Alliance for an Innovation-Driven Recovery Submission

Department of Finance Review of EIIS

1. Executive Overview and Key Proposals

1.1 Overview

One of the key objectives of the Programme for Government is to support the SME sector, which is described as the 'backbone of the economy'. It also states that the government will continue to support entrepreneurs and investors in high-risk innovative start-ups and will review our existing supports in light of Covid-19. It states it will set clear targets that will increase the survival rate of start-ups. It also said that it will 'review the taxation environment for SMEs and entrepreneurs with a view to introducing improvements to different schemes so that Ireland remains an attractive place to sustain and grow an existing business or to start and scale-up a new business'.[1]

In relation to the National Economic Plan and business financing, the programme states 'it will support the role that venture capital can play in driving growth in the indigenous economy by ensuring a stable long-term funding landscape.'[2] It also states that it will review the Capital Gains Tax in each budget over the next five years, with the particular objective of supporting innovation-driven enterprises that will help us transition to a low carbon economy.[3]

At present, early-stage indigenous tech start-ups are struggling to attract private investment which they need to grow and expand their companies. These concerning trends have been consistently outlined in numerous reports on investment trends and have become more acute in recent times.

Coupled with this, significant funding has gone towards investment into Irish firms through the three schemes (BES, EII and SCS) over the ten years (€816 million) up to 2018. However, research by TechIreland has found that the majority of this investment has been focused on lower-risk businesses (71% / €579M) as distinct from higher-risk, high-growth start-ups and scale-ups (29% / €238M), with the percentage of investment going to start-ups and scale-ups consistently about **30% of the total** each year.[4]

These findings confirm the observation in the **2018 Indecon Report commissioned by the Minister for Finance:**

"The evidence on firms assisted shows that some of the companies are in lower-risk sectors. There is merit in considering whether the focus of the scheme can be amended in order to target companies most in need of finance and thereby reduce economic deadweight and Exchequer costs".[5]

We welcome the review of EIIS by the Department of Finance and recommend significant changes to EIIS to restore investor confidence in early-stage indigenous tech start-ups and to foster a viable long-term culture of private investment in Ireland.

The Alliance also welcomes the proposals of the SME Taskforce (Jan 2021), which was established by the government. It proposed significant reforms to EIIS to help high-growth companies, including:

- Reduce the CGT rate to 20% for founders, private investors, VCs or Angel Investors who invest in non-property SMEs
- Allow CGT losses for loss-making EIIS investments
- Offer full CGT relief on profits on EIIS investments made for a year
- Change EIIS structure to allow VC investments via Limited Partner

The Alliance is seeking to expand the source of finance available to these companies in Ireland, and make it more accessible for those who have disposable income and want to reinvest it back into the economy. Building a more dynamic investment ecosystem will ensure that there is less reliance on the exchequer and greater support for indigenous enterprises. Wider participation from private investors would be more forthcoming if EIIS was more accessible and user friendly for both individuals and companies. This will help Irish companies raise capital to scale faster, increase their exports and therefore compete in the international markets. This will require fiscal policy changes such as relief of losses as well as structural changes such as opening up other investment vehicles to benefit from EIIS.

1 Programme for Government (16th June 2020), p.22
2 Ibid p.22-23
3 Ibid p.24-25
4 Review of EIIS Support for high-growth start-ups and scale-ups (11th November 2020) by TechIreland and the Alliance.
5 Indecon Evaluation of EIIS and SURE (2018) p.5

1.2. Summary of our Key Proposals for EIIS Review

In order to ensure that EIIS is a vehicle that can make significant impact in its role as a provider of risk finance to SMEs, we believe that the scheme should be redesigned to include the following:

1. **Enable loss relief on investments under EIIS.**
2. **Seek an increase in investment limits under EIIS.**
3. **Allow other investment vehicles, including venture fund partnerships, to qualify for designated investment funds for EIIS investments.**
4. **Standardise investment period to four years for all qualifying investments.**
5. **Enhanced reliefs for investing in micro-companies.**
6. **Greater clarity and increased certainty for companies that they are eligible for EIIS and simplification of process.**

The introduction of a CGT exemption on all qualifying investments remains an overarching objective of the Alliance, but given the current circumstances, there is a strong imperative to focus on loss relief in order to incentivise greater participation and ensure stronger levels of investment.

2. Introduction

2.1 Alliance for an Innovation-Driven Recovery

This submission is being collectively made on behalf of the Alliance for an Innovation-Driven Recovery, which is a coalition of five national organisations, all of whom have a shared interest in the growth of the indigenous high-growth tech start-up sector in Ireland. Our organisations understand the importance and the role of having the right type of finance available for companies at each stage of their journey, in order to ensure that they can fund their business strategy. The Alliance comprises:

Scale Ireland Represents and advocates on behalf of the indigenous tech start-up and scale-up companies.
HBAN Ireland's largest network of business angels and syndicates with over 15 angel groups across Ireland and abroad.
IVCA The representative body for venture capital private equity firms on the island of Ireland
Euronext The leading pan-European exchange, covering Belgium, France, Ireland, The Netherlands, Norway, Portugal and the UK.
TechIreland An independent not-for-profit, on a mission to promote Irish and Ireland based innovation to the world, through data, content and community activities.

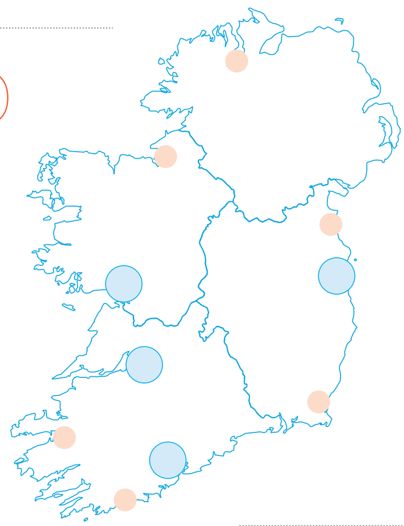
***employed** people nationwide*[6] 47,000

***start-up & scale-up companies** in operation*[7] 2,000

***start-ups and scale-ups** based outside of Dublin* 900

***co-working spaces** across the country* 190

*as many **indirect job** as direct jobs*[8] 5x



6 Source TechIreland Ibid
7 Ibid
8 The New Geography of Jobs (Houghton Mifflin Harcourt, 2012) by Enrico Moretti
9 SME Taskforce Report (2021) p. 33

2.2. Indigenous Tech Sector:

85% of these businesses offer Business-to-Business solutions and nearly all of these companies focus on export markets. This is against the backdrop of the findings of the OECD Review of SME and Entrepreneurship Policy in Ireland. It found that Ireland has one of the lowest ratios of exporters to total enterprise numbers in the EU, with only 6.3% of SME employer firms engaged in exporting activity. This compares with 9.6% in France, 17% in the UK and 27% in Denmark. These findings were highlighted in the report of the SME Taskforce, which was commissioned by the Government and published on 21st January 2021.[9] A key objective of the report is to promote the export potential of the SME sector.

Table1: Distribution of Tech Start-Up and Scale-Up Companies by Size:[10]

Number	Size	Employed
1,841 Companies	<100 employees	25,000
105 Companies	100-500 employees	22,000

Table 2: Tech Start-Up and Scale-Up Companies by Sector:[11]

Sector	Companies
Enterprise Solutions	435
Health/ Medical	326
Fintech	183
Entertainment/Sport	158
Industrial Technologies	126
Consumer/ eCommerce	122
CleanTech	105
Travel	90
Agri/Food	85
Education	83
TelecomTech	79
Social Media/ Advertising	78
Security/ Safety	76

Table 3: Regional Spread of Tech Start-Up and Scale-Up Companies:[12]

Region	Companies
Cork	188
Galway	151
Limerick	87

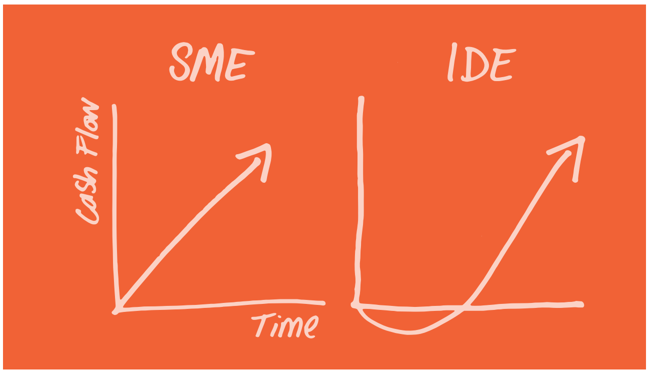
Other areas where companies are located include counties Clare, Kerry, Kildare, Louth, Waterford.

10 Source: TechIreland
11 Ibid
12 Ibid

2.3 The Importance of Investment and EIIS to the Sector:

Investment needs of 'Innovation-Driven Enterprises' versus traditional SMEs

The term 'Innovation-Driven Enterprise' or 'IDE' is used in relation to start-up and scale-up companies that are innovation-driven, spanning sectors from ICT to biotech and medical devices. MIT developed the term IDE to distinguish these businesses from traditional SMEs.[13]



They typically face negative cash-flows early on as they invest in innovation, characterised by a "*J-curve*" over time. IDEs are important within an evolving, open knowledge, digital economy. IDEs have common characteristics and face distinct challenges. They are high-risk and require significant upfront investment before breaking even, thus are very dependent on equity-based finance. These companies present huge potential in terms of employment, exports and innovation. They are distinct from lower-risk asset-backed or service businesses.

2.4 Economic Impact of Increased Private Investment

For 15 years, the Irish Venture Capital Association (IVCA) has commissioned research on member equity funds portfolio companies, which illustrates the impact of venture capital and innovation-driven enterprises on Ireland's job creation and economic growth. The research only covers the Irish companies within the equity funds portfolio at specific points every year. Venture-backed companies are a subset of innovation-driven companies, and this research is illustrative of the different dynamic and growth rates of innovation-driven enterprises that require equity funding.

The analysis shows that venture-backed companies:

- Create high calibre jobs
- Are export-led
- Grow faster
- Provide graduate employment
- Invest heavily in R&D

The IVCA-commissioned research shows that Irish venture-backed companies have increased employment on average by 30% per annum since 2016. This compares to an overall increase in employment in the economy of 3% per annum since 2016, (CSO). Graduate employment represents 77% of the total workforce in these companies.

The data also shows that the average annual growth rate in revenues is 28% and that exports typically increase by over 20% per year. Exports represent between 77% of total revenues in young companies (3-5 years) to 95% in older companies (10+ years). Momentum in growth rates escalates as these companies age. Companies that are in operation over 10 years have an average annual growth in sales of 28% over the 3 years of this study.

Expenditure on R&D by venture-backed companies represents between 35% - 40% of all SMEs share of total spend on BERD (Business Expenditure on Research and Development) in the years 2016-2018. Typically, R&D intensity is higher in younger companies, with those less than three years old at 71%. This intensity falls to 14% in companies over ten years old.

It is clear from the results of IVCA economic impact studies that equity funding drives job creation and economic growth by helping entrepreneurs to turn innovative ideas and scientific advances into products and services that change the way we live.

Separately there is huge potential in terms of increasing and encouraging the number of individual investors. In 2019, 74% of the cheques written by individual HBAN investors were under €50k, and 43% were under €25k. The Alliance strongly believes our proposals to reform EIIS would incentivise individual and private equity investment.

[13] The New Geography of Jobs (Houghton Mifflin Harcourt, 2012) by Enrico Moretti

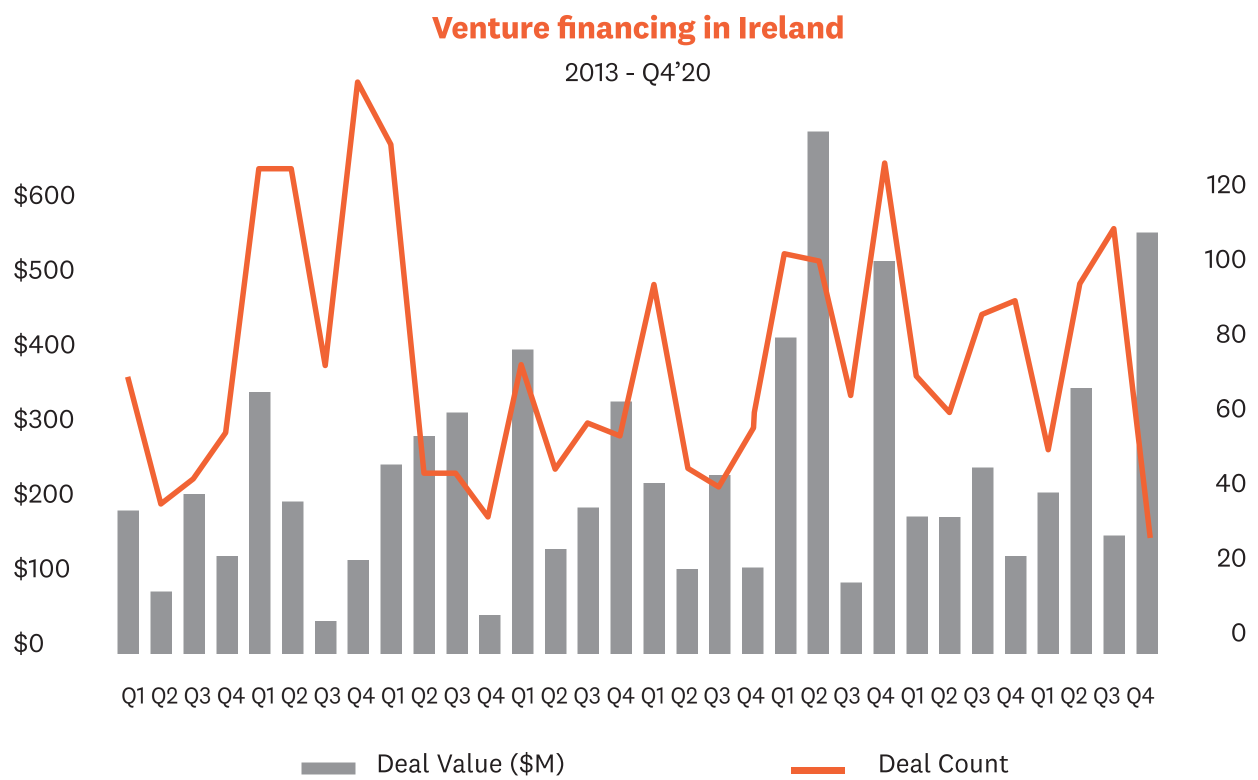
3. Sectoral Issues with EIIS:

3.1 KPMG Venture Pulse – Q4 2020 - Report on Global VC Investment

The KPMG report states that '*in the absence of significantly sized rounds, VC invested in Ireland plunged last quarter; however, the Irish ecosystem is still producing mature, healthy companies as is evidenced by the resurgence in Q4 2020 due to the hefty round ($190 million) closed by solar power platform Amarenco.*'

- **The KPMG 2020 report highlights that the deal count in Ireland is the lowest since 2013.**
- **In relation to venture capital activity in Ireland during Q4 2020, Anna Scally, KPMG's Head of Technology and Fintech in Ireland,** said "*Despite the global pandemic, the VC market in Ireland remained very robust in 2020. There were a lot of transactions in the pipeline coming into 2020, and many companies got funded in Q1 and Q2. After a dip in Q3, we've seen excellent activity to the end of the year.*"

"The bigger picture, however, is a real cause for concern. While established companies are attracting big investments in sectors that are already coping quite well, it's clear that not enough investment is going to early-stage companies, which could affect future deal activity. When early-stage companies don't receive funding, they will not be capable of scaling up and securing follow-on investment, which will have a significant longer-term impact."[14] - Anna Scally



Source: Venture Pulse, Q4'20, Global Analysis of Venture Funding, KPMG Private Enterprise. 'As of 12/31/20. Data provided by Pitchbook, 1/20/21.

[14] The New Geography of Jobs (Houghton Mifflin Harcourt, 2012) by Enrico Moretti

3.2 2020 - Investment Figures - Irish Venture Capital Association

The Irish Venture Capital Association's investment figures for 2020 show overall funding grew by 13% to €925m in 2020, compared to €820m the previous year. Six firms raised a combined €353m, which accounted for 38% of the total. **Overall, investment growth took place in 2020, in spite of a backdrop of deals under €5m falling by almost a third (32%) in this year**. Funding in the €5-10m range doubled to €204m in 2020 from the previous year. In addition, deals above €10m were up by almost a third (31%) to €568m. **However, the figures show some very worrying trends for early-stage start-up companies:**

- Deals under €5m, fell by almost a third (32%) to €194m in 2020, from €285m in 2019.
- This trend accelerated in the fourth quarter of 2020 when deals under €5m fell by 50% to €41m, compared to the same period the previous year.
- Additionally, the overall number of rounds fell by 18% in 2020, compared to 2019.

3.3 2020 - Investment Figures - TechIreland

TechIreland carried out an analysis of investments into Irish tech companies during 2020. 208 companies raised risk capital funding totalling €1.1bn. However, the overall funding figure is inflated by large outliers. The top 5 firms raised €452m of the total, the top ten raised €628m, the top 20 raised €791m or 78% of all investments. However, the figures also raise serious concerns about the level of investment in early-stage companies:

- The number of start-ups raising early-stage investments was the lowest in the last four years.
- This is a consistent trend as the number of early-stage investments dropped year-on-year from 149 companies in 2017 to 113 last year.
- There has also been a significant drop in the number of companies funded at the Seed/Series A stage (€1m-€3m). The figures show a 25% drop over the past 4 years in the number of companies and a 30% decrease in funding.
- There is a similar decline in investments in the €3m-€5m range.

3.4 2020 - Investment Figures - HBAN

HBAN delivered 59 deals on the Island of Ireland in 2020, with HBAN investors contributing €14.5m of private capital into those deals. In addition, a further €40.4m was invested by third parties giving a total of €54.9m (€930,000 average per deal).

- Whilst these figures are encouraging, HBAN believes it is indicative of just how much more could, and should be promoted amongst the angel and wider investment community, to support the early-stage ecosystem.
- To ensure a more dynamic angel community becomes culturally ingrained in Ireland, HBAN believes that both wider participation amongst private investors and larger investments would be forthcoming if EIIS was more accessible in a user-friendly manner (both for individuals and for companies).
- In particular, protections for investors would be improved through the necessary fiscal policy changes, such as relief of losses as well as structural changes - for instance opening up other investment vehicles to benefit from EIIS.

3.5 TechIreland Review of EIIS Investments 2007-2018

This analysis is based on data from Revenue on investment raised between 2007-2018, under four key schemes: Business Expansion Scheme (BES); Employment Investment Incentive Scheme (EIIS); Seed Capital Scheme (SCS); Start-Up Relief for Entrepreneurs (SURE).[16,17]

Our focus is on the level and type of investment incentivised under these schemes into "High-Growth Tech Start-ups and Scale-ups". These are innovation-driven businesses that are high-risk and require significant upfront investment before breaking-even, thus they are very dependent on equity-based finance. These companies present huge potential in terms of employment, exports and innovation. They are distinct from lower-risk asset-backed or service businesses.

Finding 1: Under 27% of investments have gone to High-Growth Start-ups and Scale-ups.[18]

The majority of investment (73%) under the four schemes has been focused on lower-risk businesses, as distinct from higher-risk, high-growth start-ups and scale-ups. This statistic is consistent for both the percentage of companies receiving investment and the percentage of money invested.

Breakdown Of Funding Allocations Under The Four Schemes (2007-2018)	
Total number of qualifying companies that received investments	1,899
Number of which were high-growth, Start-up & Scale-up companies	*521 (27%)*
Total value of investments in qualifying companies	€816m
Value of investments in high-growth Start-up & Scale-up companies	*€238 (29%)*

Finding 2: Less than 26% of investments under €1 million have gone to high-growth potential enterprises.[19]

Over 74% of investments under €1 million in the four schemes have gone into asset-backed or service companies. Whereas, less than 26% of seed capital has been invested in high-growth potential tech start-ups.

Break down of Early-Stage Investments Under The Four Schemes (2007-2018)

Amount of funding received	Total Number of companies that received funding	Number of "High-Growth Start-ups & Scale-ups" that received funding	Percentage of funding going to High-Growth Start-ups & Scale-ups
€0 - 100k	859	181	21%
€100 - 500k	1,541	380	25%
€500 - 1million	1,771	457	26%

Finding 3: Only 27% of high-growth start-ups & scale-ups that secured investment from the Halo Business Angel Network (HBAN) were able to avail of state investment incentive schemes.[20]

Only 25% of companies (92 out of the 335) that secured investment from HBAN (typical high-risk companies with high-potential) were able to avail of BES or EIIS, with most investments involving smaller investments [half of these 92 investments were under €200K].

[16] Revenue review of BES/EII/SCS shares issued 2007-2018
[17] EIIS Statistics 2011-2018
[18] Revenue.ie: BES/EII/SCS shares issued on or after 1st January 2007-2018
[19] Ibid
[20] Source: Halo Business Angel Network

Finding 4: The cost of tax advisory to access EIIS is prohibitive for companies raising smaller amounts of funding.

Nearly 70% of the investments under the four schemes were under €300k, 60% under €200k and 43% under €100k. Based on consultation with the investee companies, it was found that the cost to companies of hiring a tax advisor in order to apply for EIIS is up to €10k, due to the complexities within the scheme, which deters many early-stage companies from using the scheme. In contrast, in the UK the process usually costs between £250 and £2,000.

3.7 Indecon Report - Outstanding Recommendations:

The Indecon report was published in 2018 following an extensive consultation process with key stakeholders on how to improve EIIS.

The Indecon report followed a broad consultative process, and its findings were broadly welcomed by the sector. However, almost three years later, there are a number of relevant recommendations which have yet to be implemented.

Recommendation 2. An amended Enterprise Investment Scheme should involve a simplified application process based on a self-assessment with Revenue role confined to the eligibility of companies and to normal audit led supervision

Recommendation 6. EII scheme should prioritise the attraction of risk capital in sectors with the greatest levels of market failure.

Recommendation 7. Restriction of non-connected parties should be eased for micro start-up enterprises.

Recommendation 12. A simplified process involving less restrictive conditions should apply for start-ups who are raising limited investments.

These outstanding recommendations echo many of the proposals that we have outlined in this document - though the issues and the need for them have, in the interim, become more acute. If implemented, they would have a significant impact on investor confidence and participation in the scheme.

4. International Comparisons

Many organisations, including key state bodies, made submissions to the government in advance of the Indecon Report in 2018 and they referenced the UK SEIS and EIS schemes as examples of effective policies to support investment & entrepreneurship.

4.1 Key Aspects of the UK Models versus the Irish EIIS system

Table 4.1: Comparison of Irish-UK employment investment schemes (Source KPMG)

Scheme	EII	UK EIS	UK SEIS
Relief Rate	40%	30%	50%
Company Investment Limit	€5m per 12 months €15m lifetime limit	Stg£5m per 12 months Stg£12m lifetime limit	Stg£150k lifetime limit
Investor Limit	€250k pa / €500k pa	Stg£1m pa	Stg£100k pa
Holding Period	4yrs / 7 yrs	3 yrs	3 yrs
Eligible Companies	Most trading SMEs	Most trading SMEs	Small companies <25 employees + ≤Stg£200k in assets
Capital Gains Treatment	Gain on disposal subject to CGT	Gain on disposal exempt if held for 3 years	Gain on disposal exempt if held for 3 years
Share loss relief against income tax	None	Yes	Yes

4.2 Other Important Points Relating to the UK Model

Tax advisers typically charge between £500 and £3,000 for completing an AA application depending on the complexity of the company's circumstances. Loss relief in the UK allows investors to offset the loss made against *either capital gains tax or income tax*, depending on whichever is better for them. This inspires more confidence in investors to deploy capital into early-stage tech companies.

In terms of directing funding to High-risk companies, in the UK the government introduced the "Risk to Capital" condition in 2017, which had the precise remit of directing EIS monies to high-growth, high-risk companies, particularly in the tech sector. This has meant only companies who meet the new condition qualify. They have to demonstrate they have strong growth aspirations in order to "grow and develop", and there are specific criteria for ensuring companies meet these conditions. As a result, the tech sector now accounts for circa 60% of all investment through EIS/SEIS. SEIS has CGT relief if investments are held for three years, and it also includes reinvestment relief to incentivise more investment into early-stage tech start-ups.

4.3 HM Revenue & Customs - Impact of EIS Schemes in the UK

HM Revenue & Customs commissioned research by Ipsos MORI in 2016 to conduct quantitative and qualitative research into the use and impact of the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs).[21] The research involved random surveys undertaken with 628 investee companies and 546 investors, covering both EIS and VCT schemes.

Loss aversion was a particularly important factor in decision-making. The reliefs meant that the value of their investment could effectively fall by a substantial amount before investors would start to lose money, which made them more willing to invest.

One EIS investor noted that while tax reliefs did not affect the affordability of an investment for them, they preferred to invest as part of a group of investors and the reliefs had helped to bring other investors on board. Being part of a group of EIS investors in a business gave reassurance about the potential of the business and helped this investor meet like-minded individuals.

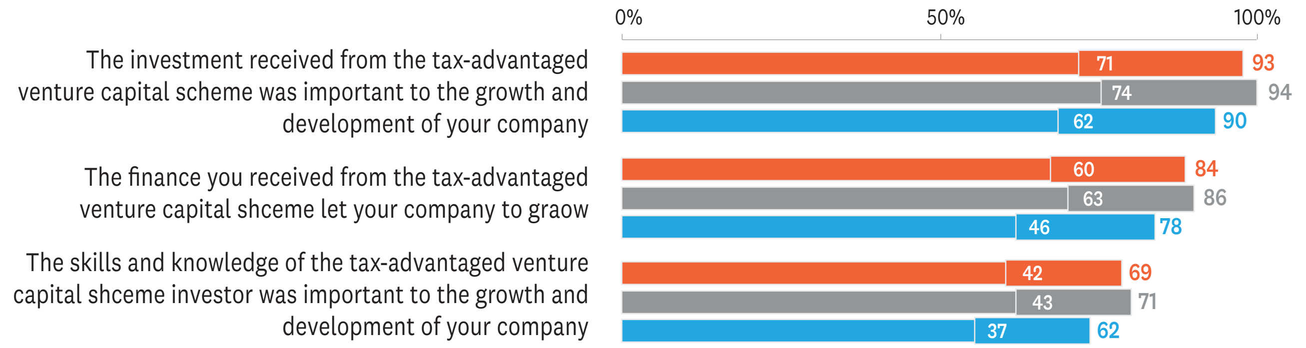
4.4 HM Revenue & Customs - Key Findings

Six in ten investee companies (63%) reported that their proposed investment would either definitely not (35%) or probably not (28%) have taken place without the tax-advantaged venture capital schemes. Just 11% felt that their proposed investment would definitely have gone ahead without the schemes.

Nine times as many investees said their company had grown (71%) rather than contracted (8%) in terms of employee numbers since they first sought EIS or VCT investment. Among investees whose companies had grown, nine in ten (90%) attributed at least part of their growth in employee numbers to their EIS or VCT investments.

Q. How much do you agree or disagree with the following statements?

% of all investees agrees % of single-company investees % of group investees % strongly agreeing in each case.



Bases: 628 investees overall; 515 single-company investees; 113 group investees

In conclusion, the report commissioned by HM Revenue concludes - 'the schemes appeared on many measures to have a particularly strong impact among the smallest and youngest companies, as well as those aiming to expand, broadly suggesting they are being targeted at those most in need of investment'.

[21] The use and impact of venture capital schemes (2nd February 2020) by HMRC Research Report

5. Recommendations

EIIS is a critical investment incentive scheme to foster equity-based risk finance for early-stage high-risk companies. In light of the difficulty in accessing funding for high-growth tech start-ups and scale-ups which has been heightened by Covid-19, it is critical that EIIS is reformed to ensure these companies can not only be sustained but scaled through private investment. We recommend several key changes to EIIS, as outlined in our EIIS Submission.[22]

These proposed changes to EIIS could help replace existing government financial support for start-ups with investment by private capital; thus reducing the net cost to the exchequer.

- Enable loss relief on investments under EIIS.
- Seek an increase in investment limits under EIIS.
- Allow other investment vehicles, including venture fund partnerships, to qualify for designated investment funds for EIIS investments (achievable outside budgetary cycle).
- Standardise investment period to four years for all qualifying investments.
- Enhanced reliefs for investing in micro-companies.
- Greater clarity and increased certainty for companies that they are eligible for EIIS. Simplification of process and reduction in the costs involved.
- Introduction of CGT exemption on all qualifying investments remains an overarching objective of the Alliance, but given the current circumstances, our main focus is on loss relief.

5.1. Provide loss relief on investments made under EIIS

Central to all of our recommendations is the critical objective of ensuring that more capital can be provided to Irish-based companies to enable them to grow and scale. In order to do that, it is imperative to encourage more individual investors to take the leap of faith required to enable them to invest their own money [or savings] in Irish companies. We believe that by providing loss relief on investments made under EIIS schemes, investors may be more willing to make investments that they may otherwise simply choose not to make. If more individual investors can be encouraged to invest in companies through EIIS arrangements, companies will have greater access to funding. This recommendation would allow investors a form of loss relief on the loss-making investment and would put such shares on a similar footing to losses made on non-EIIS shareholdings from a Capital Gains Tax perspective. (It should be noted that this issue is one of long-term structure and one that will remain in a post-Covid environment).

Problem: Investors know that if their investment in an EIIS company succeeds, then any gain arising on the disposal of their investment would be subject to tax. However, unlike the other shareholdings, there is generally no relief for any loss arising on disposals of EIIS shares, where the investment is not successful. Therefore, EIIS shares are treated less favourably from a Capital Gains Tax perspective than other investments. As you will be aware, CGT loss relief is provided for under the UK's EIS.

Solution: Introduce CGT loss relief on failed or loss-making EIIS investments. This could be done by allowing a deduction for the acquisition cost of the EIIS share (decreased by the requisite reduction in the income tax payable given to the EIIS investor) from the ultimate disposal proceeds if any. In that way, there should be no "doubling up" of income tax and capital gains tax relief on the same investment. [Such an approach would be similar to that adopted by the UK EIS regime and was suggested as part of Indecon's review].

Impact: This would remove the difference in CGT treatment between EIIS and other investors. This would make EIIS investments more attractive to potential investors, thereby increasing the supply of capital to Irish based companies.

5.2 Seek increase in investment limits under EIIS

As with point 5.1, the purpose of this suggestion is to ensure that funding sources available to companies are maximised. This proposal should also assist companies in streamlining the number of investors they need to attract to fund their development and may enable them to raise more meaningful amounts to accelerate their development. This will also likely reduce the costs associated with raising EIIS funding (which is also a concern we have addressed below – in recommendation [5.6]).

Problem: The current maximum allowable investment in an EIIS company is €500,000. That has a 7-year retention period. The UK's EIS has a maximum allowable investment in an EIS company of €1m, with a shorter retention period. This difference in investment level makes Ireland's regime less competitive and makes it more difficult for companies to raise significant funds through EIIS; we discuss the retention periods in a separate point.

Solution: Increase the investment limits to €1m per investor.

[22] EIIS Submission (25th November 2020) by the Alliance for an Innovation-Driven Recovery

Impact: This would remove some of the differences between the Irish and UK systems and should enable companies to raise more significant amounts with fewer investors and administrative burden. It should expand the cohort of investors prepared to invest in companies under an EIIS, again increasing the pool of investors willing to invest in Irish based scaling companies.

5.3 Allow other investment vehicles to qualify for tax relief on EIIS investments (achievable outside budgetary cycle)

Problem: The supply of capital is constrained by the fact that only one type of collective investment scheme can act as an EII Fund. This limits capital from investors who want to invest across several SMEs, using the services of an investment professional.

Under the terms of the EIIS legislation, the Revenue Commissioners can designate a fund as a "designated investment fund". Once approved and designated, the fund can be used as a collective investment vehicle which can invest in qualifying EIIS companies. The investors can secure EIIS relief by reference to their investment in the fund. A fund will only be designated where certain conditions apply.

In practice, Revenue's approval has been limited to funds formed under the Designated Investments Funds Act 1985. This provides for a fund established under irrevocable trusts for the sole purpose of investing in qualifying EIIS companies. The legislation governing the creation of designated funds dates from 1985 and is prescriptive and outdated. This restricts the type of private equity funds that can invest in qualifying EIIS investments. Funds formed under the 1985 Act are distinct from common forms of private equity and growth-stage funds which managers, investors and investee companies may utilise.

This limitation in the types of funds which can access EIIS relief reduces an important potential supply of funds to early-stage companies. It prevents fund managers from using modern forms of funds, such as the Irish Investment Limited Partnership. This vehicle has recently been reformed, with the express intention that it be available to invest in private companies, however, it is unable to provide Irish investors with access to the EIIS.

This situation does not provide investors with the sufficient choice of the fund manager as new entrants are reluctant to create such EII specific funds given that formation, structure and approval are cumbersome and outdated. There are a very limited number of such funds. Finally, the use of designated investments funds restricts the ability for EIIS investors to pool their capital with non-EIIS investors.

Solution: To increase the supply of funds to early-stage companies, we are recommending that other investment vehicles, such as private equity partnerships, should qualify for tax relief on EIIS investments. We would highlight that this should not impact any taxes paid. It is merely a structural change. We would suggest only partnerships be used as EII Funds, so no changes would need to be made to the Irish funds' regime.

Funds should be limited to cases where the fund, or the fund manager, is already subject to appropriate supervision under the Alternative Investment Fund Management Directive or MIFID. This would allow Irish investors to access EII relief through modern fund structures. It would also allow EIIS investors to pool their capital with other forms of institutional equity. EIIS relief would be available to qualifying Irish investors, in the same way as currently.

Impact: This will increase the range of collective investment structures which can access EIIS tax relief and will generate much-needed funding for SMEs at this time. It will also enable less sophisticated and more cautious investors to take advantage of a diversified portfolio approach to investing.

5.4 Standardise investment period to four years for all qualifying investments

Problem: Finance Act 2019 amended the annual limit an investor can make from €150,000 per annum to €250,000 and €500,000. Where an investment of greater than €250,000 is made, the investor must retain the qualifying shares for seven years. The increase to the annual limits has been welcomed by the Alliance. With the economy currently contracting, there is a limited appetite by investors to lock in a substantial investment for a seven-year period. Where an SME is fortunate to attract an investor that can invest greater than €250,000 in a year, the seven-year retention period is a substantial barrier to invest.

Solution: To incentivise investors to make investments greater than €250,000, we are recommending that the investment period for all qualifying investments up to €500,000 is adjusted to four years. It should be noted that as an alternative to investing €500,000 which attracts a seven-year retention period, investors can make an annual investment of €250,000 per annum for two years. As the investment amount is €250,000, the qualifying investment period is four years. As such, the investor can obtain the same quantum of relief of €500,000 over a two-year period but reduce the total investment period from seven years to five years. However, in the current economic environment and with the shortage of liquidity in the marketplace for SMEs, it is important that businesses can obtain the maximum funding upfront.

Impact: As such, reducing the investment period from seven years to four years for investments up to €500,000 will incentivise the investor to make a greater upfront investment. This would result in efficiencies regarding administration and the additional cost to the exchequer should be negligible, on the basis, it is simply bringing forward the relief to the investor by one year. This will also give companies the certainty required to execute their strategy knowing that the required funding is in place.

5.5 Enhanced relief for investing in micro-companies

Problem: Providing funding to businesses that are high-risk, high-potential, innovation-driven and early-stage is inherently riskier than investment in more established asset-backed enterprises. As the economy contracts, limited private sector funding is available and the appetite for riskier investment has substantially diminished. The EII scheme, therefore, needs to acknowledge that not all businesses that qualify for the scheme will be an equally attractive investment prospect to investors. To encourage investors to bear the additional risk of investing in high-risk start-ups and early-stage businesses, additional relief for the investor is required.

Solution: Our recommendation is that the EIIS relief should be extended to provide a deduction for USC and PRSI purposes where the qualifying investment is in a "micro company". The Taxes Consolidation Act already recognises that the investor profile for micro-companies is substantially different from other SMEs eligible to participate in the EII scheme. It is proposed that the extended relief should be available to investors in micro-enterprises, within the meaning of Annex 1 of the General Block Exemption Regulation. A micro-enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed €2 million. Connected party rules could also potentially be amended for micro-companies to further incentivise enhanced relief.

Impact: By limiting the application of the extended relief to micro-companies, it should strike the appropriate balance of Exchequer cost while ensuring that such expenditure is also focused on smaller, higher risk, higher potential enterprises.

5.6 Increase certainty for companies that they are eligible for EIIS and simplification of process

Problem: The need for certainty is essential in the operation of any tax relief. Currently, investors do not have certainty that investee companies will be able to retain EIIS status as they are subject to audit in subsequent years. If the company subsequently is admitted to trading on an EU SME Growth Market (or equivalent) this would not result in the relief granted to investors under the EIIS being withdrawn.

A key issue for early-stage start-ups is the cost of capital. In Ireland, the cost of capital is unacceptably high. For start-ups, their cost of capital is driven by both the terms of investment and the time, effort and opportunity cost required to secure and manage the investor. As such, a streamlined EII process has the potential to reduce the cost of capital to innovation-driven enterprises and would be highly desirable. In the UK, tax advisers typically charge between £500 and £3,000 for completing an EIS application depending on the complexity of the company's circumstances, whereas in Ireland, the cost is on average €10,000 which is a deterrent to companies. In addition, a simplification of the rules around connected persons could be considered as part of the simplification process, and would bring about further certainty for applicants.

Solution: To provide companies with certainty, we are recommending that a company is provided with a final confirmation that it is eligible for EIIS investment where the information provided to the Revenue Commissioners is correct and complete. Separately, the Indecon report states that "An amended enterprise investment scheme should involve a simplified application process to facilitate efficient decision making and approval should focus on confirming the eligibility of companies." It goes on to state that "A simplified process involving less restrictive conditions should apply for start-ups that are raising limited investments."

Impact: This would only involve one stage in the Revenue approval process and would increase the confidence of investors. Reducing costs involved in an EIIS application would incentivise more investments into early-stage tech companies and ensure more companies avail of the government incentives.

CGT exemption on all qualifying investments

The Alliance has consistently sought in its various submissions to the government, to *Incentivise more investments in SMEs, by providing an exemption from capital gains tax for all qualifying investments. This is still an overarching goal for the Alliance which we believe would incentivise private investment. However, in the short term, we are focusing on prioritising loss relief on investments under EIIS.*

Problem: In an address to the Institute of International and European Affairs earlier this year, the Central Bank Deputy Governor warned that "*Half of large corporations hold less than 8% of annual turnover in cash. Half of SMEs hold less cash and SMEs have less access to undrawn credit than their larger counterparts*." Liquidity is a substantial issue for SMEs and COVID-19 has increased the risk of insolvency. The knock-on impact of reduced liquidity on the economy is an increase in unemployment, reduced spending, reduced tax revenues and additional cost to the exchequer in the form of welfare payments. The pre-existing difficulty in accessing financing/ investment by SMEs has further reduced with the economy contracting. The appetite to invest in riskier assets, such as SMEs, has reduced substantially.

Solution: We have previously seen the success of implementing a CGT exemption[23] to intervene when the Irish property markets were stagnating. In 2011, a CGT exemption for property purchased during the period 7 December 2011 and 31 December 2014 resulted in a substantial increase in the amount of both domestic and international investors into the Irish property market. We are recommending that in addition to income tax relief (see below), a capital gains tax exemption is introduced and should apply to all qualifying EIIS investments.

The exemption would apply to disposals made after the expiry of the four year investment period. We are recommending the exemption is time-bound to balance the cost to the Exchequer with the current market failing to invest in riskier assets, such as SMEs, where access to liquidity is imperative for the business' survival. The reality is, many investors in SMEs do not actually realise gains on their investments. However, the lucky few do.

Impact: By providing a CGT exemption on gains made on the ultimate realisation of EIIS investments made in the Covid Emergency Period, the Government could provide an added incentive which might encourage otherwise reluctant investors to put their capital at risk.

6. Conclusion

The Alliance welcomes the Government's review of EIIS. Supporting companies to scale is key to enabling future Irish economic growth.

Finance is the fuel for companies to grow and scale, and the Irish enterprise needs to be supported by ensuring a stable long-term funding landscape. Research shows that providing access to equity finance enables companies to scale faster and invest in innovation.

As outlined in this submission we believe that a dynamic, efficient, and fit for purpose EIIS will be a meaningful provider of the required capital for start-ups and SMEs to continue to grow and innovate. This will accelerate the creation of strong indigenous enterprises, rooted in Ireland, developing IP in Ireland, paying taxes in Ireland and passing leadership skills to the next generation.

We believe that the reforms that we have suggested to EIIS will ensure that this important source of funding is available for the deployment of risk capital into innovation-driven sectors of the economy.

The Alliance is committed to working with government departments and state agencies and bodies to achieve a long term strategy to enable and support the funding of Irish enterprise.

7. Appendix

Reports Database

[23] Section 604A, Taxes Consolidation Act (1997)

Alliance for an
Innovation-Driven Recovery
Submission

Department of
Finance Review of EIIS