other assets from the company or unusually high interest on a loan to them; or
- The company ceases to meet the conditions of the SEIS scheme.

HMRC must be told within 60 days of any of the above events occurring.

Time limit to claim SEIS relief

Relief may be claimed up to five years after 31 January immediately following the tax year in which the investment was made.

Example 1 – time limit

Mike makes an SEIS qualifying investment on 30 April 2020.

He has until 31 January 2027 to claim relief under SEIS.

The tax year of investment is 2020/21. 31 January immediately following this tax year is 31 January 2022. Five years from this date takes us to 31 January 2027.

How to claim SEIS relief

The company will send the investor a compliance certificate that explains the conditions of the SEIS scheme have been met and how long the shares need to be held for. It's called an SEIS 3.

Relief under SEIS cannot be claimed until this certificate is received.

Investors wanting to make a claim in respect of the current tax year may:

- Request a change to their PAYE tax code; or
- Make an adjustment to any Self Assessment Payment on Account that is due.

A claim for carry-back against the income tax liability of the prior tax year can be made on the investor's Self Assessment return.

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WITHDRAWAL OF SEIS TAX RELIEFS

Money raised under SEIS must be used for the qualifying activity within three years, or the tax reliefs available will be withdrawn.

Income tax relief is given on SEIS shares once 70% of the money raised has been spent, or the company has been trading for four months. The company can then submit a compliance statement to HMRC who will issue a compliance certificate if they are satisfied that the qualifying conditions have been met for the time being.

It is possible to claim CGT reinvestment relief without receipt of a compliance certificate.

There are however extensive provisions for the withdrawal of relief, covering all forms of relief. The withdrawal of relief is applied as if it had never been given.

SEIS relief is withdrawn in the following circumstances:

- The investor sells the shares to someone other than their spouse or civil partner;
- A call option is granted in respect of the shares;
- The investor acquires a put option in respect of the shares;
- The investor or an associate receives "value" from the company, or a person connected with the company;
- The company carries on a trade that was previously carried on (at any time since the date of incorporation) by someone other than the company or a qualifying subsidiary;
- The company acquires at least half the assets used in a trade where the investor has or had more than a half share of the acquired trade or controls or has controlled both the issuing company and the company selling the trade;
- The company acquires all the issued share capital of another company where both companies are controlled by the same individual; or
- Relief is subsequently found not to be due, for example if the requirement to use the money is not met, or the company ceases to qualify.

Receipt of value

An investor (or an associate of an investor) receives "value" in the following circumstances:

- Repayment, redemption or repurchase of the investor's shares or securities;
- Repayment of loans to an investor/ director in connection with the acquisition of the shares (this does not apply where the debt is incurred on or after the date of the share issue and is unrelated to any debt existing before that date);
- Payment by the company to the investor for giving up a right to a debt;
- Release or waiver of any liability the investor has to the company;
- The discharge by the company of the investor's liability to a third party;
- The provision by the company to the investor of a loan or other benefit;
- The sale of assets at undervalue to the investor;
- The purchase of assets at overvalue to the investor;
- The purchase of the company's shares from the investor by a person connected with the company;
- Any payment by the company to the investor, except certain specified payments. The payment of reasonable remuneration for services provided to the company is permitted.

The payment of dividends which do not exceed a "normal" return should not represent a receipt of value. The payment of dividends out of funds raised by the share issue is not permitted however, since the money would then not be employed for the purposes of a qualifying trade.

Receipts of "insignificant" value are ignored. Insignificant means not in excess of £1,000, or such amount as is insignificant in relation to the size of the SEIS subscription.

Unlike with EIS, under SEIS the repayment or repurchasing of share capital from other investors does not lead to the withdrawal of SEIS relief.

Shares ceasing to be eligible

If the shares cease to be eligible for SEIS before the end of the three year holding period then relief is withdrawn. This may happen in various circumstances, including for example:

- The company ceasing to be a qualifying company (eg. where it ceases to carry out a qualifying trade);
- The money raised is not used for the purpose of a qualifying business activity; or
- The investor gains a substantial interest in the company.

Relief should not be withdrawn if the company goes into liquidation for genuine commercial reasons.

If the investor is granted an option that binds the grantor to buy the shares, or grants an option which on exercise obliges him to sell the shares, then the shares do not qualify.

Notification

Investors are required to notify HMRC within 60 days of any of the above events occurring within three years of the date of the share issue.

CLAWBACK

When SEIS relief is withdrawn, the tax reliefs are "clawed back".

Relief clawed back is limited to no more than that originally claimed.

The main reasons for relief clawback are considered below.

Gift or sale of SEIS shares

If the investor sells or gives away the shares within the three year period following the date of issue (except to a spouse or civil partner), income tax relief previously received will be withdrawn.

If the shares are sold or gifted to an unconnected party, the income tax relief withdrawn is calculated as 50% of the sales proceeds.

If the shares are sold at a profit or gifted to a connected party (other than a spouse or civil partner), the full amount of relief originally given is withdrawn.

If the shares are sold at a loss, there is only a partial clawback, calculated as 50% of the sales proceeds.

The clawback cannot exceed the original income tax relief. If the original relief was limited by either i) the tax liability or ii) the permitted maximum (i.e. if they subscribed for more than £100,000 of shares in any one tax year), then the sales proceeds, for the purpose of calculating clawback, are adjusted by the fraction:

Original tax relief / (original subscription x 50%)

Example 1 – sale at a profit

Simon sells his SEIS shares to a third party after two years at a £100,000 profit. He obtained relief of £30,000 on his original £75,000 investment. The original relief of £30,000 is now withdrawn.

Example 2 – sale at a loss

Karen sells her SEIS shares, originally bought for £50,000, for £40,000 after eighteen months. She obtained income tax relief of £25,000 on the original investment. Relief of £20,000 is now clawed back (being 50% of the sales proceeds).

Example 3 – sale at a loss where original relief was limited

Mark sells his SEIS shares, originally bought for £50,000, for £40,000 after a year. He obtained income tax relief of £15,000 on the original investment.

The sales proceeds, for the purpose of calculating clawback, are adjusted by the fraction 15,000 / (50,000 x 50%) = 0.6.

The relief now clawed back is therefore limited to 50% x 0.6 x £40,000 = £12,000.

Matching rules

For the purpose of calculating income tax relief clawback, gifts and sales of SEIS shares are calculated on a first in, first out basis.

In the case of shares acquired on the same day, the disposal is matched in the following order:

- Shares on which neither SEIS, EIS nor capital gains tax deferral relief has been claimed;

- Shares on which only SEIS relief has been claimed;
- Shares on which EIS deferral relief and/ or income tax relief have been claimed.

Shares that have been transferred to a spouse or civil partner are treated as having been acquired on the original date of issue, not the date of transfer.

Where a SEIS subscription has been carried back, this is not treated as a separate issue of shares and given priority over shares in the original issue which were not carried back.

Interaction with capital gains tax

If SEIS shares are sold at a gain, the capital gain is exempt from capital gains tax, providing the investor received income tax relief on the original issue and that income tax relief has not been withdrawn. A loss is allowable for capital gains tax purposes.

For CGT purposes, to calculate the allowable loss the income tax relief given (and not subsequently withdrawn) must be deducted from the base cost of the shares.

Example 1 – allowable loss calculation

Simon acquired SEIS shares for £100,000 on which he obtained income tax relief of £45,000. Five years later he sells the shares for £40,000. The allowable loss for CGT purposes is calculated as the proceeds, £40,000, less the adjusted base cost £55,000, ie. £15,000.

Receipt of value

If the investor or an associate receives value from the company (as discussed in the preceding chapter), the amount of income tax relief withdrawn is calculated as 50% of the value received.

The value received is reduced pro-rata if full income tax relief was not received originally.

How HMRC administers clawback

HMRC will raise an assessment for the tax year in which the relief was originally obtained, rather than the year in which the event that triggers the clawback occurs.

HMRC must give notice to the company or the company must notify HMRC if it considers that SEIS relief should be withdrawn.

Interest on the withdrawn relief runs from 31 January following the end of the tax year in which the assessment was made.

FINDING A COMPANY TO INVEST IN

Investing in relatively small, unquoted companies is a high-risk activity. It is normally the domain of business angels – sophisticated, often high net worth individuals acting individually or as part of business angel syndicates.

Local business angel groups may have investment opportunities.

SEIS funds also exist that enable investment across a range of qualifying companies.

Always consult your financial advisor before making an SEIS investment.

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HOW WE CAN HELP

Entrepreneurs

Scholes CA helps aspirational business owners organise and manage their business finances effectively by providing a range of accountancy, taxation and advisory services designed to help drive improved business performance. Read more at www.scholesca.co.uk.

Investors

Our experienced personal tax team advises investors on a range of tax efficient investment options, provides support with personal tax management and mitigation strategies and offers a complete Self Assessment service.