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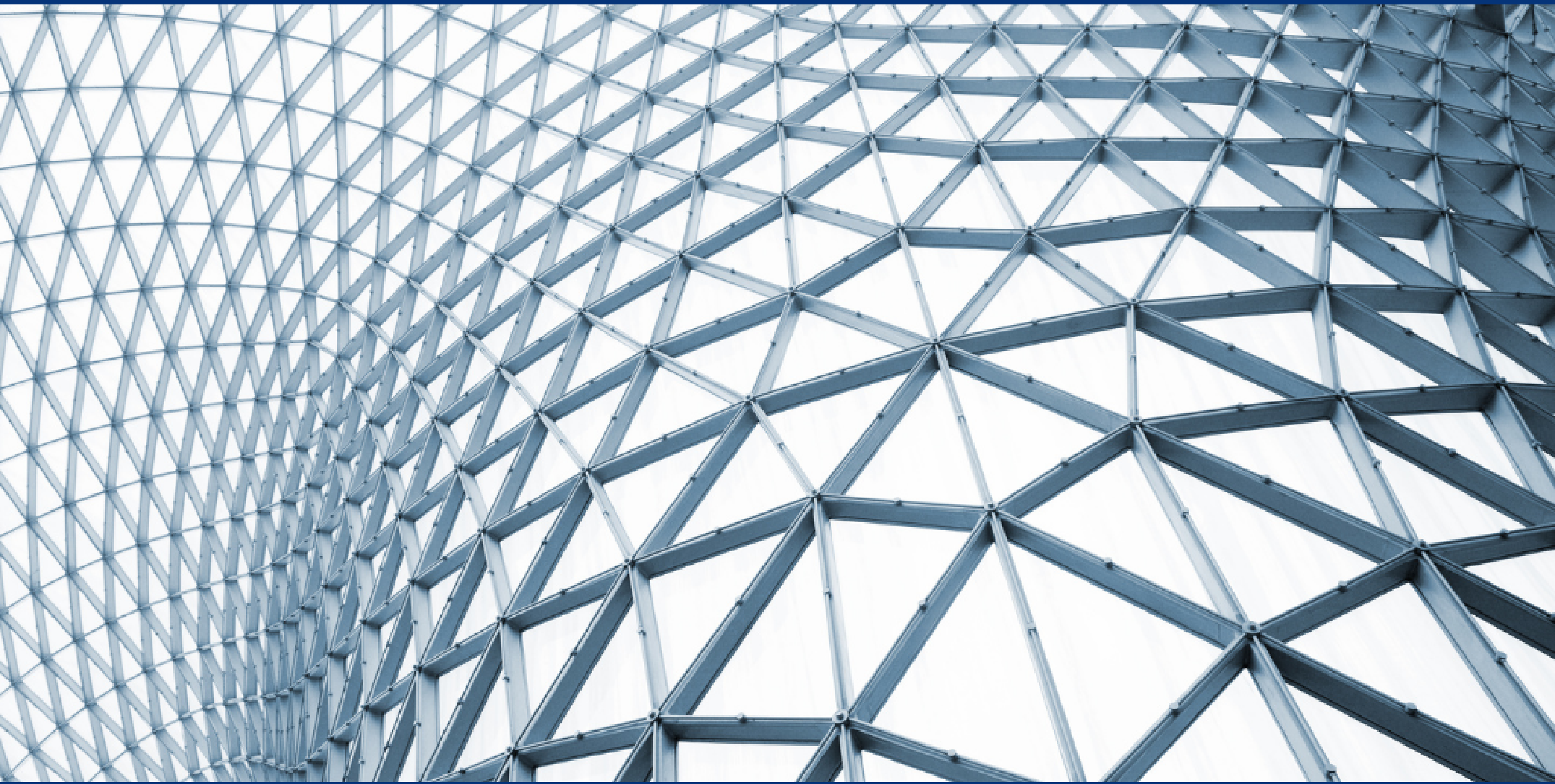

CORPORATE AND COMMERCIAL

EIIS: The Structure is Key to Avail of Relief

by **Ruairí Mulrean**

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With increasing investor appetite for EIIS investment opportunities, once again EIIS type investment is being seen as a viable funding source for private limited companies.

As the incidence of these types of investments is on the rise, a recent case in the UK is a timely reminder of the need to strictly comply with all the terms of EIIS relief when structuring such investments.

The Employment and Investment Incentive Scheme ("EIIS") replaced BES relief in 2011. By providing income tax relief for individuals who subscribe for new shares in qualifying SMEs, EIIS provides SMEs with an alternative source of capital. EIIS allows an individual investor to obtain income tax relief on investments up to a maximum of €150,000 per annum in each tax year up to 2020, subject to satisfying certain conditions. From October 2015, the overall limit of EIIS funds that may be raised by companies increased to €15,000,000 subject to a maximum of €5,000,000 in any twelve month period.

One condition of EIIS, contained in section 488 of the Taxes Consolidation Act 1997 ("Section 488"), is that shares issued to investors seeking to partake in an EIIS type investment should "carry no present or future preferential right to a company's assets on a winding up". This requirement is intended to prevent an investor being shielded from the economic risk of the investment whilst also obtaining the tax benefits of EIIS. Full participation in the economic risk of the investment is the key feature of EIIS.

Flix Innovations Ltd v The Commissioners for Her Majesty's Revenue & Customs ("**HMRC**")

The share capital of Flix Innovations Ltd ("Flix") was made up of ordinary shares and deferred shares and its articles of association gave the ordinary shares (which were the shares issued to the investors) a preferred right to a return of capital in the event of liquidation or otherwise. When Flix submitted form EIS1 (the equivalent to form EII1), HMRC denied the application as it did not comply with section 173(2)(a) of the Income Tax Act 2007, which, states that shares may not carry "any present or future preferential right to a company's assets on its winding up" (which is similar to the provisions contained in Section 488).

The tribunal rejected the argument made by Flix that because the preferential right represented only 0.05% of the market value of the shares, it was so minute that it was *de minimis*.

While accepting that in certain instances, a *de minimis* approach can be applied when interpreting legislation, the tribunal held that the conditions attaching to the relief are so "closely articulated", that the principle did not apply here. The tribunal placed some reliance on the fact that the legislation requires the certification by the company of compliance with the provisions of the scheme in coming to its conclusion that no *de minimis* approach should be applied.

Given the similarities of the relevant provisions of the schemes in Ireland and the UK, it would be prudent for EIIS investors in Ireland to take note of the decision of the tribunal in the *Flix* case. It is likely that Revenue would apply a similarly strict interpretation of the legislation. Therefore, matters that might have been considered merely trifling and minor technicalities could result in an investment falling outside EIIS and income tax relief not being available to the investors. As such, the *Flix* case serves as a timely reminder that when structuring an EIIS investment the legislative conditions of the EIIS should be strictly interpreted

and complied with.

If you would like further information, please contact Ruairi Mulrean at rmulrean@lkshields.ie.

About the Author

Ruairí Mulrean
Partner

Ruairí practises in the areas of corporate law, mergers and acquisitions, corporate restructuring and insolvency.
T: + 353 1 638 5844 **E:** rmulrean@lkshields.ie