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The Employment Investment Incentive Scheme

by **Kris O'Shea**

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Looking to the Future

The Employment Investment Incentive Scheme (EIIS) is a tax relief incentive scheme, which provides small and medium enterprises with early-stage and/or growth funding and qualifying investors with income tax relief.

Established under the Taxes Consolidation Act 1997, qualifying investors can avail of income tax relief for investments through share subscriptions in certain qualifying small and medium sized trading companies.

Companies seeking EIIS relief must seek clarification from Revenue, tax advisors and legal advisors that they qualify. There are guidelines on the Revenue website which outline how a company qualifies. Importantly, it is a self-certifying process whereby the company issues its own statement of qualification.

Investments made under the EIIS are subject to the General Block Exemption Regulation (GBER) which deals with state aid. Under the GBER, the cumulative EIIS investment is now €15m.

EIIS for the Investor

An individual can invest up to €250,000 in any one year. This has traditionally been done through a private placement (where an individual invests on their own) or through a designated investment fund (where a number of individuals invest in a fund which then chooses companies to invest in).

What are the positives for the investor?

- There is a tax relief of up to 40% on the investment amount.
- There is also potential for additional capital return on exit.
- In using a designated investment fund for the EIIS, it can be possible to gain access to larger and more stable companies.

What are the negatives for the investor?

- There is a minimum four-year holding period.
- There is an equity risk for the investor, as it ranks behind most debt in the company unless explicitly stated otherwise.
- If the transaction is poorly structured, it could result in loss of tax relief.
- It is an investment risk as there can be no guaranteed return.

Investors cannot be existing members of a company being invested in.

EIIS for the Company

A company can raise up to €15m in equity capital under the EIIS subject to a limitation of €5m in any 12-

month rolling period. It is important to note that this €15m limit includes all companies within the group.

There are restrictions on the types of trade that a company can carry on in order to access the scheme. Most trades do qualify - it is often professional services that do not qualify.

What are the positives for the company?

- There is a competitive cost of funding.
- There is equity, not debt, on the balance sheet.
- Can act as mezzanine finance in addition to senior debt.
- There will be an agreed defined exit mechanism which will not have a guaranteed bottom price.

What are the potential negatives for the company?

- It is typically prescribed through preference shares, which will rank above most other shares in terms of rights (often including shares held by founders).
- EIIS investors could ask for full equity upside as opposed to a capped return.
- The rights typically demanded by investors can be substantial.
- The company is required to repay Revenue, should it become non-qualifying.

The Finance Act 2019

The Finance Act 2019 introduced some changes to the EIIS:

- An investor's investments are now treated as a deduction from the qualifying investor's total income for the tax year of the share subscription.
- The maximum investment by a qualifying investor is now €250,000.
- Some requirements have been removed, such as "Qualifying Employees" and "Research and Development".

The Future of the EIIS

Plans to reform the EIIS to give it greater freedom have been confirmed in the 2022 budget. These plans have been broadly welcomed. The Minister for Finance has lauded the potential of the EIIS, which might suggest that it is here to stay for the foreseeable future in some iteration.   As of now, it has been extended to 2024.

A substantial change is the dropping of the requirement that a company raising EIIS funds had to spend 30% of the funds before it could issue a statement of qualification. This is in line with the self-certifying approach mentioned above. Previously, a company had to wait until 30% of the EIIS invested funds were spent before issuing their statement of qualification. Now, for investments from 1 January 2022 onwards, the statement of qualification can be issued immediately after the investment is made. This is relevant for the investee company because it will reduce the pressure to deploy funds invested as quickly as possible. From an investor's perspective, earlier confirmation of qualification will assist in financial planning.

Another positive change is the introduction of greater flexibility around the capital redemption window: investors can redeem capital after the minimum four-year hold period even where the investor may have participated in a follow-on funding round with the same company in subsequent years. Previously, if a follow-on investment was made, the initial investment could not be taken out until the follow-on investment had passed the four-year holding period. Now, investors with a number of investments in a company over multiple years may redeem an investment for a year that is outside the compliance period.

In summary, in addition to a few technical amendments, the 2022 budget's main changes are aimed at encouraging greater investment by relaxing the rules relating to EIIS investments and broadening the range of investment funds that can procure EIIS investments. It is expected that further guidelines on the EIIS will be issued in the near future. Consequently, the EIIS should be watched closely by both investors and companies as it is set to have a very interesting future.

Conclusion

Each EIIS transaction is unique, and our expert knowledge and experience ensure that our clients, whether investors or companies, will achieve an optimal outcome.

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