Employment Investment Incentive (E.I.I) Scheme

Article by Paul McDevitt, FCCA, Examiner – Formation 2 Taxation

In its original format this incentive was known as the Business Expansion Scheme (BES). It was first introduced in 1984 and proved very successful. The current scheme was first introduced in the 2011 Finance Act. It has undergone a couple changes since then so it is pertinent to review the current scheme.

A taxpayer who invests in an EII scheme before December 2013 can deduct thirty forty firsts (30/41) of the investment from his or her taxable income for the year of assessment in which the shares are issued. The investor is entitled to a tax refund if he/she have paid tax on the deductible portion of his/her income, which effectively means the taxpayer gets 30% of the investment back from the Revenue Commissioners.

A further 11% tax relief will be available to investors where it has been proved that the employment levels have increased at the company at the end of the holding period or where evidence is provided that the investee company used the capital raised for expenditure on research and development.

The EII scheme allows an individual investor to obtain income tax relief on investments up to a maximum of €150,000 per annum in each tax year. Relief is available at the investor's highest rate of income tax. An investor who cannot obtain relief on all his/her investment in the year of assessment, either because his/her investments exceeds the maximum of €150,000 or his/her income in the year that is insufficient to absorb all of it, can carry forward the unrelieved amount to following years up to and including 2020, subject to the normal limit of €150,000 on the amount of investment that can be relieved in any one year.

QUALIFYING INDIVIDUALS

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, connected with the company.

An individual is deemed to be connected with the company if:

- he/she is a partner of the company;
- he/she possesses , or is entitled to acquire, more than 30% of (a) the issued ordinary share capital of the company or (b) the loan capital and issued share capital of the company, or (c) the voting power of the company;
- he/she controls the company (as defined in section 11 of the Taxes Consolidation Act, 1997); or
- he/she is investing in the company as part of a deal whereby a person connected with the company in turn invests in a separate company which the individual is connected.

The above conditions relating to connected parties as qualifying investors do not apply to an investor investing his/her own company where the amounts subscribed for the issued share capital and the loan capital do not, in aggregate, exceed €500,00. Employees and directors of the investee company may invest in the company under the scheme but are subject to certain rules.

QUALIFYING COMPANIES

In order to qualify for the EII investment the investee company must be a 'qualifying company' and must be:

- incorporated in Ireland or in another European Economic Area (EEA) State;
- a Micro, Small or Medium Sized enterprise within the European Commission definition in force for the relevant period;
- its shares must be unquoted, i.e. they must not be listed on the official list of stock exchange or on an unlisted securities market of stock exchange. Companies listed on the Enterprise Securities market of the Irish Stock Exchange do , however, qualify;
- it must be tax resident in Ireland or in an EEA State and, in the latter case , carry on a business in Ireland through a branch or agency;
- throughout the 3 year holding period;
    - carries on relevant trading activities from a fixed place of business in the State, or
    - consists wholly of the holding of shares or securities of, or the making of loans to, one or more qualifying subsidiaries of the company, or
    - both the holding of such shares or securities, or the making of such loans and the carrying on of relevant trading activities from a fixed place of business in the State.

QUALIFYING TRADES

EII will be available to the majority of small and medium sized enterprises (SMEs) as the qualifying trade limitations contained in the BES scheme have been for the most part removed. However, there are certain specific trades which are excluded including the following

- adventures or concerns in the nature of trade;
- dealing in commodities or futures or in shares, securities or other financial assets;
- financial activities;
- the provision of services, which would result in a close company that provided those serviced being treated as a service company;
- dealing in or developing land;
- the occupation of woodlands;
- operating or managing nursing homes or residential care homes or managing properties used as the same;
- operations carried on in the coal industry or in the steel industry and ship building sectors;
- the production of a film.

If the company is not trading at the time the shares are issued it must commence trading within two years of the share issue or it must expend not less than 30% of the money subscribed for the shares on the research and development activities which are connected with the relevant trading activity.

In recognition of the start up enterprises, organisations which have not yet commenced to trade but are engaged in research and development activities may be eligible under the EII scheme. In order for relief to be available such companies are required to expend at least 30% of the investments proceeds on research and development activities.

AMOUNT OF CAPITAL AVAILABLE

The EII scheme has raised both the annual and lifetime limit of the amount of capital a company can raise. The lifetime limit has increased to €10m and the annual limit is €2.5m.

THE SHARES
The investment must be made for ‘ordinary shares’ which are defined in the legislation as ‘shares forming part of the companies ordinary share capital’.

The shared must be fully paid up on issue and must further qualify as ‘eligible shares’, which is defined as:

‘*new ordinary shares which, throughout the period of 3 years beginning on the date on which they are issued, carry no present or future preferential right to dividends or to a company’s assets on its winding up and no present on future preferential right to be redeemed.’*

The must be issued for the purpose of raising money for a qualifying trade which is being carried on by the company or which it intends to carry on.

The company must provide satisfactory evidence to the Revenue Commissioners that the money was used for any of the following purposes;

a) Enabling the company, or enlarging its capacity, to undertake qualifying trading operations.
b) Enabling the company to engage in R&D, the acquisition of technological information and data, the development of new or existing services or products, or the provision of new products or services.
c) Enabling the company to identify new markets and to develop new and existing markets for the products and services.
d) Enabling the company to increase its sale of products or provision of services.

In all cases the money must be used with a view to the creation or maintenance of employment in the company.

An EII investor must now hold his shares for a period of three years from the date of issue.

In the event that the shares are sold within that three-year period it will result in a clawback of the EII relief for the EII investor.

CONCLUSION
Since its introduction in 1984, the BES scheme became quite a complicated piece of legislation. It is hoped that the EII scheme will stimulate greater investment in the SME sector. The widening of the trading activities that will be allowed to participate and the reduction holding period of the shares are particularly welcome charges. As can be seen from the above summary, a lot of the requirement under the existing BES scheme has transferred over to the new EII scheme and it would be advisable for companies looking to raise funds through the new EII scheme to obtain professional advice before deciding to take the EII funding route.