FARRINGFORD LEGAL

SEIS vs EIS Schemes for SMEs: Which scheme should I apply for?

- UK Government investment schemes
- Help grow your business fast

What are SEIS and EIS?

SEIS and EIS are investment schemes which are offered by the UK Government to promote innovation and entrepreneurship. The purpose of the schemes is to help SMEs grow their business quickly and provide investors with tax relief through the investments they make.

Although the schemes aren't industry-specific, HMRC's statistics reveal that the schemes are mostly used by the tech industry, accounting for 41% of all SEIS investment and 34% of all EIS investment respectively.

We will take in turn to see how the schemes differ from each other and look at the criteria for each scheme in detail.

EIS vs SEIS: What are the similarities and differences?

Similarities

Both schemes provide a number of tax reliefs to investors. However, you need to meet the following criteria to be eligible for SEIS or EIS:

- The company was incorporated in the UK.
- It isn't trading on a public stock exchange.
- The money raised by the investment must be used for trading purposes.
- Either the company or at least one of its qualifying subsidiaries (if there is one) must exist to carry on a qualifying trade involving a qualifying business activity. You won't be eligible for EIS and SEIS if over 20% of your business undertakes the following activities, which include but are not limited to:
    - Legal and accounting services
    - Banking, insurance and debt services
    - Property Development

- Running a hotel
- Running a nursing home
- Leasing activities

For more information on excluded activities , please read here.

Importantly, SEIS and EIS shares must be fully paid when they're issued to investors. The shares must be ordinary non-redeemable shares, with no preferential rights to assets on a winding up. Once you have issued the shares, you will need to submit a compliance statement (form SEIS1 for SEIS and form EIS1 for EIS) to HMRC for investors to claim tax reliefs.

Differences

It's important for SMEs to understand that SEIS and EIS are different. SEIS is aimed at seed companies that are in the very early stages of the business, whereas EIS applies to established companies. The table below shows the key differences explained further:

	SEIS	**EIS**
Maximum trading age of business	3 years	7 years but 10 years for knowledge-intensive companies
Maximum gross assets	£350,000 before share issue	£15m before share issue
Maximum investment permitted per year per investor	£200,000	£1m
Maximum raise per year	£250,000	£5m (£12m in the company's lifetime)
Corporate investors eligible?	No	Yes but they do not get tax relief on their investment.
When funds must be spent	Within 3 years	Within 2 years
Can directors hold SEIS/EIS shares?*	Yes, and relief is available	No, unless certain exceptions apply. Please read here for more information.

* A director/individual can't hold SEIS/EIS shares if they're connected to the company (i.e. holding 30% or more shares or voting control along with "associates"). Associates include a spouse/civil partner, parents/grandparents and children/grandchildren. For further information, please read here.

What do investors need to know?

Although both EIS and SEIS provide a number of tax advantages to investors, it's crucial for them to understand the reliefs they can claim. The table below is a comparative overview of reliefs available.

Farringford Legal Limited: registered in England & Wales with company number 13546843
Registered office: Farringford House, 24 Kent Road, East Molesey, Surrey KT8 9JZ

	SEIS	EIS
Income Tax	Income Tax relief is applied at 50% of the amount invested in new shares, providing a maximum annual investment of £200,000 per investor.	Income Tax relief is applied at 30% of the amount invested in new shares, providing a maximum annual investment of £1m per investor.
Capital Gains Tax (CGT) exemption	With SEIS and EIS shares, you pay 0% CGT tax on sale regardless of the amount of the gain. SEIS and EIS investors can claim CGT exemption on the sale of SEIS/EIS shares, provided the shares were held for at least 3 years.	
Loss Relief	Investors can claim loss relief to offset a loss made on a SEIS/EIS company against their taxable income or CGT. For example, you're an additional rate taxpayer paying income tax at 45%. You invest £200,000 into an EIS company. You claim 30% income tax relief which is £60,000. This means £140,000 of your total investment would be at risk. This is the amount you would have lost when the business failed. Your loss relief would therefore be 45% of £140,000 which is £63,000.	
Capital Gains reinvestment relief	With SEIS, there's a potential exemption of 50% of an existing CGT bill.	With EIS, there's a potential unlimited and indefinite deferral of an existing CGT bill.
Business Property Relief (BPR)	Where an investor holds SEIS/EIS shares in the company for at least 2 years, they will be eligible for 100% BPR for inheritance tax purposes.	

What scheme should my company use?

It depends on your company's circumstances and your funding needs. If your business doesn't satisfy the SEIS eligibility criteria, for example, if it's older than 3 years or there are more than 25 employees, you must go through the EIS route. Alternatively, if your company qualifies for SEIS, but you require more than £250,000, you could consider SEIS first and then go through the EIS route, or just consider EIS.

What happens if my company exceeds the EIS timeframe?

Just because you're outside the EIS timeframe of 7 to 10 years, that doesn't mean that you are ineligible to apply. HMRC have provided the exceptions below if your company falls outside the EIS age limit.

Condition A: Follow-on funding
Where your company received its first SEIS/EIS investment before the end of the initial investment period, Condition A allows for investment as a follow-on funding. To qualify under this condition, the company needs to prove that the funding will be used for the same business activity as the first investment and satisfy that the additional follow-on funding was foreseen at the time of the initial investment.

Condition B: Investment to enter a new product or geographic market
Condition B applies to companies that have never received SEIS/EIS investment in the past. As the name suggests, the funding must be used to enter a new product or geographic market. The aim is to help companies enter a new growth phase, and so the company must satisfy that the amount of relevant investment must be at least 50% of the company's average annual turnover, averaged over the last five years.

Can you use both schemes at the same time?

You can apply for both schemes at the same time despite being a little more complicated and time-consuming. If you're seeking investment using both the SEIS and EIS, you need to issue the shares on different days, by raising the initial investment via SEIS first before moving onto EIS provided all the conditions are met. You can't raise EIS for the first round and use SEIS for the second round. For example, once your company exceeds the £250,000 SEIS limit, you can raise additional funds of up to £5m or more via EIS.

We understand that it's really challenging for clients to grasp the rules. If you require further assistance, our team can help.

Farringford Legal
April 2024