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Considerations for Investors and Withdrawal of Investor Relief under the Employment Investment Incentive Scheme

Overview of EII Relief for Investors

Chapter 4 of Part 16 TCA 1997 provides for income tax relief of up to 40% for investment by individuals in a qualifying company for the purposes of using the funds for a qualifying trade and the creation and maintenance of employment. The Employment Investment Incentive (EII) provides the only form of "all income" tax relief currently available to individual taxpayers. For an investment to qualify for EII relief, it needs to be for "eligible shares" by a "qualifying investor" in a "qualifying company". At a high level:

- Eligible shares for the purposes of the EII relief are newly issued shares and can now be redeemable and have preferential rights to dividends on a winding-up. The characteristics that an EII share could have

were more restricted in the past, e.g. they could not have preferential rights.

- Subject to certain exclusions and other conditions, a qualifying company is an unquoted micro, small or medium-sized trading company falling within the meaning of a RICT (relief for investment in corporate trades) group in the SME category of Annex 1 of the General Block Exemption Rules (GBER). The company must also be unlisted and must not be an undertaking in difficulty.
- A qualifying investor is an investor who is not connected with the company and is not partaking in a tax-avoidance scheme. The investor must retain the EII shares for a minimum period of four years from the date of issue to remain a qualifying investor.

Essentially, the relief is intended to offer an alternative source of finance to start-up companies or existing companies that wish to branch into a new product or market where they may not meet the parameters for regular bank financing or bank finance is too expensive.

This article is intended to cover certain key tax considerations for investors, as well as some practical issues that may arise where there is a clawback of EII relief from a compliance point of view. It is not intended to provide an overview of the EII legislation as a whole.

Investing in an Individual Company Versus Investing Via a Designated Investment Fund or Qualifying Investment Fund

A designated investment fund (DIF) is a fund that has been designated by the Revenue Commissioners under s506 TCA 1997. A DIF comprises the subscriptions of a number of investors and is likely to invest in a number of companies. Broadly, each investor will get a share in each company in proportion to the value that their subscription bears in relation to the total size of the fund. The individual companies will issue Statements of Qualification (SOQs) to the fund, and the fund will, in turn, issue a Manager's Certificate to the investors. Full relief cannot be claimed until all Manager's Certificates have been received in respect of each investment made by the fund. The relief for investment through a DIF may therefore be issued on a piecemeal basis as the investments are made in individual companies. This may be a drawback from a timing and administrative point of view for the individual investor when compared to investing in an individual company, which will issue the SOQs for the full amount of the investment to the investor directly to claim full relief.

A prior benefit to an investment via a DIF was that the investor could choose whether relief would be claimed in the year when the investment was made in the fund or the year when the fund subscribed for shares in a company. From 1 January 2020 this option is no longer available, and relief can be claimed only in the year when the investment is made in the DIF. From a commercial point of view the investor can, however, get the benefit of diversification and spreading of risk by investing through a DIF.

Investments can also be made through a qualifying investment fund (QIF). A QIF is similar to a DIF, with the main difference being that a QIF is not required to invest only in EII companies and may also invest in other companies – for example, those listed on the stock exchange.

Claiming EII Relief

The relief, which is subject to maximum limits, is claimed by the individual investor on receipt of a Statement of Qualification from the qualifying company (or a Manager's Certificate if the investment was made via a DIF). The mechanism for claiming the tax relief depends on whether the individual investor is a PAYE or self-assessed taxpayer:

- PAYE taxpayers can claim the relief by selecting "Employment Investment Incentive" from the "Other Credits" section of the income tax return in their Revenue myAccount.

- Relief in respect of self-assessed taxpayers is claimed under "Employment Investment Incentive" in the "Personal Tax Credits" section of the Form 11.

It is worth noting that the particular boxes in which relief is claimed are different depending on whether the shares are to be held for less than or a minimum of seven years. As outlined in Revenue's Tax and Duty Manual "Relief for Investment in Corporate Trades" (Part 16-00-02), the amount of relief claimed in a particular tax year depends on the rules in place in the year in which the investment was made.

Relief in respect of investments on or before 8 October 2019

Relief is granted in two tranches in respect of individual investors who made an investment on or before 8 October 2019. At this time, the maximum investment on which relief could be claimed was €150,000. Thirty-fortieths (30/40ths) of the EII investment qualified for relief in the year in which the investment was made, with relief on the remaining 10/40ths available in the fourth year after the EII investment was made. For example, an investor who made a qualifying investment of €100,000 in 2018 would have received relief in respect of €75,000 (30/40ths) in 2018 and will receive relief on the remaining €25,000 (10/40ths) in the 2022 Form 11 (or via an income tax return through myAccount if not required to file a Form 11).

Relief in respect of investments on or after 9 October 2019

A change in legislation resulted in the ability to claim relief on the full amount invested on or after 9 October 2019, subject to a maximum amount of €150,000. The maximum amount on which relief can be claimed increased to €250,000 in respect of investments made on or after 1 January 2020. This limit can be further increased to €500,000 where an investor elects at the time of share issue to retain the shares for a period of seven years.

As you will note, the rules in relation to the amount of investment that could be claimed changed from 30/40ths to 40/40ths (i.e. 100% of the investment) during the 2019 tax year (from 9 October 2019 onwards). It is therefore important to take note of the date on which the EII shares issued for a 2019 investment to ensure that the correct treatment is applied. The date of share issue should be clear from the Statement of Qualification received in relation to the investment.

Events that Give Rise to a Clawback of EII Relief

EII relief may be clawed back where:

- an investor does not retain his or her shares for the required period (minimum four years, or seven years in certain circumstances),
- an incorrect Statement of Qualification was issued to investors,
- the company ceases to be a qualifying company for the purposes of the relief,
- the investment is not a relevant investment,
- the investor ceases to be a qualifying investor,
- the company fails to create and maintain employment in the specified period,
- the funds were raised as part of a tax-avoidance scheme or
- persons other than the EII investors receive value from any company in the RICT group during the relevant period outside of the capital redemption window.

Before 1 January 2019 the clawback of relief could be assessed only on the EII investor; therefore, EII investors were in the precarious position whereby they could suffer a clawback of their EII relief owing to an action taken by the company, over which they had no control. As a result of the changes to the EII legislation introduced from 1 January 2019, there are now a number of specific circumstances whereby the clawback will be assessed on the company as opposed to the EII investor. The table below outlines the clawback position before and after 2019 when assessed on both the company and the individual investor.

	Before 1 January 2019	On or after 1 January 2019
Withdrawal of relief assessed on the company	Withdrawals of relief not assessed against the company.	Where "the company is responsible for an event for which the investor is not and could not be a party to the transaction, the withdrawal of the excess relief granted will be made by raising an assessment against the company". Such instances include: • an incorrect Statement of Qualification issued, • the company ceases to be a qualifying company within the relevant period, • the investment ceases or partially ceases to be a qualifying investment within the relevant period and • persons other than the EII investors receive value from any company in the RICT group during the relevant period outside of the capital redemption window. The withdrawal will be made by means of raising a Case IV assessment for corporation tax of 1.2 times the amount of the relief claimed by the investor in respect of shares issued up to and including 31 December 2022. Per Finance Act 2022, a Case IV assessment will be raised for corporation tax of 1.6 times the amount of relief claimed by the investor in cases of withdrawal of relief in respect of shares issued on or after 1 January 2023. The company cannot offset any loss or deficit against the Case IV amount, and the Case IV amount should not be subject to the close company surcharge.
Withdrawal of relief assessed on the individual investor	Withdrawals of relief in respect of shares issued before 1 January 2019 are made from the investor and not the company. This may happen where: • the investment is no longer a qualifying investment, • there is a disposal of shares within the required holding period that results in a clawback event or	Withdrawals of relief are made from the investor where it is identified that the withdrawal is not to be made from the company. This may happen where: • the investor ceases to be a qualifying investor within the relevant period (e.g. becomes connected with the company), • the investor receives value from the company during the compliance period or • there are arrangements, agreements or understandings to substantially reduce the risk for an investor. (Continued)

	Before 1 January 2019	On or after 1 January 2019
	• the risk finance is raised for reasons that are not bona fide commercial reasons. The withdrawal will be made by means of raising a Case IV, Schedule D, assessment for income tax for the year of assessment for which the relief was given.	The withdrawal will be made by means of raising a Case IV, Schedule D, assessment for income tax for the year of assessment for which the relief was given.

Although the recording of a withdrawal of relief from a company can be easily achieved via an amendment to the Form CT1, the mechanism by which the clawback of relief from the individual investor is to be recorded is somewhat more cumbersome.

Amending the Form 11 – or income tax return in myAccount, as a PAYE taxpayer – to include Case IV income in the amount of the investment from which relief is to be withdrawn results in income tax, USC and PRSI being chargeable on the amount of the investment to be withdrawn. This obviously gives an incorrect result, as the tax relief on the investment will have been granted only in respect of income tax at the investor's marginal rate of 20% or 40%. There is no USC or PRSI relief in respect of a qualifying EII investment.

As an alternative to amending the Form 11 or income tax return in myAccount, Revenue will, if provided with the details of the withdrawal of relief, manually amend the Form 11 in the year in which the relief was claimed and issue a notice of amended assessment to account for the clawback of the relief at the correct amount actually claimed by the investor.

Interest

Interest on an underpayment of tax by virtue of a withdrawal of EII relief tends to run from the date of the event that triggered the clawback. Section 508V TCA 1997 expands on this, outlining that:

- where relief is withdrawn due to anti-avoidance, interest runs from the date on which the agreements, arrangements or understandings were entered into; and
- where value is received by persons other than qualifying investors, interest runs from the date on which value was received.

Other Tax Considerations

Capital gains tax

Any gain arising on a sale of shares in an EII company is generally subject to capital gains tax (CGT), similar to any other investment. Section 508K TCA 1997 provides that for the purposes of calculating CGT the full acquisition cost (indexed for inflation, if applicable) may be deducted from the sales proceeds.

In the event of a loss, the amount of the deduction allowable will be reduced by the lower of:

- the amount of the income tax relief obtained (that is, the amount of relief allowed, not the tax saved) and
- the amount by which the deduction exceeds the consideration.

The effect of this restriction is that the result for CGT will normally be no gain/no loss.

Care should be taken in cases where the exit is effected as a buyback of the EII shares by the EII company itself, as a buyback of shares is

prima facie subject to income tax as opposed to CGT because it is treated as a deemed distribution unless certain conditions are met that facilitate CGT treatment's applying.

High-earners' restriction

Tax relief on EII investments is not subject to the high-earners' restriction. A married couple can each obtain individual relief on an investment of €250,000/€500,000 provided each spouse has sufficient taxable income.

Impact on preliminary tax

Self-assessed taxpayers must make a preliminary tax payment calculated on the basis of:

- 90% of the tax due for the current tax year,
- 100% of the tax due for the immediately previous tax year or
- 105% of the tax due for the pre-preceding tax year (if paying by direct debit).

If making a preliminary tax payment based on 100% of the immediately previous tax year, then the EII relief must be ignored and the preliminary tax due must be calculated as though the EII investment was not made in the previous tax year.

If basing a preliminary tax payment on 90% of the current-year liability, then account may be taken of the income tax relief applicable from the current-year EII investment, providing the EII investment is made in the tax year.

Individuals making multiple year-on-year EII investments in the same company

Companies may raise their EII funding in different tranches, and investors, in turn, may invest in each individual tranche (subject to the annual limits applicable). If an individual investor has multiple EII investments year on year in the same company, each will have its own compliance period, and care must be taken when any of that investor's shares are being redeemed to avoid triggering a clawback of relief. Section 508P TCA 1997 allows a company to redeem shares from an investor when some of the investor's EII investments are still within their compliance period and some are no longer within their compliance period, provided certain conditions are met:

- the most recent EII, Start-up Capital Incentive (SCI) or Start-Up Relief for Entrepreneurs (SURE) fundraising by the RICT group was 18 months before the return of capital;
- the RICT group will not seek to raise EII/SCI/SURE funding for 12 months after the return of capital; and
- the qualifying investor from whom the investment is redeemed will not be allowed to make another qualifying investment in that company for a period of five years after a redemption of their investments.

Taxpayers who invest in individual companies can mitigate exposure to this potential clawback of EII relief by choosing not to make year-on-year investments in the same company. Taxpayers who invest under the EII via a DIF may not have the same ability to mitigate this risk.

Conclusion

EII relief remains a very important tax relief for companies in the SME sector. The fact that the EII legislation must comply with the EU GBER has, however, resulted in the rules' being quite complex in certain areas, and this leads to issues from a practical point of view in some cases. As mentioned above, the main points to note from a practical perspective are:

- Withdrawals of relief in respect of shares issued before 1 January 2019 will always be made from the investor. In the author's experience, to avoid any issues with USC or PRSI arising on the amount of relief withdrawn, Revenue should be notified of such withdrawals of relief via MyEnquiries to enable it to issue a notice of amended assessment in respect of the tax year in which the relief was claimed. This will also apply if the withdrawal of EII relief is in respect of shares issued on or after 1 January 2019 and it has been confirmed

that the withdrawal is not to be made from the company.

- Where relief is to be withdrawn in respect of shares issued on or after 1 January 2019 and it is identified that the withdrawal is to be made from the company, the company will suffer the clawback through an increase in corporation tax and the individual investor will not need to pay any monies to Revenue in respect of a clawback of income tax relief.
- Any gain on a successful EII investment is generally subject to CGT. A loss on an EII investment is not allowable, as the CGT restrictions on the CGT calculation generally provide for a no gain/no loss result.
- Taxpayers should consider the basis on which they wish to have their preliminary tax calculated, as no account of an EII investment may be made if basing the preliminary tax payment on 100% of the tax due in the previous tax year.
- Taxpayers should also consider the implications of making multiple year-on-year investments in the same company due to the potential clawback of relief on a redemption of capital where specific conditions are not met.