Business Expansion Scheme (BES)

Darragh Kelly, BDO Dublin, outlines what Business Expansion Scheme (BES) funding is and how it can assist Ireland’s SME sector in these difficult times.

As the lack of bank credit available to small and medium-sized enterprises (“SME’s”) continues, growth trends and opportunities for SME’s continue to be delayed and threatened. Consequently, SME’s are looking for an alternative source of finance to bank funding.

The Business Expansion Scheme (BES) is a tax relief incentive scheme that provides tax relief for investment in certain corporate trades. The BES was a scheme originally introduced in 1984 intended to operate for a three year period but has been renewed on a regular basis since.

There are two main aspects to each BES investment;

1. the investor and the criteria they must fulfil to obtain the tax relief; and
2. the company and the criteria that they must meet in order to qualify for the scheme.

The Investor

A qualifying individual can invest up to €150,000 annually up to and including 2013 through a BES scheme and avail of tax relief at the higher rate of tax.

A qualifying investor is an individual who:

- Is resident in the State for the tax year in respect of which he/she makes the claim;
- Subscribes on his/her own behalf for eligible shares in a qualifying company; and
- Is not for the relevant period, as defined per the Taxes Consolidation Act 1997, connected with the company.

Eligible shares are new ordinary fully paid shares which throughout the period of five years beginning with the date on which they are issued carry no present or future preferential rights to dividends, to assets on a winding up, or to be redeemed.

The Company

The maximum BES investment in any one company or its associated companies is €2 million, although it is subject to a limit of €1.5 million in any twelve month period. Consequently a qualifying company can raise significant finance under the BES scheme.

There is detailed legislation under the Taxes Consolidation Act 1997 setting out the rules for company qualification under the scheme. In summary, a qualifying company for the BES is one which is:

- A micro, small or medium size enterprise under the EU Guidelines;
- An unquoted company (except in the case of companies listed on the Developing Companies Market);
- Engaged in a qualifying trade;
- Incorporated and resident in Ireland or any EU state;
- Has its issued share capital, fully paid up; and
- Is not regarded as a firm in difficulty for the purposes of the Community Guidelines on State Aid for rescuing and restructuring firms in difficulty.

It is important to note that medium size enterprises operating in “non assisted” areas in Ireland may only qualify for BES in their start-up phase of development as per changes made by the European Commission in 2007. “Non assisted” areas include Dublin, Meath, Kildare, Wicklow and Cork (except for the Cork Docklands). A medium size enterprise is defined as an enterprise that has more than 50 employees and less than 250 employees and has an annual turnover not exceeding €50 million or an annual balance sheet total not exceeding €43 million.

Qualifying trades include companies carrying out traditional manufacturing activities (including renewable energy generation), companies that are involved in internationally traded services, approved tourism projects and certain recycling activities.
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Enterprise Ireland, County & City Enterprise Boards, Fáilte Ireland and other Irish State Bodies have a responsibility for certifying certain client companies as qualifying trades/companies in respect of Business Expansion Schemes (BES). A company that carries out a manufacturing trade in Ireland which represents 75% or more of its annual turnover is a qualifying trade and does not require certifying.

The Approval Process
Prior to completing a BES investment the company is advised to complete a RICT Outline form (Relief for Investment in Corporate Trades) and submit to the Revenue Commissioners for review. The purpose of the RICT Outline form is to enable the company to ascertain whether or not a proposed BES share issue is likely to attract relief under the scheme.

A claim for relief by an individual in respect of a subscription for eligible shares in a qualifying company cannot be allowed unless a certificate of relief has been issued by the company in the specified form. Such a certificate cannot be issued until the company has been authorised to do so by the Inspector of Taxes. To obtain the authority to issue a certificate, a company must complete and submit the RICT 1 form to the Revenue Commissioners following RICT Outline approval and the proposed share issue.

The RICT 1 form is reviewed and on approval, the Inspector of Taxes authorises the company a RICT 2 form to issue a certificate of relief known as a RICT 3 form to the claimant (individual). The RICT 3 form should be retained by the investor for production in the event of a Revenue audit.

It should be noted that if a qualifying BES Fund invests in the company, a RICT 5 form is issued by the Fund Manager to the participants in the qualifying BES Fund to claim their relief. As a qualifying BES Fund will invest across a number of companies during the year, the manger of the fund retains the RICT 3 forms from these companies and then issues the RICT 5 form in due course.

The BES Advantages for the Company
While there is no tax advantage for the company in receipt of the BES, it is an attractive source of funding particularly in the current restricted lending environment. BES may have the following advantages for your company;

- Offer a fixed cost of finance for five years;
- Decrease the company’s gearing as the investment is equity and not debt;
- May assist in triggering additional funding (Bank, Enterprise Ireland, etc.);
- Existing shareholders retain control of the business; and
- The BES investment period is a minimum of five years and there is no repayment until the end of the five year period.

Key Rules to be Aware of
Shares must be held for at least five years if the investor wants to retain the full tax relief on his/her investment. He/she must continue to be a “qualifying investor” for a period of five years after the shares have been issued.

Conditions in relation to qualifying companies, trades and subsidiaries must continue to be met for a period of three years after the shares have been issued. The trade must be conducted on a commercial basis with a view to the realisation of profits.

The investor cannot enter into any binding agreement for any person/entity to purchase any eligible shares for a price other than the market value of the shares.

If these conditions are not met for the prescribed periods, the relief will no longer be due and, if already given, may be withdrawn.

Sources of BES Funding
There are two options available for companies who are interested in raising a BES investment. They can raise funds through a BES private placing which is aimed by the promoters at their family, friends and the market or they can raise funds from a BES Fund.

Option 1 – Private Placing
The key items a company should complete regarding a BES private placing include:

- Information memorandum which provides details on the company and the proposed investment including detailed information on risks associated with the BES investment for the investor;
- RICT Outline approval from the Revenue Commissioners;
- Tax advice regarding the structure of the proposed BES investment;
- Legal advice regarding the agreements of the investment;
- Tax & legal advice regarding the exit of the proposed BES investment after the five year BES period;
- Filing of the relevant company secretarial documents; and
- RICT 1, 2 & 3 approvals from the Revenue Commissioners following the investment.

Option 2 - BES Fund
There are a number of BES Fund Managers involved in raising and investing BES Funds. While the investor appetite for BES investment may have decreased during 2009 as a result of the current economic climate, the increase in current BES funds from the previous year signifies that investor interest and appetite may well be on the way back up for 2010.

The main difference between raising BES monies by way of a private placing or a BES Fund in respect of the company is that a BES Fund will generally have the funds raised in advance of targeting companies to invest in. This eliminates the uncertainty of receiving funds if approved by the BES Fund for investment.

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