Irish Tax Institute

February 2021

Employment Investment Incentive

Response to the Public Consultation

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1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the 30,000 strong international CTA network which includes the Chartered Institute of Taxation UK and the Tax Institute of Australia. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

2. Summary

The Irish Tax Institute welcomes the opportunity to engage with the Department of Finance and provide input to the Public Consultation on the Employment Investment Incentive (EII).[1]

The EII scheme is a very important source of finance for early stage and small businesses that often have limited funding options available to them. Our members have in-depth experience of the operation of this scheme and their input has informed our recommendations in this submission. We have responded to previous consultations undertaken by the Department of Finance on EII in 2018[2] and 2019[3] and a number of the recommendations made in those submissions remain relevant to this review.

In the post-Brexit environment, smaller businesses in particular, have had to diversify into new markets and expand existing ones. Changes to supply chains and logistics have been necessary in certain sectors, such as the food industry, and these can be complex and expensive. This investment requires serious financial support, by way of capital, a strong balance sheet and funding from a range of external sources.

Rather than having to rely solely on Government to inject cash into the economy, the EII could be used as a way for the private sector to support the return to business following the Covid-19 pandemic and to boost the creation of new jobs.

Some businesses are thriving due to Covid-19-related demand for their products or services and need investment to expand. This investment will require financial support and funding from a range of external sources, and it will be critical to the survival of many businesses. The EII scheme can provide support to viable and fundamentally sound Irish SMEs and start-up businesses with short-term financing at a reasonable rate of return to help them grow and develop.

The Institute welcomed the publication of the *Indecon Evaluation of the EII and SURE*[4] in October 2018. Many of the recommendations from that report have been adopted in successive Finance Acts and we look forward to the full implementation of the recommendations from the Indecon Evaluation to further improve both schemes. For example, Indecon's recommendation for capital losses realised on EII investments to be available for offset has not yet been implemented.

Whilst the changes introduced in 2018 and 2019 are commendable, further steps are needed to ensure the effectiveness of the EII scheme for start-ups and smaller businesses in particular. The publication of updated Revenue guidance[5] at the end of last year has helped to provide more clarity on Revenue's interpretation of the General Block Exemption Regulations (GBER)[6] which underpins the relief. But the guidance runs to 98 pages, demonstrating the inherent complexity for taxpayers attempting to raise EII finance.

It was hoped that moving to the self-certification model in 2019 would streamline and significantly improve the EII application process. However, member feedback suggests that

[1] Department of Finance, Employment Investment Incentive Public Consultation, December 2020.
[2] https://taxinstitute.ie/wp-content/uploads/2019/06/2018-05-28-ITI-submission-to-EII-2018-consultation-FINAL2.pdf
[3] https://taxinstitute.ie/wp-content/uploads/2019/06/2019-05-24-Final-ITI-submission-to-EII-SURE-SCI-consultation.pdf
[4] Indecon Evaluation of EII and SURE, 14 September 2018.
[5] Revenue's Tax and Duty Manual - Relief for investment in corporate trades Part 16-00-02, December 2020.
[6] 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

considerable delays continue to be experienced in dealing with legacy applications and taxpayers' queries in some cases. Such delays are having a significant impact on companies and investors who cannot get clarification on outstanding queries.

Dedicated full-time staff with the required technical and commercial knowledge who understand the complicated rules of the scheme must be assigned to ensure consistency in dealing with applications in a timely manner. We believe it is essential for an appropriate customer service standard to be agreed for EII applications to restore investor confidence in the scheme.

Whilst EII relief is very valuable for companies and investors, the inherent complexities of availing of the scheme can act as a significant barrier to expansion. As the scheme rules in many cases do not reflect commercial investment norms in today's world, our members report of instances where the scheme has hampered a company's ability to grow and expand, or accelerate their ability to do so, which is contrary to the spirit of the scheme.

The number of companies qualifying for EII investment has been on a consistent downward trend, falling sharply from 2016. The most recently available data[7] shows that 37 companies qualified for EII investment in 2018[8], compared to 209 companies in 2016[9] and 232 companies qualifying when the scheme was first established in 2011,[10] while 1,137 investors claimed EII relief in 2018 (at a cost to the Exchequer of €14.5 million) compared to 1,423 investors in 2011. This data highlights the difficulties many smaller businesses are experiencing in raising investment under the scheme.

We have summarised in section 3 of this submission, the Institute's 15 tax policy and administration recommendations for EII (including SURE), which we believe are necessary enhancements to improve the overall effectiveness of the scheme. We have outlined our detailed responses to the five consultation questions in section 4.

The Institute would be happy to engage further in this consultation through stakeholder meetings or direct discussions. Please contact Anne Gunnell at agunnell@taxinstitute.ie or (01) 6631750 if you require any further information.

[7] https://www.revenue.ie/en/corporate/documents/statistics/tax-expenditures/eii-stats.pdf
[8] In 2018, 37 qualifying companies raised a total of €48 million EII investment, with an average investment of almost €1.3 million per company.
[9] In 2016, 209 qualifying companies raised a total of €105.6 million EII investment, with an average investment of €506,000 per company.
[10] In 2011/2012, 232 qualifying companies raised a total of €52.2 million EII investment, with an average investment of €225,000 per company.

3. Institute Recommendations

Enhanced support for start-ups through EII

1. Introduce a streamlined administrative process for small and micro companies to help them avail of EII finance, by adopting non-mandatory template forms (for business plans, cash-flows etc.) which would ease the extensive administrative burden for them.

2. 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.

Broadening the eligible funds from Irrevocable Trusts/Designated Investment Funds by opening EII Funds to other relevant regulated fund structures

3. To increase the attractiveness of the EII scheme for institutional investors, the rules governing EII should be broadened to cater for investors pooled in vehicles which mirror the operation of an alternative investment fund established to invest in "qualifying companies" for the purposes of EII.

4. In our view, Designated Investment Funds (and other fund investments) should be permitted to utilise the capital redemption window provided under the rules of the scheme to facilitate more follow-on investment.

5. In our view, the definition of financial intermediary for the purposes of the 7-year window for firms in difficulty should be broadened beyond regulated bodies.

Relationship between Renewable Energy Support Scheme (RESS) and EII

6. We suggest that a technical amendment is made to section 490 (3)(a)(ii) TCA 1997 to ensure that a “qualifying company” for the purposes of EII includes a Renewable Energy Community (the “Relevant REC”) for Community-Led Projects under the RESS.

7. The exclusion of holding company structures is causing genuine businesses to be precluded from raising EII finance which in our view is in stark contrast to other Government funding sources. We would recommend that section 490 TCA 1997 is amended to address this issue, specifically for holding companies established by founder(s), as these structures are often a result of incubator programmes, partnerships/JVs or due to the understanding of the founder as to market norms and investor expectations on certain structures.

How EII might respond to the changing environment in which it operates

8. Introduce a carve out in “qualifying trading activities” for green/energy efficient specific projects that would permit companies that would not normally qualify for EII, to raise EII finance for investment in such products and help their business to become energy neutral.

Any matters considered relevant

9. Appropriate and adequate resourcing must be committed to processing EII applications. This could be achieved by establishing a dedicated single point of contact/team for all EII-related

queries within Revenue and applying an appropriate Revenue customer service standard to EII applications.

10. We believe it would be more proportionate for a monetary penalty to be imposed, rather than a clawback of the entire EII relief, as a sanction for an administrative error or the late filing of a return.

11. We believe the EII scheme should recognise exit strategies for investors beyond what is provided by way of a share redemption under section 508R (9) TCA 1997 or trade sale, given the high commercial risks investors assume.

12. Consideration should be given to having a 4-year holding period for all EII investments. If the 7-year rule for investments up to €500,000 is retained, we believe only a partial clawback should occur between years 5 to 7. At the very least, the first €250,000 beyond year 4 should not suffer a clawback, instead of the entire EII relief claimed.

13. In our view, enabling the Statement of Qualification to be issued once an investment has been made in a qualifying company would reduce the administrative burden for early-stage companies.

14. Capital losses, net of tax relief already received, incurred on EII investments should be allowable, in line with the recommendation made by Indecon in their 2018 evaluation of the scheme.

15. 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). Increasing awareness of the SURE scheme should also be prioritised.

4. Response to Consultation Questions

4.1. Enhanced support for start-ups through EII

The main objective of the Employment Investment Incentive (EII) scheme is to provide SMEs and start-ups with an alternative source of funding and to support the creation and retention of employment in SMEs across the economy.[11] It has been recognised as an essential source of finance for early stage and small businesses that often have limited funding options available to them.

Whilst EII relief is very valuable for companies and investors, the inherent complexities of availing of the scheme, which is underpinned by GBER[12], can act as a significant barrier for start-ups. It is having a major impact on the pace with which start-ups can raise finance and commence business.

The *Indecon Evaluation of EII and SURE*[13] recommended a simplified application process for an amended EII scheme, including an easing of the connected party restriction for small and micro companies and for a more simplified process (involving less restrictive conditions) for start-ups raising limited investments. These recommendations led to the EII scheme moving to a self-certification basis and the introduction of the Start-up Capital Incentive (SCI) scheme[14] from 1 January 2019.

However, these developments have not adequately addressed the difficulties in practice for start-ups because self-certification has now placed a significant burden on these businesses to implement complicated shareholder structures and business plans that meet GBER requirements or risk exposing the company to a clawback of the relief granted to investors. The inherent risks for the company and its directors often necessitate the engagement of external advisers to navigate the EII requirements, the cost of which many start-ups cannot afford. This issue is further compounded by the fact that any amount raised under EII cannot be used to meet the cost of such professional fees, as fees associated with raising equity risk finance are not considered a qualifying purpose for EII.[15]

Although the SCI scheme was introduced to alleviate the connected party restrictions for early-stage micro companies embarking on a brand-new venture in recognition of their reliance on friends and family for initial small-scale capital, claimants are still subject to the same level of administrative requirements as a company seeking to raise EII finance. This means start-ups raising funds under the SCI scheme must do so through a similar shareholder structure that satisfies the complicated GBER rules and detailed business plan requirements, as companies availing of EII.

Typically, small/micro businesses or their accountants do not have the in-house expertise (or the time to upskill) to raise EII finance, which means they must engage further outside experts to prepare and implement the scheme at additional cost. The penalties are disproportionately high for any missteps under the scheme, which means the same process must be followed for raising €5 million as it is for €50,000.

[11] Indecon Evaluation of EII and SURE, 14 September 2018, page iii.
[12] 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
[13] Indecon Evaluation of EII and SURE, 14 September 2018, page xiii.
[14] Section 503 TCA 1997.
[15] Revenue's Tax and Duty Manual - Relief for investment in corporate trades Part 16-00-02, December 2020, page 35.

Members have also reported cases where small businesses have undertaken to raise the EII finance themselves because they cannot afford to engage external advisers and have fallen foul of the complicated GBER requirements, resulting in a failure to secure the necessary funds. The following case example illustrates some of the difficulties and pitfalls that smaller businesses are facing when they go to the market for EII funding.

Example 1:

A small coffee shop business had an opportunity to expand into the coffee roasting business, supplying a large reseller but needed to raise finance to fund the expansion. The company was unable to raise bank finance for the new venture and did not yet meet the criteria for funding from Enterprise Ireland as a High Potential Start-up. The company sought funding from "friends and family" but could not raise sufficient funds to meet its needs. Because the coffee roasting business was considered a "linked/partner enterprise" to the coffee shop trade and not a brand-new venture, it could not avail of the SCI scheme, even though the funds required were less than €500,000.

The company decided to seek to raise the required funds under EII. The costs initially quoted to engage external advisers to prepare a business plan, legal documentation (constitution, shareholders subscription agreement), Information Memorandum, company secretarial and accounting work (including business projections) etc. needed for the company to implement an EII scheme was c.€25,000 (ex VAT) but the company considered these costs as prohibitive and undertook to prepare the EII scheme documentation themselves.

This resulted in the company implementing a shareholders' agreement (based on old Revenue guidance that was published on Revenue's website at the time) which inadvertently included terms and conditions that were no longer permitted under the EII scheme rules. The company's structure was subsequently reviewed by an adviser of a potential investor, who identified the issues, resulting in that investor and another investor pulling out of the investment, leaving a funding gap of €125,000 which was not filled. The company ultimately incurred costs of c.€20,000 to correct the legal documentation and proceeded to raise EII finance at a lower amount.

Streamlined EII process for small and micro companies

In order for the EII scheme to become more accessible to start-ups, the administration of it needs to be made simpler because early-stage micro companies do not have the means to navigate through the complexity of the EII scheme requirements. In our view, this could be achieved by introducing a more streamlined administrative process for small and micro companies.

By way of comparison, Enterprise Ireland operates the Capital Investment Initiative (CII)[16], the purpose of which is to assist Enterprise Ireland client companies improve productivity and competitiveness through the acquisition of new capital equipment and technology. The fund provides grant support up to a maximum of €250,000. The requirements of the scheme, such as business plans, project plans etc. are set out in a clear manner, providing instructional documents and templates for claimants. Support from an Enterprise Ireland advisor is also available if further assistance is required. In addition, Teagasc and the

[16] https://www.enterprise-ireland.com/en/funding-supports/Company/Esetablish-SME-Funding/Capital-Investment-Initiative.html

Department of Agriculture, Food and the Marine provide similar support for the agricultural sector.

Member feedback suggests that the viable business plan submitted by claimants is often rejected by Revenue. Undoubtedly, there is significant crossover between schemes run by Enterprise Ireland and the EII scheme which we believe could be adapted by Revenue to help reduce the complexity and administrative burden for small and micro companies.

For example, Revenue could adopt, for smaller businesses at least, non-mandatory template forms (e.g., business plan, cash flows etc.) for EII scheme purposes. This would reduce the administrative burden for taxpayers, provide clarity on the requirements to access the scheme and reduce the number of queries raised with Revenue's Incentives Branch.

Institute Recommendation: Introduce a streamlined administrative process for small and micro companies to help them avail of EII finance, by adopting non-mandatory template forms (for business plans, cash-flows etc) which would ease the extensive administrative burden for them.

Connected parties

The "connected party rule" was initially introduced into EII legislation in November 2017 in response to concerns raised by the European Commission regarding founders availing of the relief. 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.[17]

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.

However, by restricting investments to solely EII investment by self and spouse means that a spouse cannot follow their money if their non-EII spouse has already invested for non-EII securities.

The following case example illustrates how the connected party rule can operate in practice and the difficulties it can create:

Example 2:

Q Limited raised funds by way of preference shares and ordinary shares in 2017 at a time when preference shares did not qualify for the EII scheme. Mr A subscribed for preference shares and his wife subscribed for EII ordinary shares. She qualified for the EII scheme because her husband did not already have non-EII securities, as they invested simultaneously.

In 2020, Q Limited went back to its investors for a second round of funding, which was foreseen in the 2017 business plan. The company offered preference shares to investors. Mr A could not qualify for EII because he already owned preference shares, which did not at that time qualify for EII relief. Mrs A could not follow her money because her husband owned non-EII shares, even though this did not preclude her from qualifying for EII relief when she acquired her original shareholding.

In our view, the outcome outlined above does not make sense and it is not in the spirit of what the European Commission was trying to counteract.

The connected party rule presumes that the potential pool of investor money for high-risk early-stage companies in Ireland is so considerable that a company can raise funds from an entirely different cohort of investors on each round. This is not the case in the Irish market.

It also does not recognise the commercial reality that a company will seek a second round and future funding from existing investors. Investors are more likely to follow their money, which reduces the time and cost of raising capital.

In addition, shareholder agreements typically have pre-emption rights, which requires the

[17] Sections 500 & 501 TCA 1997sets out the connected party rule. A RICT Group means the company concerned, its partner businesses and linked businesses under section 489 TCA 1997.

company to offer the opportunity for investment to its existing shareholders in the first instance. Having to undergo this process knowing that they are unlikely to invest again because of the potential impact on their EII investment on Round 1 can also add to unnecessary time, cost and complexity to the funding process.

In practice, the connected party rule also limits the ability of early-stage companies to attract strong board membership because shares and share options granted to non-executive directors or other key employees, with a view to incentivising them to come on to the board, are curtailed.

Example 3:

Z Limited raised funds from both EII and non-EII scheme investors in 2019. One of the investors was a highly experienced and influential person in the sector in which the company operated. She truly believed in the technology developed by Z Ltd and was prepared to support it by way of both monetary investment and "knowledge" capital, guiding the CEO and making important industry introductions. This support greatly de-risked the investment for all stakeholders, including the State who provided the EII tax relief.

Two years post investment, the investor was invited to join the company's board of directors and was granted share options in the company in recognition of her contribution thus far. Her agreement to sit on the board was a very public and influential endorsement of the company in the market, which reduced the risk of the enterprise further and helped secure additional investment and strategic partnerships.

However, her share options rendered her a "connected person" under s500 TCA 1997 on the basis she was entitled to acquire shares in the company at a future date, which would trigger a clawback of relief claimed at a time when she was not, and had no intention of becoming, connected to the company.

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. Feedback from members suggests that the connected party rule, which handcuffs a company's ability to grow, strengthen its board and create value can make the EII scheme very unattractive to both investors and investee companies. The position is contrary to the policy objective of EII to incentivise the development of Start-ups.

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.

4.2. Broadening the eligible funds from Irrevocable Trusts/Designated Investment Funds by opening EII Funds to other relevant regulated fund structures

Allow investors to access EII through a broader range of investment vehicles

Currently, institutional investors can access the EII scheme using a "designated investment fund". A designated investment fund must be established under an irrevocable trust with investors subscribing to such a fund and the subscription monies invested held by a trustee, as nominee.[18] However, this mechanism does not cater for the full range of investors who may be interested in investing in Irish SMEs.

For example, certain investors may be pooled in limited partnership funds or structures not established under an irrevocable trust, where capital is committed by means of a mixture of debt and equity.

Institute Recommendation: To increase the attractiveness of the EII scheme for institutional investors, the rules governing EII should be broadened to cater for investors pooled in vehicles which mirror the operation of an alternative investment fund established to invest in "qualifying companies" for the purposes of EII.

Permit Designated Investment Funds (and other funds) to utilise capital redemption windows

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.[19] However, this means under the existing rules of the scheme that any individual who has multiple investments or a connected party cannot utilise the capital redemption window to enable a company to redeem their shares.[20]

The application of this restriction significantly impacts the potential for follow-on investment and reduces the potential amount that can be raised, as companies are forced to fundraise with separate investment groups or attempt to raise their full financing requirements upfront.

In addition, this restriction blocks follow-on investment from Designated Investment Funds (and other fund investments) due to the potential for repeat investors and/or connected party risks, further narrowing the investor pool available in Ireland. This approach is inconsistent with the normal equity funding environment, which occurs in rounds as milestones are hit, especially in the case of earlier stage companies.

Institute Recommendation: In our view, Designated Investment Funds (and other fund investments) should be permitted to utilise the capital redemption window provided under the rules of the scheme to facilitate more follow-on investment.

[18] Section 508I TCA 1997.
[19] Section 508R TCA 1997.
[20] Section 508R TCA 1997.

Broaden the interpretation of financial intermediary

The nature of early-stage company funding cycles often means losses are incurred and equity capital is essential to drive development. Revenue guidance on EII[21] states that where a company is deemed an "undertaking in difficulty" but it is less than seven years since its first commercial sale, a MiFID[22] regulated investment firm can deem that company to be financially viable for EII purposes if it has carried out investment research and financial analysis.

A financial intermediary is defined under GBER[23] as "*any financial institution regardless of its form and ownership, including fund-of funds, private equity investment funds, public investment funds, banks, micro-finance institutions and guarantee societies".* However, GBER does not require a financial intermediary to be regulated.

By only permitting the 7-year window for an undertaking in difficulty to be available to companies that have had the benefit of due diligence by a regulated body means those that have undergone that due diligence cannot extend the benefit of it to investors who invest directly in the company or via another non-regulated fund, notwithstanding that the due diligence may have been shared and collectively relied upon.

By narrowly confining the definition of financial intermediary to MiFID regulated firms means Designated Investment Fund managers, registered auditors, corporate finance firms etc. cannot deem companies to be financially viable for EII investment.

Institute Recommendation: In our view, the definition of financial intermediary for the purposes of the 7-year window for firms in difficulty should be broadened beyond regulated bodies.

4.3. Relationship between Renewable Energy Support Scheme (RESS) and EII

RESS[24] provides support to renewable electricity projects in Ireland. The scheme is designed to promote investment in renewable energy generation which can contribute to Ireland's ambition of 70% renewable electricity, and an EU-wide renewable energy target of 32%, by 2030, within a competitive auction based, cost effective framework.

RESS aims to encourage growth of the green economy, generate sustainable employment, and ultimately benefit the consumer, as renewables become more cost effective. Companies, joint ventures and communities that wish to participate in renewable energy projects should be supported in their endeavours.

The EII scheme should be used to help secure much needed funding in renewable electricity projects, which in turn can help deliver Ireland's ambitious renewable energy target by 2030.

[21] Revenue's Tax and Duty Manual - Relief for investment in corporate trades Part 16-00-02, December 2020.
[22] Under Regulation 5(2) European Union (Markets in Financial Instruments) Regulations 2017 SI No. 375 of 2017.
[23] Commission Regulation (EU) No 651/2014 - Article 2 (18): 'financial intermediary' means any financial institution regardless of its form and ownership, including fund-of funds, private equity investment funds, public investment funds, banks, micro-finance institutions and guarantee societies.
[24] https://www.gov.ie/en/publication/36d8d2-renewable-electricity-support-scheme/

Amend the definition of a qualifying company for EII to include Relevant REC

In order for Community-Led Projects to participate in the RESS, they must meet certain requirements under the RESS 1: 2020 Terms and Conditions. The Community-Led Project must *"at all relevant times be at least 51% owned by a Renewable Energy Community (the "Relevant REC")".* In most Community-Led Projects, the Relevant REC is structured as a Company Limited by Guarantee without a share capital (CLG). The CLG is regarded as a company for the purposes of EII.

An unintended consequence of these terms and conditions means where the Relevant REC of a Community-Led Project is structured as a company (which under RESS must hold 51% of the shares in the renewable energy project company), it will be precluded from raising funds under the EII scheme. Effectively to be a "qualifying company" for the purposes of EII, the company cannot be owned by more than 51% corporate shareholders.[25]

Institute Recommendation: We suggest that a technical amendment is made to section 490 (3)(a)(ii) TCA 1997 to ensure that a "qualifying company" for the purposes of EII includes a Renewable Energy Community (the "Relevant REC") for Community-Led Projects under the RESS.

Permit founder holding companies

Following on from the remarks above regarding Community-Led Projects, it is evident that the exclusion of holding company structures is causing genuine businesses to be precluded from EII funding. Typically, founder holding companies are established before raising EII finance is even a consideration. These structures are inadvertently borne out of genuine commercial arrangements, sometimes as a result of partnerships or Joint Ventures (JVs) arising from incubator programmes or due to the understanding of founders as to market norms and investor expectations on certain structures. In limited cases, the structure can be a legacy from a previous failed venture.

The exclusion of founder holding companies from the EII scheme is in stark contrast to other funding sources (including Enterprise Ireland and other Government funding) where founder holding company structures are permitted and in fact, are encouraged in certain sectors. GBER does not prohibit holding companies. They form part of the RICT group[26] and must therefore, conform with many of the conditions in any event. Furthermore, there are broad anti-avoidance provisions included in EII legislation[27] which Revenue can rely on to address any concerns regarding investments through founder holding company structures.

Institute Recommendation: The exclusion of holding company structures is causing genuine businesses to be precluded from raising EII finance which in our view is in stark contrast to other Government funding sources. We would recommend that section 490 TCA 1997 is amended to address this issue, specifically for holding companies established by founder(s), as these structures are often a result of incubator programmes, partnerships/JVs or due to the understanding of the founder as to market norms and investor expectations on certain structures.

[25] Section 490 (3)(a)(ii) TCA 1997.
[26] RICT Group means the company concerned, its partner businesses and linked businesses under section 489 TCA 1997.
[27] Part 16, Chapter 3, TCA 1997.

4.4. How EII might respond to the changing environment in which it operates

As outlined in 4.3 above, one of Ireland's key policy objectives is to deliver on ambitious renewable electricity targets by 2030. In looking forward to a greener economy, adapting the EII scheme to fund projects in this area would be a welcome development.

Introduce a carve out in "qualifying trading activities" for green/energy efficient specific projects

Companies carrying on green energy activities are considered qualifying companies for EII, where they produce energy from renewable sources and have made an application for a connection to a grid.[28] Consideration could be given to also permit companies that do not carry on "relevant trading activities" per se for the purposes of EII, to avail of EII finance to invest in ringfenced green energy efficient products to improve their carbon footprint.

For example, many commercial retail parks/centres may wish to install PV Solar panels on the rooftops of premises to source power for the building and become energy neutral. While we appreciate that capital allowances are available for energy efficient equipment, this does not solve the funding issue for many companies that wish to invest in such energy efficient specific projects. If a carve-out in "qualifying trading activities" was permitted for investment in ringfenced green/ energy efficient projects, consideration could be given to restrict the capital allowances available on the equipment to the extent of the amount of EII relief obtained, similar to the treatment for normal grants.

Institute Recommendation: Introduce a carve out in "qualifying trading activities" for green/ energy efficient specific projects that would permit companies that would not normally qualify for EII, to raise EII finance for investment in such products and help their business to become energy neutral.

4.5. Any matters considered relevant

Resourcing

It was hoped that moving to the self-certification model in 2019 would streamline and significantly improve the EII application process. However, member feedback suggests that considerable delays continue to be experienced in dealing with legacy applications and taxpayers' queries in some cases. Some members have noted the average wait time for a response to EII queries is 38 weeks. These delays are having a significant impact on companies and investors who cannot obtain the necessary clarifications and tax certainty on outstanding queries.

Appropriate and adequate resourcing must be committed to processing EII applications. Dedicated full-time staff who understand the complicated rules of the scheme, together with staff who have commercial knowledge and experience in dealing with businesses, must be assigned to ensure consistency in dealing with applications in a timely manner. An appropriate Revenue customer service standard[29] should apply for EII applications.

Institute Recommendation: Appropriate and adequate resourcing must be committed to

[28] Section 491(3) TCA 1997.
[29] https://www.revenue.ie/en/corporate/information-about-revenue/customer-service/service-standards/commitments-and-standards.aspx

processing EII applications. This could be achieved by establishing a dedicated single point of contact/team for all EII-related queries within Revenue and applying an appropriate Revenue customer service standard to EII applications.

Impact of non-compliance and over-reporting

Under the current rules, administrative errors or delays in the certification and reporting process can result in a full clawback of the relief on the fundraising company[30] which in our view is disproportionate to the mistake made. These penal sanctions can act as a disincentive for companies considering using the EII scheme.

All parties (i.e. founders, investors, advisers etc.) want to comply with the rules but the scheme has become so complicated over the past six years that individuals have become wary of EII as a source of finance. Furthermore, the complexity and risks involved make it one of the most expensive (and therefore unattractive) sources of finance for companies.

In our view, a monetary penalty would be a more proportionate sanction for administrative errors or the late filing of a return, rather than the claw back of the entire relief, which can act as a disincentive for companies considering using EII.

Institute Recommendation: We believe it would be more proportionate for a monetary penalty to be imposed, rather than a clawback of the entire EII relief, as a sanction for an administrative error or the late filing of a return.

Exit strategies for EII investors

EII investors assume higher than normal commercial risks compared to the normal commercial risks investors take when making an equity investment, as the scheme imposes a clawback of relief for investors still within their relevant period if other EII investors are taken out.

Furthermore, the EII scheme does not allow for exit strategies in advance of investing. Normal commercial investment decisions are always made with exit strategies being provided to investors. Investors will always ask about what the company will do with their money and how and when they will receive a return on their investment.

The EII scheme only allows investors exit by way of share redemption or a trade sale. The former attracts income tax treatment, requiring the company to have accumulated distributable reserves, and the latter only materialises for a small number of companies. Investee companies also need the ability to tidy up their share capital tables in advance of a potential exit or for other commercial reasons without the fear of contravening the EII scheme rules.

Additionally, in the event a company raises several rounds of EII funds, it is not reasonable to expect the investors in Round 1, who took on the highest levels of risk, to have to wait until the 4-year period of the final round has expired to receive a return on their investment. The redemption windows set out in section 508R (9) TCA 1997 are not sufficient.

[30] For example, where eligible shares are held by a nominee, a failure to file a nominee return (Form 21R) may result in such shares ceasing to be eligible shares and therefore there will no longer be a qualifying investment for the purposes of the relief (see section 494(2) and section 496 TCA 1997). This means that there is a clawback of the relief on the company under section 508U TCA 1997.

Institute Recommendation: We believe the EII scheme should recognise exit strategies for investors beyond what is provide by way of a share redemption under section 508R (9) TCA 1997 or trade sale, given the high commercial risks investors assume.

7-year rule for investments

From 1 January 2020, an individual investor can claim EII relief on investments up to a maximum of €250,000 per tax year. In addition, an individual investor can claim EII relief on investments up to a maximum of €500,000 from 2020 onwards, provided the relevant EII shares are retained for 7 years.[31]

Where investors haver undertaken not to dispose of the EII shares for 7 years and have availed of the maximum €500,000 relief, they cannot then 'opt out' of the election at a future date before the 7 years have expired, without suffering a clawback of the total relief initially claimed. In our view, the clawback of the entire relief initially claimed in these circumstances is not proportionate.

Instead, consideration should be given to having a 4-year holding period for all investments or, in the event that the 7-year term is retained, only a partial clawback should occur between years 5 to 7. At the very least, the first €250,000 beyond year 4 should not suffer a clawback.

Institute Recommendation: Consideration should be given to having a 4-year holding period for all EII investments. In the event that the 7-year rule for investments up to €500,000 is retained, we believe only a partial clawback should occur between years 5 to 7. At the very least, the first €250,000 beyond year 4 should not suffer a clawback, instead of the entire EII relief claimed.

Enable Statement of Qualification to be issued once an investment has been made in a qualifying company

A company is required to issue a Statement of Qualification once 30% of funding is spent on a qualifying purpose or within two years of investment.[32] There is a significant administration burden on early-stage companies to track expenditure and ensure compliance with a qualifying purpose. This administrative burden reduces the attractiveness of funding for investors due to the lack of clarity on timing on tax relief.

Institute Recommendation: In our view, enabling the Statement of Qualification to be issued once an investment has been made in a qualifying company would reduce the administrative burden for early-stage companies.

Allow the offset of capital losses

The Institute welcomed the implementation of the recommendations of the *Indecon Evaluation of the EII and SURE* in Finance Act 2018 and Finance Act 2019. However, Indecon's recommendation for capital losses realised on EII investments to be available for offset has not yet been implemented.

[31] Section 502 TCA 1997.
[32] Section 508E TCA 1997.

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 considered by potential investors. Capital losses, net of tax relief already received, incurred on EII investments should be allowable. This would bring EII in line with the equivalent Enterprise Investment Scheme in the UK.

Institute Recommendation: Capital losses, net of tax relief already received, incurred on EII investments should be allowable, in line with the recommendation made by Indecon in their 2018 evaluation of the scheme.

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

Under the Start-up Relief for Entrepreneurs (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. Apart from discriminating against self-employed workers, this restriction acts as a significant barrier to the effectiveness and applicability of SURE.

In addition, feedback from our members suggests that there is little awareness of this incentive, particularly among people who have recently left employment and are looking to quickly start up a new business. We believe promoting this incentive would increase uptake and in turn encourage entrepreneurship and job creation.

Institute Recommendation: The SURE scheme should be extended to include new business founders who were previously self-employed as well as those coming from employment. Increasing awareness of the SURE scheme should also be prioritised.