Subject: State Aid N 311/2004 – Ireland
“Business Expansion Scheme and Seed Capital Scheme”

Sir,

1. PROCEDURE

On 5 March 2004, 30 April 2004 and 24 June 2004, DG Competition services met the Irish authorities to discuss the Business Expansion Scheme and the Seed Capital Scheme. By letter dated 13 July 2004, registered at the Commission’s Secretariat-General on 15 July 2004, the Irish authorities notified the above-mentioned measure to the Commission pursuant to Article 88(3) EC.

By letter of 17 August 2004 the Commission requested additional information, which was sent by the Irish authorities by letter of 18 August 2004, registered on 24 August 2004.

2. DESCRIPTION

2.1. Objectives of the measures

The Business Expansion Scheme (BES) aims to provide an incentive to private individual investors to invest long-term equity capital in small and medium-sized enterprises operating in certain sectors, which would otherwise find it difficult to raise such funding. It foresees an annual tax relief for individuals on their financial investments in qualifying companies.

The Seed Capital Scheme (SCS) is an extension of the BES that aims to encourage individuals to establish new business ventures. It enables individuals who are currently or formerly in employment and wish to start new business ventures in specific activities to be reimbursed of the taxes paid in the six years prior to their investment.

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2.2. Legal basis, duration and budget


The starting of the schemes is subject to the signing of a Commencement Order by the Minister of Finance after a positive decision by the Commission. The schemes are planned to run from 5 February 2004 to 31 December 2006.

The cost of BES is estimated at EUR 25 million per year in terms of tax revenue foregone, with around 2,500 taxpayers investing in 250 companies annually. The cost of SCS is estimated at EUR 1.5 million per year in terms of income tax revenue foregone, with around 100 taxpayers investing in around 50 companies annually.

2.3. Rules and conditions of application

The BES and the SCS are administered by the Office of the Revenue Commissioners. The Revenue Commissioners approve investments for tax relief and ensure compliance with the requirements of the legislation with respect to qualifying activities and companies, amounts invested, types of shares, duration of investment, etc.

2.3.1. Individual investors

The BES allows individuals to obtain income tax relief on investments up to EUR 31,750 per year. The investor must be a resident of the Republic of Ireland for the tax year in respect of which he/she requests the relief and he/she must purchase new ordinary shares in qualified companies. Shares cannot carry any preferential rights and the investor cannot be connected with the investee companies. The investor must hold the shares for a minimum period of five years.

The SCS allows an unemployed person, a person made redundant or an employee leaving employment, who invests by means of shares in a qualified company, to claim a refund of personal income tax paid in the past six years. The individual may select any or all of the six tax years prior to the year of investment. For each of the selected years the refund is limited to the tax paid, with an upper limit in any year of EUR 31,750. The individual may obtain a refund in this manner for two investments in the same company made in a three year period, subject to an overall maximum refund of the tax paid on EUR 182,240. The individual must enter into a full-time employment contract for at least one year with the company. He/she must acquire at least 15% of the issued share capital of the company and maintain this percentage for at least two years.

2.3.2. Designated investment funds

Investments in qualifying companies made by individuals through designated investment funds are also eligible. Some investors may wish to spread their investments over a number of ventures and benefit from expert advice to appraise the relevant companies. A designated investment fund comprises the subscriptions of a number of investors. Each investor then gets a share in each company invested in by the designated fund in proportion to the value of his/her subscription to the total size of the fund.

For a fund to be designated, the Revenue Commissioners must be satisfied that it is properly established and audited in the interests of the investors. The Irish Financial
Services Regulatory Authority must approve fund managers in accordance with the Investment Intermediaries Act 1995. Each fund must prepare a prospectus for approval by the Minister for Enterprise, Trade and Employment, which details the fees and other charges related to the management of the fund, a statement on the risks involved and transfer of shares as well as the publicity arrangements. It must be clear that the responsibility for the risk associated with the investment remains entirely with the investors.

2.3.3. Qualified companies

The target companies are engaged in certain innovative and creative activities that have been identified as being particularly risky, such as the operation of tourist resorts, software development, healthcare services, research and development activities, and record production. Some qualifying activities require certification by a development agency to ensure their innovative and creative nature. For instance, where a company plans to promote a tourist facility and benefit from the BES and/or the SCS, it must obtain the approval of its three year development and marketing plan from the National Tourism Development Authority. In order to qualify for BES and/or SCS, companies carrying on research and development activities must also get certification from a government industrial development agency. Certification is provided following the examination of technical and commercial description of the activities by a technical assessor.

The investee company must be unquoted, i.e. not be listed on the Full List or the Unlisted Securities Market of the Stock Exchange. Companies listed on the Developing Companies Market or whose shares are traded in an over-the-counter market may qualify. They must be incorporated in the EEA and have an establishment in Ireland carrying out qualifying activities. They must not intend to wind up within 3 years of receiving BES, unless for bona fide commercial reasons. In order to qualify for the SCS, a company must obtain a certificate from an appropriate financial authority attesting that the company will be a bona fide new venture.

The investment in any company under the SCS is limited to EUR 182,240 over the lifetime of the company. The maximum investment limit by all investors in any one company or group of companies over their lifetime under BES and SCS cannot exceed EUR 1.5 million.

2.4. Undertakings

The Irish authorities have undertaken to integrate the amendments requested by the Commission in the Finance Act 2005 with effect from 2004:

- Qualifying companies under BES and SCS will be SMEs within the meaning of the Community definition in force. The legislation will provide that the current Community definition\(^1\) of an SME will be applicable to 31 December 2004 and will also provide that the revised Community definition\(^2\) will apply from 1 January 2005.

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The schemes will respect the investment tranche ceilings per company as set out in the “Commission Communication on State Aid and Risk Capital” (hereafter referred to as SARC)\(^3\) for regions qualifying for assistance under Article 87(3)a and Article 87(3)c.

Ship building and ECSC sectors will be explicitly excluded from BES and SCS.

Firms in difficulties, as defined by the Community Guidelines on State Aid for rescuing and restructuring firms in difficulty\(^4\), will not qualify for BES and SCS.

Individual investments in companies registered in the EEA, and with an establishment in Ireland that carries out qualifying activities, will be eligible to BES and SCS.

The Irish authorities have undertaken to send to the European Commission the relevant sections of Finance Act 2005 relating to the Business Expansion Scheme and the Seed Capital Scheme once it has been adopted by the Irish Government and the Irish Parliament.

3. **ASSESSMENT**

3.1. **Legality**

By notifying the schemes before their application, the Irish authorities have respected their obligations under Article 88(3) EC.

3.2. **Existence of State aid**

In line with point IV.2 of the SARC, the existence of State aid within the meaning of article 87(1) of the Treaty must be examined at three different levels:

- Aid to investors;
- Aid to any fund or other vehicle through which the measure operates;
- Aid to the companies invested in.

3.2.1. **Aid to investors**

Article 87(1) of the EC Treaty targets State aids that favour certain undertakings or the production of certain goods. Only individual investors can benefit from the tax relief under the BES and from the tax refund under the SCS.

The Commission therefore considers that there is no State aid within the meaning of article 87(1) of the Treaty at the level of the investors.

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\(^3\) OJ C 235, 21.08.2001, p. 3

\(^4\) OJ C 288, 09.10.1999, p. 2.
3.2.2. Aid to the designated funds

Designated investment funds comprise the subscriptions of a number of investors. The responsibility for the risk associated with the investment remains entirely with the investors. The Commission therefore does not consider the designated funds to be separate aid beneficiaries.

The Commission considers that there is no State aid within the meaning of Article 87(1) EC at the designated funds level.

3.2.3. Aid to the enterprises invested in

Pursuant to point IV.5 (3) of the SARC, the main test for the existence of State aid at the level of the companies is whether the enterprise has received the investment on terms that would be acceptable to a private investor in a market economy. Both schemes increase the rewards the investors will obtain from making a particular investment and these can no longer be said to be operating as normal economic operators. There is therefore the possibility that any advantages awarded to investors are passed on to the enterprises invested in.

Furthermore, the four criteria for existence of State aid in the meaning of article 87(1) are met:

– Both schemes involve State resources as the tax relief and the tax refund are income tax revenues foregone for the Exchequer.

– Both schemes target only certain qualifying companies in some sectors. The measure is therefore selective.

– The aim of the schemes is to improve access to risk capital for certain enterprises. Better access to equity finance constitutes an advantage.

– Qualifying companies are from sectors that are in general open to EU trade. The measures may therefore affect trade between Member States.

The Commission therefore considers that there is State aid within the meaning of Article 87(1) EC at the level of the enterprises invested in.

3.3. Compatibility of State aid

The Commission has examined the schemes in the light of Article 87 EC, and in particular on the basis of the SARC.

3.3.1. Evidence of market failure

The case for market failure is accepted with respect to point VI.5 of the SARC, as Irish authorities have undertaken that both schemes will respect investment tranche ceilings
Furthermore, the Irish authorities have justified the schemes on the findings of the *Equity capital survey*, a survey carried out by the Department of Enterprise, Trade and Employment in 2002 that identifies the shortage of early stage development capital.

### 3.3.2. Criteria for assessing the compatibility of the measure

Point VIII of the SARC outlines a set of positive and negative elements that the Commission will evaluate in order to assess the compatibility of a risk capital measure once market failure has been established.

**Restrictions of investments**

Only unquoted companies may qualify under BES and SCS. Moreover, Irish authorities have undertaken to limit by law access to BES and SCS to SMEs within the EU definition. Furthermore, investment tranches per company will be restricted to EUR 750,000 in regions qualifying for assistance under article 87(3)c and to EUR 1,000,000 in regions qualifying for assistance under article 87(3)a.

According to point VIII.3 of the SARC, these restrictions are regarded as a positive element.

**Focus on risk capital market failure**

Qualifying shares are solely equity and carry no preferential rights as to dividends or redemption.

According to point VIII.3 of the SARC, measures providing finance to enterprises principally in the form of equity or quasi-equity will be regarded positively.

**Profit-driven nature of the investment decisions**

All capital is provided by private individual investors and these make the investment decisions.

In the case of investments through designated funds, the managers of the designated funds are responsible for selecting and assessing proposals for investments. This assessment typically focuses on the capability and the industry experience of the management team, the applications of the products, the strong growth potential, the commercial innovation and the appreciation of the market strategy definition. However, risks associated with investment decisions remain entirely with the investors. Furthermore, the management of the designated funds is subject to the regulatory supervision of the Irish Financial Services Regulatory Authority.

According to point VIII.3 of the SARC, all these elements are regarded as positive indications of the commercial nature of the investments.

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5 Under the 2002-2006 regional aids map, Ireland regions are assisted regions within the meaning of articles 87(3)a and 87(3)c.
Minimisation of the level of distortion between investors and investment funds

All taxpayers may benefit of the schemes.

Regarding the designation of funds, it is a transparent control process where the Revenue Commissioners verify the fees and other charges related to the management of the fund, the distribution of profits and losses and the publicity arrangements. Any fund complying with these minimal requirements may be designated.

Potential investors will generally be invited to invest through public advertisements to subscribe as ordinary shareholders in companies. The shares cannot carry any preferential rights and the risk is entirely borne by individual investors.

These elements are in-line with point VIII.3 of the SARC.

Sectoral focus

There is no specific sector orientation as qualifying companies can carry out various activities within a broad scope. Selectivity of the schemes is based on the innovative nature of the activities rather than any sector orientation. The Irish authorities have confirmed that companies in ship-building and ECSC sectors will be excluded under the schemes.

This is in-line with point VIII.3 of the SARC.

Investment on the basis of business plans

All investments will be made on a commercial basis. Funds seek business plans from potential investee companies in order to assess the best investment options. Business plans would also be necessary generally for companies to attract investments from individuals.

According to point VIII.3 of the SARC, the existence for each investment of a business plan is regarded positively.

Avoidance of cumulation of aid measures to a single enterprise

The measure foresees the possibility to cumulate SCS and BES. However, the possibility to cumulate both schemes is restricted by the general maximum limit of EUR 1,500,000 capital injection per company that applies over the company lifetime. The investment under the SCS may represent a maximum of EUR 182,240.

In some cases, cumulation is a condition for a company to be qualified under the schemes. For traded services, a grant must be awarded or a share must be taken in the company by an industrial development agency. For computer services, an employment grant must be awarded by an industrial development agency.

This last element is the only negative element according to point VIII.3 of the SARC.

3.3.3. Conclusion

In view of the above positive elements and the sole negative element, the Commission has come to the conclusion that the aid granted under the BES and the SCS fulfils the conditions as set out in the “Commission Communication on State Aid and Risk
Capital”. The Commission has accordingly decided to consider the aid to be compatible with Article 87(3)c of the EC Treaty.

4. DECISION

The Commission has decided to raise no objection to the BES and SCS.

The Commission further reminds the Irish Government to send to the Commission the relevant sections of Finance Act 2005 relating to the Business Expansion Scheme and the Seed Capital Scheme once it has been adopted by the Irish Government and the Irish Parliament. The Commission also reminds the Irish Government that all proposals to modify and/or extend the schemes must be notified to the Commission.

If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/. Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition.
State aid registry
B-1049 Brussels
Fax no +32-2-296 12 42.

Yours faithfully,

For the Commission

Mario Monti
Member of the Commission