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EII/SURE/SCI Public Consultation
Room 2.2
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To: EIIconsultation@finance.gov.ie

24 May 2019

Dear Sir/Madam

Re: Employment and Investment Incentive (EII), Start-Up Refunds for Entrepreneurs (SURE), & Start-Up Capital Incentive (SCI)

The Institute welcomes the opportunity to provide input to the Public Consultation on EII, SURE and SCI.

The EII is a very important source of finance for early stage and small businesses that often have limited funding options available to them. It plays a vital role in scaling start-ups and small businesses to the next level of growth, helping them to expand, increase employment and raise further future investment.

In a Post-Brexit environment, smaller businesses in particular, will need to diversify into new markets and expand existing ones. Changes to supply chains and logistics may be needed in certain sectors, such as the food industry, and these can be complex and expensive. This investment will require serious financial support, by way of capital, a strong balance sheet and funding from a range of external sources. It will be critical to the expansion of the indigenous sector. The EII scheme is a vital tool that allows many viable and fundamentally sound Irish SMEs and start-up businesses to raise short-term financing at a reasonable rate of return to grow and develop.

Indecon recommendations

The Institute welcomed the recommendations of the Indecon Evaluation of the EII and SURE when it was published in October 2018. Some of the recommendations from the report were adopted in Finance Act 2018 and we look forward to the full implementation of the recommendations from the Indecon Evaluation to further improve the schemes. In particular, we firmly endorse Indecon's recommendation to allow full tax relief in the year of investment, which would significantly increase the attractiveness of the scheme to investors.

We also believe that Indecon's recommendation to increase the annual investment limit for longer-term EII investors and higher risk sectors would significantly enhance the scheme and that capital losses should be allowable for such investors.

Finance Act 2018 changes

Finance Act 2018 inserted a new Part 16 into Taxes Consolidation Act 1997 (TCA) 1997 which changed the application procedure to a primarily self-certification model. In addition, the new SCI scheme was introduced, which is intended to allow family members to make qualifying investments in certain circumstances.

The Institute very much welcomes these steps to address significant blockages within the EII scheme, although, the full impact of these changes is not yet known, as the majority of EII funds tend to be raised towards the end of the calendar year.

However, there are a number of technical issues that have arisen regarding the operation of the new legislation, which require amendment to ensure that the relief can operate as intended. We have set these out in detail at Appendix 1, together with our recommended legislative amendments.

Need for an effective scheme

Whilst the changes introduced in Finance Act 2018 are welcome, further administrative improvements are necessary to ensure the effectiveness of the EII scheme. It is hoped that the new self-certification process introduced last year will improve the EII application process going forward, however, appropriate and adequate resourcing is required to deal with legacy cases, where delays in processing applications continue to be experienced.

Such delays are creating uncertainty for taxpayers surrounding the availability of tax relief on their investments and in some cases, compromising the ability of businesses to raise EII funds. Dedicated full-time staff with the required technical knowledge to understand the complicated rules of the scheme, within the parameters of the General Block Exemption Regulations (GBER)[1], are necessary to ensure consistency in dealing with applications.

Given the complexity of the GBER, further guidance from Revenue on its interpretation of key GBER concepts is also vital, to provide taxpayers with the necessary certainty over their EII applications.

Finally, we believe that it is also essential for an appropriate customer service standard to be agreed for EII applications. This would help to restore investor confidence in the scheme.

We have summarised in Appendix 2 to this submission, our tax policy and administration recommendations for EII and SURE, which we believe are necessary to improve the overall effectiveness of the schemes.

The Institute would welcome the opportunity to attend the stakeholder consultation event on 6 June 2019 to engage further on proposals to improve EII, SURE and SCI schemes. Please contact Anne Gunnell at agunnell@taxinstitute.ie or on (01) 6631750 if you wish to discuss matters raised in this submission.

Yours truly

Marie Bradley

Marie Bradley
Institute President

[1] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible internal market in application of Articles 107 and 108 of the Treaty.

Appendix 1
Technical issues arising from Finance Act 2018 amendments to Part 16 TCA 1997

A number of technical issues have arisen as a result of the amendments introduced by Finance Act 2018 to Part 16 TCA 1997.

1. **Confirmation in legislation that conversion to ordinary shares is acceptable (Section 494 and Section 495 TCA 1997)**
   Revenue's guidance[2] clarifies that, for the purposes of sections 494 and 495, eligible shares may be shares which are convertible into ordinary shares in the event that they are not redeemed, provided the terms of the conversion are reasonable. However, this is not reflected in the existing tax legislation governing the scheme.

   Institute Recommendation: In order to provide the necessary certainty for taxpayers, Revenue's clarification that eligible shares may be shares which are convertible into ordinary shares, provided the terms of the conversion are reasonable, should be incorporated into EII legislation.

2. **Formula for calculating a clawback (Section 497 TCA 1997)**
   Section 497 sets out the formula for calculating a clawback where the maximum amount which may be raised through the issue of eligible shares is exceeded.

   For example, if a company raises any amount through the issue of eligible shares in excess of €5m in a 12-month period, an amount determined by a formula will not be a qualifying investment.

   The formula set out in section 497(3) to calculate the clawback is as follows:

   A - B,

   Where:
   A is €5 million; and
   B is (in summary) the lesser of €5 million and the amount raised through the relevant issue.

   It would appear that the formula does not achieve the desired result, because if a relevant share issue exceeds €5m, the result of the formula will always be zero.

   For example, if the relevant shares issued in a 12-month period are €7m, the lesser of €5m, and the amount raised through the relevant issue €7m, is €5 million. In that scenario, the excess is A (€5m) minus B (€5m) which equals zero. This would mean that there is no excess which is not a qualifying investment, even though €7m was raised.

[2] Relief for investment in corporate trades: as it applies to companies, Tax and Duty Manual, Part 16-00-02, Revenue Commissioners

Irish Tax Institute

We would recommend that the formula should be amended as follows:

B – A,

Where;

A is €5m; and

B is (in summary) the greater of €5m and the amount raised through the relevant issue.

A similar amendment is required in respect of the formula in section 497(4) where the amount raised exceeds the maximum threshold of €15m.

Institute Recommendation: The formulas in section 497 to calculate the clawback where relevant thresholds are exceeded should be amended to ensure the intended result is achieved.

3. Connected parties (Sections 500 and 501 TCA 1997)

The EII scheme does not permit the investor or his/her associate (including a relative) to hold any shares in the company before making the EII investment. An individual is connected with a company if they or an associate is a partner, director or employee of the company or any company in the RICT Group.

A director or employee is only connected in circumstances where they receive a payment from a company in the RICT Group, other than normal and reasonable amounts of employment related expenses, remuneration, interest, dividends, payment for goods etc.

In practice, this means that shares and share options granted to non-executive directors or other key employees, with a view to incentivising them to come on board at a start-up stage in a business, will mean that they are subsequently excluded from availing of EII relief, should they choose to invest in the company at a later date.

Investment by such individuals is key to the development of a business, as it means that they are committed to the future of the business. The position is contrary to the policy objective of EII to incentivise the development of such businesses.

In contrast, under the UK Enterprise Investment Scheme (EIS) an investor is considered 'connected' if he/she or an associate owns more than 30% of the company.

Institute Recommendation: In our view, there should be a carve-out from the connected party rule linked with a control test, so that shares and share options granted to non-executive directors or other key employees will not automatically result in them being disqualified from being a qualifying investor.

4. **Anti-dilution clauses and bonus share issues (Section 495 and Section 500 TCA 1997)**
Anti-dilution clauses are a common feature in most private investment structures. The purpose of an anti-dilution clause is to ensure that an early investor's investment in a company is not diluted as a result of the issue of new shares. Such a clause typically provides that additional bonus shares at no cost, or new shares at par, will be issued to existing investors if the company in question seeks to raise additional funds from other investors at a lower share price than what was paid by the early-stage investors.

   At present, it is unclear whether such a clause would result in otherwise eligible shares falling foul of the anti-avoidance provisions contained in section 495 TCA 1997. It is also unclear whether the receipt of such shares, during the compliance period, potentially renders the individual a non-qualifying investor under section 500 TCA 1997, as a result of them acquiring share capital in the company that did not qualify for EII relief.

   The general capital gains tax position of bonus share issues is set out in section 584 TCA 1997, which provides that the original cost is spread between the original shares and the new shares.

   Shares acquired under a rights issue are treated in the same way as shares acquired under a bonus issue. The only difference is that there is an allowance made for the amount paid to acquire the additional shares. This payment is treated as enhancement expenditure. When there is a subsequent disposal of the shares, part of the cost of the rights issue is allowed against those shares.

   Institute Recommendation: We would suggest that a similar approach to that set out in section 584 TCA 1997 for bonus share issues, should apply to bonus shares issued to EII investors.

   In addition, the legislation should be amended to clarify that anti-dilution rights will not fall foul of the anti-avoidance provisions contained in section 495 TCA 1997 or the provisions in section 500 TCA 1997.

5. **Receipt of value by a non-EII investor (Section 508R TCA 1997)**
In certain circumstances, a qualifying company can redeem shares, or purchase shares, from a member other than an EII investor who is within their compliance period, without triggering a clawback of EII relief under section 508R.

   We understand that the specific circumstances where it is intended that such a return of capital can occur is where:
   - The most recent EII/SCI/SURE supported funding in the RICT group was 18 months prior to the return of capital, and
   - The RICT group will not seek to raise EII/SCI/SURE supported funding for 12 months after the return of capital.

(i) **Amend reference to “relevant investment” to “qualifying investment”**

Currently the provision refers to a “relevant investment” which is defined in section 504 as a SURE scheme investment. Our understanding is that it is intended that this provision should refer to a “qualifying investment”, so as to include relief under Part 16 generally and that it is not solely confined to SURE.

Institute Recommendation: The reference to “relevant investment” in section 508R(9) should be amended to refer to a “qualifying investment” so as to ensure that the provision refers to relief under Part 16 generally and that it is not solely confined to SURE.

(ii) **Extend the relaxation of clawback provisions to RICT Group**

The relaxation of the clawback provisions currently only apply where there is a redemption of shares by the “qualifying company”. However, there is no such relaxation of the rules where there is a redemption by a member of the RICT Group (other than the qualifying company).

In practice, this would mean that an EII company may be required to use EII funds to fund a clawback, in circumstances where there is a redemption by a member of the RICT Group, even though if the redemption had happened in the qualifying company there would have been no such clawback.

Institute Recommendation: In our view, the relaxation of the clawback provisions contained in section 508R(9) should be extended to apply where there is a redemption of shares by any member of the RICT Group.

6. **Withdrawal of relief and assessments on investor (Section 508V TCA 1997)**

Section 508V(1)(b)(v) provides that where EII relief was claimed and the relief is no longer due because the investor ceases to be a qualifying investor, the relief shall be withdrawn, and an assessment issued to the investor to tax under Case IV of Schedule D. However, section 508V(3) fails to specify the date on which income tax charged by such an assessment becomes due and payable.

Institute Recommendation: We would suggest that a technical amendment is required to clarify the date on which income tax charged by such an assessment withdrawing relief from an investor, becomes due and payable.

7. **Report within 60 days of an event triggering a clawback of relief (Section 508Y TCA 1997)**

Section 508Y(2) provides that where an event that would trigger a withdrawal of relief occurs, the company and any connected party who has knowledge of the matter must give notice of the matter to Revenue in writing within 60 days of the event or of acquiring knowledge of the event. However, a technical amendment is required, as the section does not specify the consequences of failing to notify Revenue of such an event.

Institute Recommendation: We recommend that an amendment is made to section 508Y in order to specify the consequences of failing to notify Revenue of an event that would trigger a withdrawal of relief.

8. **Definition of "financing activities" (Section 489 TCA 1997)**

   Section 489 defines "relevant trading activities" for the purposes of Part 16 and provides that it excludes "financing activities". However, whilst there is a definition provided for "financial activities", there is no definition of "financing activities" and the term financial activities is generally understood to have a different meaning to financing activities.

   Institute Recommendation: We suggest that a technical amendment is made to section 489 to ensure that the meaning of "financing activities" is clearly understood.

Appendix 2
EII & SURE – Tax Policy and Administration Recommendations

EII – Tax Policy Recommendations

1. **Full tax relief provided in year one**
   Income tax relief for investors is currently split into two tranches - 30% in the year of investment and an additional 10% after three years, if the company meets certain employment targets. Indecon noted in their report that the requirements to trigger the additional relief did not justify the phased approach to the relief. Investors have no influence over whether the company will achieve the necessary employment targets to allow them to claim their second tranche of relief.

   Institute Recommendation: We believe that the splitting of the relief significantly reduces the attractiveness of the EII and firmly endorse Indecon's recommendation that full relief should be granted in the year of investment.

2. **Allow the offset of losses**
   Given the high-risk nature of investments in EII companies, the non-availability of capital losses for a business venture which is ultimately unsuccessful, is an additional cost factor that must be taken into account by potential investors. Losses, net of tax relief already received, incurred on EII investments should be allowable, as recommended in the Indecon report. This would bring EII in line with the equivalent EIS scheme in the UK.

   Institute Recommendation: Capital losses realised on EII investments should be available for offset.

3. **Raise the €150,000 annual investment limit**
   The Irish market contains a limited number of individuals who have funds to invest in a business through the EII. At a time when these businesses need a diverse range of finance, the annual cap of €150,000 for these investors is further limiting the funding available for companies through the scheme. The equivalent UK EIS scheme has a Stg£1million investment limit and the limit for the Irish scheme should be increased to an equivalent amount.

   Institute Recommendation: The annual investment limit of €150,000 for EII investors should be increased.

4. **Extend EII relief to USC and PRSI**
   Currently EII relief is only available against income tax and not either USC or PRSI. This reduces the relief available to 40%, when the investor's marginal tax rate may be as high as 55%.

   Institute Recommendation: EII relief should be extended to include USC and PRSI.

EII – Tax Administration Recommendations

We have outlined below three key tax administration recommendations which we believe would address some prevailing concerns and would help to restore investor confidence in the operation of the scheme.

1. **Resourcing**

It is hoped that the new self-certification model will improve the application process, however, member feedback suggests that considerable delays continue to be experienced in dealing with legacy cases.

Appropriate and adequate resourcing should be committed to processing EII applications, as a matter of priority. Dedicated full-time staff with the technical knowledge to understand the complicated rules of the scheme, within the parameters of GBER, are necessary to ensure consistency in dealing with applications and to provide pre-clearance on GBER requirements (where applied for) in a timely manner.

Institute Recommendations: Appropriate and adequate resourcing should be committed to processing EII applications.

2. **Agree a customer service standard for EII applications**

We also urge the development of an agreed customer service standard for EII applications. This would be consistent with Revenue protocols that introduce service standards for processing taxpayer correspondence and tax returns, which is currently 20 working days for most correspondence.

An appropriate customer service standard for EII could be agreed through the Tax Administration Liaison Committee (TALC). A general review of the resourcing of the EII administration should also be conducted to ensure that the unit is adequately resourced to meet the agreed customer service standard going forward.

Institute Recommendations: We urge the development of an agreed customer service standard for EII applications to restore investor confidence in the scheme.

3. **Address areas of uncertainty through enhanced Revenue guidance**

Revenue guidance should be further enhanced, with practical examples encountered by Revenue, on their interpretation of the key GBER concepts, such as ‘business plans’, ‘linked/partner businesses’ and ‘an undertaking in difficulty’. It should also include information on any common errors occurring in applications. This would provide taxpayers with the necessary tax certainty regarding their EII applications.

Institute Recommendation: Given the complexity of the GBER, further guidance from Revenue on its interpretation would be particularly beneficial together with regular updates on common queries received by Revenue and any common errors encountered in applications.

SURE – Tax Policy Recommendations

1. **Extend SURE to include business founders who were previously self-employed**

   Under SURE, the individual needs to have paid sufficient income tax through the PAYE system in the previous four years. This means that a previously self-employed person, who has paid equivalent levels of income tax through the self-assessment system, does not qualify for relief. This design feature of the SURE acts as a significant barrier to the effectiveness of the scheme.

   Institute Recommendation: The SURE scheme should be extended to include new business founders who were previously self-employed and starting up another business (as well as those coming from employment).