

The Business Expansion Scheme

Relief for Investment in Corporate Trades

Introduction

Owners of businesses looking for outside investors or investors looking to invest in unquoted companies may be able to take advantage of the tax incentive known as the Relief for Investment in Corporate Trades, otherwise known as the Business Expansion Scheme (BES). The Scheme provides individual investors with tax relief in respect of investment in certain manufacturing, service, tourism, R & D and plant cultivation companies, companies formed for the purpose of constructing and leasing advance factory buildings and certain music recording activities. By so doing the BES can substantially reduce the cost to an investor or his/her investment. It also enhances the ability of eligible companies to attract outside investment.

For details of the legislation pertaining to the BES, see Note I.

Summary of Scheme

- The scheme was introduced in 1984 and was originally planned to run until April 1987. The scheme was extended on various occasions after that date and, is now extended to 31 December 2006.

- It is open to most people who pay Irish income tax.

- It allows the individual to obtain income tax relief on investments up to a maximum of €31,750 per annum in each tax year up to 2006. Relief is available at the investor's highest rate of income tax. An investor who cannot obtain relief on all his/her investment in a year of assessment, either because his/her investment exceeds the maximum of €31,750 or his/her income in that year is insufficient to absorb all of it, can carry forward the unrelieved amount to following years up to and including 2006, subject to the normal limit of €31,750 on the amount of investment that can be relieved in any one year.

- In order to qualify, investments must be in companies engaged in certain manufacturing, service, tourism, R & D or plant cultivation activities, in the construction and leasing of advanced factories, or in certain music recording activities.
- The investee companies must be unquoted, i.e. they must not be listed on the Full List or the Unlisted Securities Market (USM) of the Stock Exchange. Companies listed on the Developing Companies Market (DCM) or whose shares are traded in an over-the-counter market do, however, qualify.
- Investors must purchase new ordinary share capital in the company. Shares must carry no preferential rights. Normally, the minimum investment by an individual in any one company which qualifies is €250. The maximum investment by all investors in any one company or group of companies is €1,000,000 subject to a maximum of €750,000 in any one six monthly period. In the case of a company engaged in the construction and leasing of an advanced factory, however, the maximum investment in any one such company is €1,270,000 subject to a maximum of €750,000 in any one six monthly period. There must be no condition which would eliminate the investor's risk.
- Relief can be claimed immediately in the case of established companies or after four months' trading in the case of new companies.
- If the company is not trading at the time the shares are issued, it must commence trading within two years of the share issue. If the company is mainly involved in R & D activity relating to the approved trade it must commence trading within three years of the share issue.
- Shares must be held and certain conditions satisfied in relation to the investor for a period of five years. Other conditions in relation to the company need only be satisfied for three years.

The Finance Act 1993 and subsequent Finance Acts have widened the scope of the BES to provide a refund of tax already paid by an individual who sets up and takes employment in a new qualifying business. This relief is known as the Seed Capital

Scheme and a separate information booklet (IT 15) on it is available from the Revenue Commissioners.

Qualifying Investments

Each investment breaks down into a number of component parts. These are as follows:

- the investor,
- the company and its trade,
- the shares purchased,
- how the company uses the money invested.

Each of the above must meet certain criteria to ensure that the investment qualifies under the scheme.

After that, certain conditions must be met for specified periods (e.g. the shares must be held for five years) to ensure that the investment continues to qualify otherwise the tax relief granted may be withdrawn in whole or in part.

The Investor

Qualifying Investors

A qualifying investor is an individual who:

- is resident in the Republic of Ireland for the tax year in respect of which he makes the claim;
- subscribes on his/her own behalf for eligible shares in a qualifying company;
- and
- is not for the relevant period, as defined, connected with the company (see below).

Where an individual is entitled to relief in respect of a subscription by him for eligible shares under the BES he shall not be entitled to relief in respect of that subscription under section 479 of the Taxes Consolidation Act 1997.

Rules Relating to Connected Parties

An individual is deemed to be connected with a company if:

- he/she, or an associate (see Note II) of his/hers, is a partner of the company;
- he/she possesses, or is entitled to acquire, including in the event of the company being wound up, more than 30% of (a) the issued ordinary share capital of the company or (b) the loan capital and issued share capital of the company, or (c) the voting power in the company.
- he/she controls the company (as defined in Section 1 of the Taxes Consolidation Act, 1997); or
- he/she is investing in the company as part of a deal whereby a person connected with the company in turn invests in a separate company with which the individual is connected.

The above conditions relating to connected parties as qualifying investors do not apply to an investor investing in his own company where the amounts subscribed for the issued share capital and the loan capital do not in aggregate exceed €317,500.

Employees and Directors as Investors

Employees and directors of the investee company may invest in the company under the scheme but are subject to certain rules. Individuals may qualify in respect of investment in companies owned or run by family members or close relatives of theirs (provided they are not otherwise disqualified).

Number of Investors in an Individual Company

The number of BES investors in any one company is subject only to the limitation on the number of shareholders in a private company and subject also to the overall limit of €1,000,000 (subject to a maximum of €750,000 in any one six monthly period) of BES funds investible in any one company or in a number of companies promoted or owned by the same people.

Number of Companies an Investor Can Invest In

There is no limit to the number of companies an investor can invest in but tax relief is subject to the overall investment limit of €31,750 per annum up to and including 2006.

The Company

Qualifying Companies

A qualifying company is one which:

- is a Micro, Small or Medium Sized Enterprise within the European Commission definition in force for the relevant period
- is resident in the state or is resident in the European Economic Area with an establishment in the state carrying out qualifying activities
- is not regarded as a firm in difficulty for the purposes of the Community Guidelines on State Aid for rescuing and restructuring firms in difficulty

- is an unquoted company (except in the case of companies listed on the Developing Companies Market),
- is engaged in a qualifying trade or whose business consists of holding shares or securities in one or more qualifying subsidiaries,
- has its issued share capital fully paid up, and
- is not intending to wind up within 3 years of receiving BES investment unless it is for bona fide commercial reasons.

Qualifying Companies and Subsidiaries

A qualifying company can have subsidiaries provided generally that:

- (a) the subsidiaries are at least 51% owned by the parent company; and
- (b) the subsidiaries are themselves qualifying companies, or carry out certain services for, or functions on behalf of, the parent company or its subsidiaries.

Subsidiaries need not be incorporated in the State.

The Trade

Qualifying Trades

The company in which the investment is made must carry on qualifying trading operations. These are:

- 1) the manufacture of goods
- 2) the operation of certain tourist traffic undertakings
- 3) internationally traded services
- 4) the cultivation of mushrooms
- 5) the micro-propagation of plants and plant cloning
- 6) the cultivation of horticultural produce in greenhouses
- 7) research and development activity which is undertaken with a view to carrying on certain of these qualifying trading operations
- 8) commercial research and development activities
- 9) the construction and leasing of advance factory buildings
- 10) the production, publication, marketing and promotion of certain musical recordings by a new artist.

Some of the above activities require certification by a development agency and/or grant aid to qualify for BES purposes as follows:

Activities requiring certification for BES

- Research and Development carried out with a view to carrying out a qualifying trade.
- Tourist undertakings.
- Cultivation of horticulture produce (in greenhouses).
- Music industry (promotion of one new artist).
- Construction and leasing of an Advance Factory.

Who certifies What Activities

- Tourist traffic undertakings
Failte Ireland.
- Micro-propagation of plants, plant cloning, and horticultural cultivation (in greenhouses)
The Minister for Agriculture and Food.
- Research and development activities undertaken with a view to carrying on certain qualifying trades
Enterprise Ireland, SFADCO or Udaras na Gaeltachta, as appropriate.
- Music industry, promotion of new artist
Minister for Arts, Sport and Tourism.

- Construction and leasing of an advance factory
I.D.A., Enterprise Ireland, SFADCO or Udaras na Gaeltachta.

Qualifying trades requiring grants

To qualify some trades require grants as follows:

- Internationally Traded Service (export company) - Grant or shares taken in the company by an industrial development agency including County Enterprise Boards.
- Computer Services, (data processing services, software development services(only need grant approval) or technical and consultancy services which relate to either or both) – Employment grant from industrial development agency.

Qualifying Trades and Other Commercial Activities

A company carrying on a qualifying trade may also carry on other trading activities provided it receives not less than 75% of its total income from the qualifying trade, over a qualifying period of three years.

The trade must be conducted on a commercial basis with a view to making profits and it must be carried on wholly or mainly in the Republic of Ireland.

The Shares

Qualifying Shares

In order to qualify under the scheme, the individual must subscribe on his/her own behalf for shares:

- (i) which represent new ordinary share capital in a qualifying company;
- (ii) carry no preferential rights as to dividends or redemption.

The whole of the company's issued share capital must be fully paid up. The minimum investment in any one company is €250. (This does not apply in relation to investments through investment funds designated for the purposes of the scheme).

The maximum investment in any one company or its associated companies is €1,000,000 subject to a maximum of €750,000 in any one six monthly period. If companies enter specified arrangements or understandings which are designed to

circumvent the €1,000,000 limit, then the maximum amount that can be raised under the BES by all such companies as a whole will be limited to €1,000,000.

The maximum investment which will qualify for relief in any one tax year is €31,750. This limit applies to individuals. A married couple can each obtain relief on an investment of €31,750 provided each spouse has sufficient taxable income to absorb the amount of his/her investment.

Use of BES Money Invested

The company must use the equity raised (a) to do one or other of the following:

- enable the company, or enlarge its capacity, to undertake its trading operations.
- enable the company to engage in, or assist the company in, research and development, the acquisition of technological information, the development of new or existing products or services or the provision of new products or services.
- enable the company to identify new markets, and to develop new and existing markets, for its products or services.
- enable the company to increase its sales of products or provision of services.

and (b) with a view to the creation or maintenance of employment in the company or, in the case of the construction and leasing of advance factory buildings, in either or both a company contracted to construct the advance factory building and a company which enters into a lease for its use.

The company may use the money received for the purpose of the trade of a subsidiary provided the above rules and those relating to subsidiaries are met. A rule relating to subsidiaries is that where a company issues eligible shares for the purposes of raising BES funding for a qualifying trade which is carried on by its qualifying subsidiary, the company is not allowed to on-lend the proceeds of the BES fund raising to the subsidiary; the company must use the funds instead to acquire eligible shares in the subsidiary.

Duration of Conditions

Shares must be held for at least five years if the investor wants to retain the full tax relief. He/she may, of course, sell them within the five years if he/she so wishes but this may result in his/her losing some or all of the relief.

Individuals must continue to be "qualifying individuals" for a period of five years after the shares have been issued.

Conditions in relation to qualifying companies, trades and subsidiaries must continue to be met for a period of three years after the shares have been issued.

If conditions are not met for the prescribed periods, the relief would no longer be due and, if already given, may be withdrawn. This would happen if, for example, the company received a full listing on the Stock Exchange or otherwise ceased to be a qualifying company within the three year period.

Other Circumstances in Which Relief May Be Withdrawn

If a company in which an individual has invested repays any debt to the individual (other than an ordinary trade debt), makes a loan to the individual or generally attempts to circumvent the requirements of the scheme by providing a benefit for the individual or transferring an asset to the individual for no consideration or otherwise attempting to pass back to investors the money which they have invested, then the individual is deemed to have "received value" from the company and his/her benefits under the scheme will be reduced accordingly. Reasonable payments to employees or directors in their capacity as employees or directors are of course permitted.

If an individual acquires an option or enters into an agreement which would bind any person to purchase any eligible shares for a price which is other than the market value of the shares, that individual will not be entitled to any relief in respect of the shares to which the option or the agreement relates.

Similarly, if an individual grants to any person an option within 5 years of the date of issue or enters into an agreement which would bind the individual to dispose of any eligible shares to any person for a price which is other than the market value of the

eligible shares, that individual will not be entitled to any relief in respect of the shares to which the option or the agreement relates.

If the relief does have to be recovered from the investor, it will be done by re-assessing the investor's liability to income tax in the year in which the relief was originally given. The investor cannot lose more tax relief than he/she originally had, but may have to pay interest to the Revenue Commissioners in some circumstances.

Payment of Tax Relief

In the case of an established company, relief will be given as soon as the regulatory conditions of the Revenue Commissioners have been complied with and will apply in respect of the tax year in which the shares are issued. Where an investor invests in eligible shares through a designated investment fund, but the shares are not issued until the following year of assessment, he/she can opt for relief for the year in which he/she made the investment in the fund rather than for the year in which the shares were issued.

In the case of new companies, tax relief will not be given unless and until the relevant company has been trading for four months. In the case of advance factory buildings the trade will be deemed to have commenced on the date on which the construction of the advance factory commenced. If the company is not trading at the time the shares are issued, the relief will not be given unless the company begins to trade within two years from the date of purchase of the shares. A period of three years before trading may be allowed where the company is engaged in research and development work. Where the company starts trading within the periods so prescribed, the relief will be allowed four months after the start of trading.

Capital Gains Tax

The normal provisions relating to capital gains tax, including those applicable to unquoted companies, will apply in regard to investments under the scheme.

For the purposes of computing an individual's liability to CGT, the purchase price of the shares will be considered to be the cost before deduction of the tax relief. In general, losses on the sale of shares will not give rise to an allowable loss for CGT purposes.

Designated Investment Funds

A Designated Investment Fund is a fund which has been designated by the Revenue Commissioners under Section 508 of the Taxes Consolidation Act, 1997. A designated fund comprises the subscriptions of a number of investors. The fund will be likely to invest in a number of companies. Broadly, each investor will get a share in each company in proportion to the value his/her subscription bears to the total size of the fund.

Investing in a Designated Investment Fund allows an investor to spread his/her investment over a number of ventures and to have expert advice to appraise the relevant projects. A fee will normally be payable by the investor to the fund manager. In addition, an entrepreneur who seeks equity from a fund can concentrate on his/her venture rather than devoting time to persuading a number of investors to invest in his/her company.

Each fund must prepare a prospectus which must be approved by the Minister for Enterprise, Employment and Trade which must include, inter alia, particulars of fees, remuneration or other charges to be levied in respect of the management of the fund. As with investments made on an individual basis, however, there is no guarantee that they will succeed and responsibility for the risk associated with the investment rests entirely with the investor. The prospectus must make this clear in a manner that is satisfactory to the Minister for Enterprise, Employment and Trade.

Queries on the Scheme

Any queries in relation to the scheme should be addressed to:

Office of the Revenue Commissioners

Business Incentives,

Direct Taxes Interpretation and International,

1st Floor Stamping Building,

Dublin Castle,

Dublin 2.

Ph: 01-7024107 or 01-6792777 Extn., 24107

E-Mail: cillbryn@revenue.ie

Status of this Document

This document is not a legal interpretation of any of the legislation on which this scheme is based. Nor is it intended as a comprehensive guide to the scheme. It is a general information guide to the BES.

Note I

Full details can be found in Part 16 Sections 488 to 508 of the Taxes Consolidation Act 1997.

Note II

Associate has the same meaning in relation to a person as it has by virtue of Section 433 of the Taxes Consolidation Act, 1997 in relation to a Participator except that the reference in paragraph (a) of that section to a relative of a participator shall be excluded from such meaning. A relative is defined as husband, wife, ancestor, lineal descendant, brother or sister. Associate, therefore, does not include immediate family members or close relatives.

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