Academic Spin-Out Relief

Academics - The tax consequences of shares in university 'spin-out' companies

Many universities have an IP-sharing policy that recognises the academics' contribution to research by allowing them to share in any benefits received from the commercialisation of the IP. Where the commercialisation results in the formation of a 'spin-out' company the academics often receive shares in that company. Whilst this can represent an excellent opportunity for the academics themselves they do need to be aware of the potential taxation implications.

Employee-related shares
When academics acquire shares in spin-out companies the shares are deemed to be 'employee-related shares'. As such there is a potential that a liability to income tax, (and in some circumstances NIC), may arise on the academic.

The employee-related share tax legislation requires the academic to consider whether they have paid market value for their shareholding. If they pay less than market value then income tax is payable on the difference or undervalue.

In many cases the academic will acquire their shares at a time when the spin-out company has no assets, prior to the transfer of IP or the first funding round. As a result the shares might have no value at the time they are acquired.

However the tax rules also include provisions which could also impose a tax charge on the academic if the IP is transferred into the spin-out at less than market value or is licensed in on favourable terms.

Academics relief
There a specific tax exemption available for academics acquiring shares in spin-out companies. Broadly, the relief operates so as to ignore the effect on the market value of the shares in the spin-out company of the transfer of the IP and therefore seeks to remove the charge to income tax on the formation of a spin-out.

In order to fall within the exemption the right to acquire the shares in the spinout must have arisen:

- as a result of an employment either with the university that has signed an IP Agreement with the spin-out company or with the spin-out company itself; and

- that person must have been involved in researching the IP that is the subject of the IP Agreement.
Accordingly employees of the university who acquire shares as a result of their contribution to the establishment of the spin-out, will be covered by this exemption if they have been involved in researching the IP. Students who are involved in the research of the IP and subsequently become employees of the spin-out are also covered. There is no requirement for the individuals to have been employed for a certain number of hours per week.

The relief is available not only in the context of universities but also applies to any institution that carries out research activities otherwise than for profit, which is not controlled by a person who carries on activities for profit. Transfers of IP by companies controlled by the university or other research body (for example, technology transfer companies) will also fall within the exemption. If more than one university collaborates on a project, the employees of one would be exempt from tax on any IP transferred by the other, provided that they satisfy the employment conditions referred to above.

As regards the timing of the IP transfers, academics will be exempt from tax on any value attributable to the IP if they acquire the shares before or within 183 days of the IP agreement being made.

IP is widely defined and includes such items as patents, trademarks, registered designs, copyright, information or techniques which have an industrial, commercial or other economic value and goodwill.

**Funding**

There is also a potential tax charge when funding is provided to a spin-out company. The legislation specifically states that academic relief applies only to value added to the shares as a result of an IP transfer. HMRC have indicated however that if the funding occurs after the academics have acquired shares and if there is no specific tax avoidance motive then a charge should not normally arise.

**SEED EIS and EIS**

The Enterprise Investment Scheme (EIS) and the newer SEED Enterprise Investment Scheme (SEIS) helps smaller higher-risk unquoted trading companies obtain a competitive edge in securing equity funding. It does so by providing income tax and capital gains tax reliefs for investors in qualifying shares in these companies. EIS delivers income tax relief at 30% to individuals on investments on up to £1,000,000 each tax year and SEIS is designed to benefit new start up companies. Individuals will be able to invest up to £100,000 each tax year and obtain 50% tax relief. Gains on the disposal of SEIS or EIS shares are exempt after three years so long the qualifying conditions continue to apply.

It can be possible for Academics to benefit from these tax efficient arrangements. However the rules are complex and it is crucial that specific advice is obtained before the investment is made and preferably before the spin-out company is incorporated.