

Since 1994 the Government, via the Enterprise Investment Scheme (“EIS”), has offered favourable tax reliefs to investors investing in small, unquoted companies. More recently, the Government has also introduced the Seed Enterprise Investment Scheme (“SEIS”), an even more generous tax relief scheme to invest in high risk, early stage businesses.

The criteria for eligible EIS/SEIS investments are complex and can be easily overlooked by both investors and companies, at the initial investment and during the 3 year holding period.

Several of our entrepreneurial and private clients have been facing issues when structuring their companies or investing in EIS/SEIS companies and getting confused of how the reliefs work in practice. We have prepared the following publication to help clear some of these uncertainties and highlight how we may be able to help you.

### **Key SEIS and EIS tax reliefs/benefits, summarised below:**

- 1) Income tax relief** – 50% income tax relief for SEIS and 30% income tax for EIS investments;
- 2) CGT exemption** – No capital gains on disposal of SEIS or EIS shares;
- 3) EIS deferral relief / SEIS reinvestment relief** - Allows investors to defer capital gains crystallised on disposal of any other asset, if they are reinvested into EIS/SEIS shares;
- 4) Loss relief** - If the SEIS/EIS investment fails, the net exposure could be as low as 27.5p in the £ (for SEIS) or 38.5p in the £ (for EIS); and
- 5) Inheritance Tax Relief (“IHT”)** - Investment potentially qualifies for 100% relief from IHT, if shares held for more than two years.

### **How can we help you?**

Our team of EIS/SEIS specialists can assist you whether you are an entrepreneur seeking to raise finance via an EIS/SEIS scheme or an individual looking to invest in an EIS/SEIS company.

#### ***If you are an investor, we can:***

- Advise you on how to maximise your EIS/SEIS relief subject to your personal situation (e.g. recent gains or utilising prior year EIS/SEIS claims);
- Ensuring you structure your initial SEIS/EIS investment and advise you during the minimum 3 year holding period to reduce the risk of the EIS/SEIS income tax relief being clawed back; and
- If you like to benefit from EIS/SEIS investments and are unsure which EIS/SEIS investment you would like to invest, our sister company Duke Godley can assist by helping you choose your investment, subject to your risk appetite. Please contact [Ajit Shah](#) on 0208 515 1200.

#### ***If you are an entrepreneur starting-up or an existing SME looking to raise finance, we can:***

- Help your company qualify for raising funds, by:
  - i. Seeking EIS/SEIS advance assurance (which is not a requirement but advisable); and
  - ii. Assisting you structure your company and corporate structure pre-SEIS/EIS investment. We have specialists in this area and have prepared over 30 advance assurances across a range of sectors, with 100% acceptance rate by HMRC.

For further information please contact [Yogesh Patel](#) on 0208 515 1234.

## Key conditions

To benefit from the attractive tax reliefs and benefits, both the company seeking EIS/SEIS investment and the investors must meet strict tests and conditions. These include the following, but it is by no means an exhaustive list!

Conditions for the individual investing in SEIS/EIS companies....		
Investment holding Period	The SEIS/EIS shares must be held for at least 3 years from the date of acquisition (or commencement of trade, if later)	
Connection test	Must not be an employee or hold a substantial interest of the SEIS/EIS company (such as more than 30% share capital, including their associates) during 3 years. (Note: you can be a director but specific conditions apply)	
Conditions for qualifying SEIS/EIS companies....		
	SEIS	EIS
Qualifying Company	The company must not be trading in an 'excluded activity', such as trading in property investment, financial services, leasing, receiving royalties or nursing homes.	
Gross asset test	Qualifying company <£200,000	Qualifying company <£15 million
Max. funds SEIS/EIS company can raise	<£150,000	<£5 million
Number of employees	<25	<250
Cash raised	Must be used within 3 years	No restriction
Control test	Company cannot be under the control (>51%) of another company.	

*\*The definition of associate and substantial is not straight forward and advice should be sought prior to set up.*

As mentioned, the legislation in this area is complex and all conditions need to be met, otherwise there could be an income tax relief claw back and capital gain due to HMRC.

## Understanding the different reliefs through a worked example

We have prepared an illustrative example below to explain how an individual can benefit from the SEIS/EIS tax reliefs.

'Mr Prosperous' currently has £200,000 to invest equally in two investment opportunities: SEIS Ltd and EIS Ltd. Both companies have received advance assurance from HMRC prior to seeking investment.

### **1) Income tax relief on overall income tax liability:**

For every £1 Mr. Prosperous invests into an SEIS company, HMRC will reduce his overall income tax liability by 50p or by 30p for an EIS investment.

	SEIS Ltd	EIS Ltd
Initial investment	£100,000	£100,000
Less income tax relief (50%/30%)	(£50,000)	(£30,000)
Net cost of investment	£50,000	£70,000

*Useful tax planning note: An investor, in any one tax year, can only get income tax relief up to the annual limit of £1m for an EIS investment and up to £100,000 in an SEIS investment. However, investors may elect for share subscriptions to be treated as made in the previous tax year provided the total claim does not exceed £2m for EIS investments and £200,000 for SEIS investments.*

## 2) Capital gains exemption on disposal of SEIS/EIS:

As long as 3 years have passed since Mr Prosperous invested in the EIS/SEIS Ltd shares, the disposal of SEIS/EIS Ltd shares will not be subject to a capital gain tax.

<i>On initial investment (as above):</i>	SEIS Ltd	EIS Ltd
Initial investment	£100,000	£100,000
Less income tax relief	(£50,000)	(£30,000)
Net cost of investment	<b>£50,000</b>	<b>£70,000</b>

<i>On disposal of investment:</i>	SEIS Ltd	EIS Ltd
Disposal proceeds on disposal of shares (illustrative)	£200,000	£200,000
Return on Investment (£)	£150,000 (£200k - £50k)	£130,000 (£200k - £70k)
Return on Investment (%)	300% (£150k/£50k)	180% (£130k/£70k)

Therefore, Mr Prosperous could realise a gain of £150k and £130k for his SEIS and EIS investment and have no capital gains tax due. If these investments were not qualifying EIS/SEIS investments, there would be a capital gain liability of up to £42k and £36.4 respectively (assuming Mr Prosperous was a higher rate taxpayer).

## 3) Generous loss relief if SEIS/EIS investment fails

SEIS/EIS investments also offer generous loss reliefs of up to 45%, depending on your income tax band. Using Mr. Prosperous case, if both the investments failed and he was likely to lose his entire investment, for the EIS investment the net cost could be as low as **38.5p in £1 (38.5%)**, and **27.5p in £1 (27.5%)** for SEIS, assuming he is an additional rate (45%) taxpayer (see worked example below).

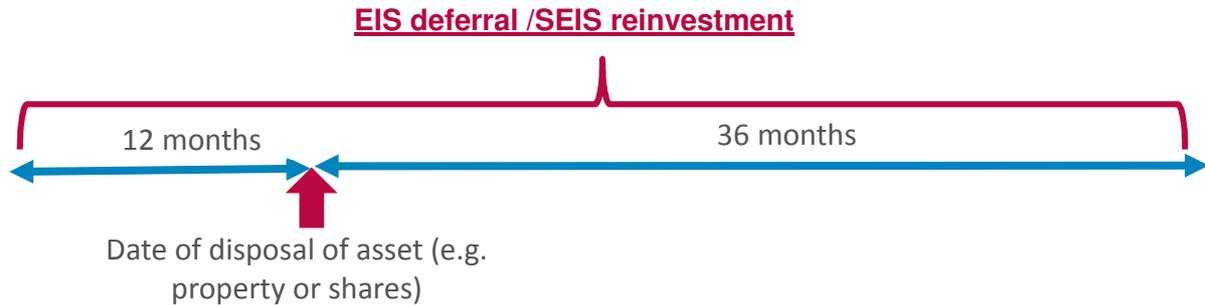
<i>On initial investment (as above)</i>	SEIS Ltd	EIS Ltd
Initial investment	£100,000	£100,000
Less income tax relief	(£50,000)	(£30,000)
Net initial cash outflow investment	<b>£50,000</b>	<b>£70,000</b>

<i>On disposal of investment:</i>	SEIS Ltd	EIS Ltd
If investments value falls to £0,	(£50,000)	(£70,000)
Loss relief @45%	£22,500 (£50k x 45%)	£31,500 (£70k x 45%)
Net loss	£27,500 (£50k - £22.5k)	38,500 (£70k - £31.5k)
Net exposure as % of initial investment cost	27.5%	38.5%

*Note: The above example assumes that Mr Prosperous has income tax payable that can be offset during the year of the disposal. If he doesn't then he can offset the loss to any capital gain during the year or carry the capital losses forward.*

## 4) SEIS reinvestment relief/EIS deferral relief when you sell any type of asset and subscribe for qualifying SEIS/EIS shares.

SEIS reinvestment relief/EIS deferral relief allows you to effectively obtain a cash flow advantage by delaying the capital gains tax due on a disposal until the SEIS/EIS shares are sold. The investment into EIS/SEIS shares must be made within 12 months before or 3 years after the original gain arose (see diagram and worked example below).



Mr. Prosperous also prior to investing in SEIS/EIS Ltd sold a buy-to-let property realising a gain of £200,000. This would have resulted him having a capital gains tax liability (@28%) of £56,000, payable on 31 January following the tax year the property was sold. However, if he reinvests part or the entire amount into qualifying EIS/SEIS shares, the CGT liability can be deferred, providing a cash flow advantage.

	SEIS Ltd*	EIS Ltd
Initial investment	£100,000	£100,000
Less income tax relief (@30%/50%)	(£50,000)	(£30,000)
Capital Gains Reinvestment (Assuming CTG at 28%)	(£28,000)	(£28,000)
Net initial cash outflow on investment	£22,000	£42,000

Therefore, the net initial cost of £100k investment in SEIS and EIS shares are £22k and £42k respectively, taking into account the income tax relief and the capital gain reinvestment/deferral relief.

However, on disposal of the SEIS/EIS investments, assuming all the qualifying conditions have been met, there will be no CGT on the disposal of the EIS/SEIS shares but the CGT deferred gain (£200,000) on the buy-to-let property will crystallise.

\* An SEIS investment has further capital gain tax benefits whereby up to 50% of any reinvestment relief obtained can be made exempt. Therefore in Mr Prosperous's case, he would only be subject to £50,000 @28% once the SEIS shares are sold, as the other £50,000 will be exempt, providing an even more beneficial advantage to invest in SEIS shares (subject to the investment risk of acquiring the shares).

For further information please contact [Yogesh Patel](#) on 0208 515 1234.

**Godley & Co.**

*Disclaimer:*

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