Sarah Meredith
Tax Director, Grant Thornton

How SMEs May Be Impacted by Finance Act 2018

Introduction

Finance Act 2018 introduced a broad range of changes to the Irish tax regime. This article is intended to outline some of the key measures that may affect the SME sector of the Irish economy. These measures include changes to the KEEP (Key Employee Engagement Programme) share option scheme, new provisions around capital allowances and the extension of start-up relief. The article also includes a very brief summary of EII (Employment and Investment Incentive) changes and finally touches on the anti-avoidance provisions introduced to the close company legislation.

Amendments to Key Employee Engagement Programme

KEEP was introduced by Finance Act 2017 and is legislated for under s128F TCA 1997[1]. The rationale behind its introduction was to assist the SME sector in attracting and retaining

1 Gemma Jacobsen, "Key Employee Engagement Programme (KEEP)", *Irish Tax Review*, 31/1 (2018).

talent though a tax-efficient share option programme. However, due to the significant number of conditions that must be satisfied, the uptake of the scheme in 2018 was minimal. As part of its Finance Bill 2018 submission, the Irish Tax Institute recommended a number of amendments to the KEEP legislation.

By way of recap, this incentive operates such that gains realised by employees and directors on the exercise of qualifying share options granted between 1 January 2018 and 31 December 2023 will not be subject to income tax, USC or PRSI. Broadly, it applies to unquoted trading companies. The option must be exercised within 10 years of grant, and the gain (if any) will be subject to capital gains tax on subsequent disposal of the shares.

Finance Act 2018 amended the limits on qualifying share options granted to qualifying individuals. Subject to a Ministerial Commencement Order, the market value of all shares in respect of which qualifying share options have been granted by the qualifying company to an employee or director cannot exceed:

- €100,000 in any one tax year (no change),
- a €300,000 lifetime limit (this was previously €250,000 in any three consecutive years) or
- 100% of the annual emoluments of the qualifying individual in the year of assessment in which the qualifying share option is granted (this was previously 50%).

The overall €3m KEEP limit remains for companies, but employees are not restricted from entering into future KEEP arrangements with future employers. Thus, an employee may avail of two €300,000 lifetime limits if that employee is employed by successive separate companies offering KEEP.

There was also a minor change to the legislation around the collection of information required for State Aid publication purposes. Essentially, the requirement for Revenue to issue a notice to a company to furnish information has now been removed, and Revenue retains its ability to publish the details related to the tax relief claimed.

Although the change to the market value of the shares that may qualify for KEEP is welcome, there continue to be significant restrictions around the scheme, and we would urge that further amendments be made to enhance the accessibility of this share scheme.

Capital Allowances

Accelerated capital allowances for energy-efficient equipment

Section 285A TCA 1997 provides tax relief to companies purchasing certain energy-efficient equipment, whereby capital allowances equating to 100% of the value of the equipment are allowed as a deduction against taxable profits in the year of purchase.

Finance Act 2018 contained a number of amendments to the scheme, with the objective of streamlining the regime and providing enhanced administrative effectiveness. A new definition of energy-efficiency criteria has been inserted in the legislation, which will provide a basis for the Minister for Communications, Climate Action and Environment to specify the criteria by Government Order, on approval by the Minister for Finance. There will be minimum levels of efficiency, speed, storage or efficacy that must be met, in conjunction with specific certifications and standards being complied with or tested. To qualify for the relief, the equipment must be new. The Sustainable Energy Authority of Ireland (SEAI) will be allowed to establish and maintain a list of energy-efficient equipment under the scheme on its website, and this may be amended where necessary to ensure that it is as up to date as possible.

Essentially, the changes remove the requirement for the Government to issue Statutory Instruments on a regular basis setting out the qualifying assets. Rather, the qualifying assets will be published on the SEAI website and amended as appropriate, with this list being based on the new definition and criteria. It is hoped that these changes will provide more certainty to taxpayers and will ensure that the list of qualifying assets is more current.

Capital allowances for gas vehicles and refuelling equipment

As part of the national objective of transitioning to a low-carbon economy, Finance Act 2018 has introduced a new accelerated capital allowances regime for capital expenditure incurred on natural-gas-propelled vehicles and refuelling equipment. The relief will be under s285C TCA 1997 and applies for qualifying expenditure incurred between 1 January 2019 and 31 December 2021.

The relief works by providing capital allowances equivalent to 100% of the qualifying expenditure incurred on both "qualifying refuelling equipment" and "qualifying vehicles" used for the purposes of carrying on a trade.

Qualifying refuelling equipment is defined as:

- a storage tank for gaseous fuel (being compressed natural gas, liquefied natural gas or biogas),
- a compressor, pump, control or meter used for the purposes of refuelling gas vehicles or
- equipment for supplying gaseous fuel to the fuel tank of a gas vehicle.

This equipment must be unused and not second-hand and must be installed at a gas refuelling station.

Qualifying vehicles are gas vehicles constructed or adapted for:

- the conveyance of goods or burden of any description,
- the haulage by road of other vehicles or
- the carriage of passengers.

Again, these vehicles must be unused and not second-hand. Furthermore, the vehicles must not be commonly used as private vehicles and should be unsuitable to be so used. The vehicles can be provided or hired, wholly or mainly, for the purpose of hire to or the carriage of the public in the ordinary course of a trade.

Capital allowances on childcare and fitness centre equipment and buildings

Finance Act 2017 introduced a new accelerated capital allowances regime for capital expenditure on equipment and buildings used for providing childcare services or fitness centre facilities to employees. However, this was subject to a Commencement Order, which never took effect. Finance Act 2018 repealed these provisions and re-enacted the relief .

Section 285B TCA 1997 provides for 100% capital allowances for the cost of plant and machinery in use for the purpose of providing childcare services or fitness centre facilities to employees. Meanwhile, s843B TCA 1997 allows employers to claim capital allowances over a seven-year period (15% in years 1 to 6 and 10% in year 7) for qualifying expenditure on a building or structure in use for the purpose of providing childcare services or fitness centre facilities to employees of the company. The relief came into operation on 1 January 2019.

There is a new restriction whereby the facilities provided must not be accessible to or available for use by the general public. In in Finance Act 2017, there had been a requirement for the facilities not to be available to persons carrying on a trade relating to childcare or the provision of childcare facilities, such as crèches or gyms, but the relief has been broadened such that it now applies to all employers.

There will be no clawback of industrial building allowances where a disposal takes place after a seven-year period. It is also worth noting that there is a condition such that, due to the State Aid rules, the relief does not apply to "undertakings in difficulty".

Finally, where relief is being claimed under s843B TCA 1997, it also is included in Schedule 25B TCA 1997, meaning that it will be subject to the high-earners' restriction.

To conclude, where taxpayers are incurring expenditure on childcare or fitness centre equipment and buildings as part of a business – for example, in-house gyms – a tax benefit should be available to reduce the real cost of this investment.

Start-Up Relief

The three-year start-up relief for small companies, as provided for under s486C TCA 1997, has been extended for a further three years. It had been due to expire at the end of 2018 and will continue to apply to the end of 2021. This extension was the result of a review undertaken by the Department of Finance, which was published on Budget Day.

This tax relief continues to be linked to employers' PRSI, ensuring that it is targeted at employment-generating companies. It can be a valuable relief to new corporates and should be borne in mind; it can be particularly beneficial because, for companies that are loss-making in initial years, it may be carried forward and be available to mitigate corporate tax when trading losses have been used.

Employment and Investment Incentive

This article is not intended to go through the EII changes in detail but, rather, to flag the headline changes to this incentive and how it differs from what had been the case previously.

The changes to the EII involve replacing the legislation with a new Part 16 inserted in TCA 1997, which applies from 1 January 2019. These changes follow the Indecon Report,[2] which involved an independent review of the EII and SURE (Start-up Relief for Entrepreneurs) schemes. Essentially, the recommendation was that the EII and SURE should be retained but that changes were warranted to improve their efficiency and effectiveness. The thresholds and limits related to the tax relief remain largely the same, with the most substantive change being a move from pre-clearance to self-certification.

Under the revised EII regime, applicant companies essentially self-certify that they have met the "company conditions" and "qualifying investment conditions", with one result being that incorrect certification will result in penalties being imposed on companies. As part of this self-certification, the companies will issue statements of qualification to investors. These statements may issue only where the company has spent 30% of the funds raised for qualifying purposes, or a period of two years has passed from when the shares were issued. There is a requirement to issue a separate statement of qualification for the second tranche of tax relief (at the end of a four-year investment term, subject to certain conditions being satisfied). In summary, companies will be confined to approaching Revenue for certification in respect of certain Group Block Exemption Regulations (GBER) criteria being met, GBER being the EU State Aid conditions imposed on the Member States.

In terms of the investors, they, themselves, will certify that they have met the various investor conditions, with any disallowed relief arising as a result of these conditions not being satisfied being clawed back from the investor.

2 Indecon International Economic Consultants, "Indecon Evaluation of EII and SURE", report for the Minister for Finance, 14 September 2018.

The rationale behind this move to self-certification was to address the delays that were prevalent for investors seeking to avail of EII relief. Thus, the process of applying to Revenue for outline approval will no longer apply, with any Revenue rulings being confined to GBER queries.

One of the important points to be aware of on foot of self-certification becoming a feature of EII relief is that where the relief is withdrawn, it may have significant financial implications for the company (which had not been the case previously, where the investor was the accountable person). For example, if a company is found to have made an incorrect statement of qualification, the company will be assessed to corporation tax under Schedule D, Case IV, with the amount being 1.2 times the initial 30/40ths of the relief given or such part of that amount that does not qualify for relief. The relief will also be withdrawn and assessed on the company where, during the relevant period:

- the company ceases to be a qualifying company,
- the investment ceases, fully or partially, to be a qualifying investment or
- value is received by persons other than EII investors.

There will also be a clawback of relief where a company provides an incorrect statement of qualification (for second-stage relief). Where the clawback arises as a result of an incorrect statement of qualification, the tax will be due and payable from the date the shares were issued, with there being a potentially high interest exposure depending on timing. In addition, a penalty may also arise, resulting in a potentially significant tax exposure for corporates in which EII relief is claimed.

Other noteworthy changes include:

- the fact that preference and redeemable shares may now be regarded as being eligible shares for EII relief;
- designated funds are now entitled to invest in non-EII companies without tainting the fund;
- the EII has also been extended to "open" funds;
- the requirement for the qualifying company to have commenced trading within two years of issuing the qualifying shares or to have spent the finances raised on R&D activities within one month of the end of the investment term has now been removed (rather, 30% of the amount raised must have been spent on qualifying purposes);
- EII relief has been extended to 31 December 2021.

In summary, the changes make some headway in addressing certain issues that had been raised as part of the Indecon review, particularly on the administrative and approval side. However, caution will need to be exercised where EII relief is being claimed, due to the new self-certification procedures and the resultant exposure of both companies and investors to clawbacks and penalties.

Close Company Anti-Avoidance Provisions

From information that Revenue received on the "Panama Papers", it became aware of a tax-avoidance scheme that was being exploited to avoid a charge to tax under s438 TCA 1997. Based on commentary included in the Finance Bill 2018 List of Items, an example of such a scheme involved the provision of a loan by a non-resident company owned by the promoter of the scheme to another, non-connected company also owned by the promoter and the subsequent onward loan to the Irish participator.

Consequently, a new provision has been brought into s438A TCA 1997 whereby if a participator in a close company or his or her associate is party to any "relevant arrangement" as a result of a loan made to the participator or associate, s438 TCA 1997 shall apply as if the loan had been made by the close company to such a participator or associate. A relevant arrangement is defined as any arrangement the main purpose, or one of the main purposes, of which is to avoid or reduce a charge to tax under s438 TCA 1997. This anti-avoidance provision takes effect for any arrangements entered into on or after 18 October 2018.

Conclusion

Although many of the changes in Finance Act 2018 span the broader economy, there have been a number of changes of particular relevance to the SME sector. The amendments to KEEP are welcome, but continued enhancements are required to make it more accessible. The changes to the capital allowances regimes, which are quite nuanced, are worthwhile considering where capital expenditure is being planned. Finally, the changes to the EII are intended to ease the administrative burden, but where this tax relief is being sought, investors and companies should ensure that they are fully aware of what the new regime involves and the potential costs where the self-certification is incorrect.

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