Submission to Department of Finance on the Employment Investment Incentive

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Chambers Ireland is the state's largest business representative network. We are an all-island organisation with a unique geographical reach; our members are the chambers of commerce in the cities and towns throughout the country – active in every constituency. Given the importance of local economies to our members, and member businesses, Chambers Ireland's perspective is unique within the Irish business community – we seek to support thriving local economies and recognise the diversity of business environments that exist across the cities and regions of the country.

Chambers Ireland is also an advocate of the Sustainable Development Goals and uses the Goals as a framework for formulating and advocating policies that support sustainable local economies. At the heart of local economies throughout the country are indigenous businesses, entrepreneurs and investors.

Drafted in correspondence with our Chamber Network and associated policy fora, Chambers Ireland is pleased to have the opportunity to make this submission to the Department of Finance on the Review of the Employment Investment Incentive Scheme (EIIS).

Context

While Ireland is, and must remain, an attractive place for Foreign Direct Investment, it is imperative that there is a strategy to improve the resilience and competitiveness of the domestic economy and indigenous, home-grown businesses. Ireland should aim to be among the most attractive countries in the world to start and scale a company, and therefore, a renewed focus on Ireland's indigenous enterprise should be at the heart of the soon to be published National Economic Plan. The recently published SME and Entrepreneurship Growth Plan[1] acknowledges this need and recognises that entrepreneurship and SME growth must be at the centre of Ireland's economic strategy post-Covid-19.

Global economic and political volatility also makes this a strategic imperative. By taking action to avoid excess reliance on a small number of highly mobile firms, we can ensure that we can make the wider economy more competitive and resilient as a result. The Employment Investment Incentive provides a valuable means of

[1] https://www.gov.ie/en/press-release/578d7-publication-of-the-report-of-the-sme-taskforce-sme-and-entrepreneurship-growth-plan/

accessing finance for start-ups. Therefore, the reform of the scheme can play a role is improving the environment for these companies.

The recent record highs in the Central Bank's figures on household deposits[2] shows that there is a great deal of private savings available which can help drive economic recovery. From the perspective of start-up companies who require capital and investment, if there was a means to more easily accessing this capital as a form of investment, this would support these companies to enable the recovery. The impact of COVID-19 on availability of finance to early-stage companies have been detrimental. For example, figures published by Tech Ireland in 2020 shows the number of investments totalling less than €500,000 down 40 per cent in the first six months of 2020. Investments of €500,000-€1 million were 60 per cent down on the same period a year earlier.[3]

In our view, Government should take a broader view in the interests of protecting employment and driving economic recovery and that the EIIS should be simplified and reformed so it can be used by business owners injecting capital into affected businesses.

Proposals for Reform

Through consultation with our member chambers, the primary issues identified concerns the efficacy of the EIIS. The complex administration involved in the scheme has been well flagged over recent years. Many of the elements which make the scheme burdensome to administer remain, despite efforts to enhance the scheme. While the objectives of the Scheme are positive, feedback informs us that the complexity involved for many businesses to understand rules is prohibitive to their engagement with the Relief. They then reach out to advisers for assistance in navigating this complexity, and so the Scheme can quickly become very expensive to apply for and administer. Simplification on the administration of the scheme would help significantly.

1. *Reduce Administrative Burden and Simplify Qualifying Criteria*

Feedback from our members consistently notes that the administrative burden involved in qualifying for the scheme prevents the initiative for realising its potential. Inappropriate barriers to qualification should be addressed where possible: This Relief is targeted at early-stage start-up companies raising funds. The detailed tax provisions are extraordinarily complex. This can create a reluctance or fear of availing of the relief by many early-stage companies.

Prior to the recent changes to the EII relief, the practice was that Revenue approved EII applications and issued certification to qualifying companies. This was necessarily abolished because Revenue stopped approving companies and caused EII tax relief to grind to a halt. Feedback has informed us that the resulting requirement for start-up companies to self-certify that they qualify for the relief, combined with the extreme

[2] https://www.centralbank.ie/statistics/data-and-analysis/financial-accounts
[3] https://www.techireland.org/content/snapshots/TechIreland%20Startup%20Funding%20Review%20H1%202020.pdf

complexity of the EII legislative provisions, is an inhibitor to early-stage companies claiming the relief. This could be reformed through the **introduction of a certification process where companies can obtain clearance that fundraisings qualify for the relief**. Such a certification process could greatly alleviate the implications of the complex legislation referred to above. It would be critical however that this process operates efficiently, and strict timelines should be imposed on responses to applications. Consideration could also be given to allocating any certification process to the Department of Enterprise, Trade & Employment as opposed to Revenue.

To qualify for the Scheme, there is a requirement that the applicant SME must not fall into the definition of an 'Undertaking in Difficulty', but this is defined as an undertaking in which accumulated losses exceed the value of 50% of subscribed share capital.[4] This criterion should be reconsidered in light of the fact that the technology and life science sectors are the area of focus of many Irish start-ups and it is typical in these industries that there can be years of research and development before material revenues are earned. The current rule is that this clause need not be satisfied if the company is registered for less than three years, but many start-ups will have accumulated significant losses by their first three years in operation.[5] The existence of such losses precludes the availability of bank debt and most venture capital funds will not invest in pre-revenue company. Therefore, EII funding has the capacity to fill a void at a critical stage of development for early-stage SMEs. However, if the SME has been in existence for more than 3 years, this "undertaking in difficulty" criterion precludes the availability of EII funding. Through focus groups hosted by member Chambers, including Dublin Chamber, many SMEs have identified this specific point as an area that requires reform. Broadly speaking, the EII Scheme should **be amended to ensure that more start-ups remain eligible**. One such proposal noted by our members is that **start-ups should be given a 5-year period of leeway for losses resulting from early-stage innovation with respect to eligibility for the EII Relief**, to ensure that the scheme reflects the realities of the start-up scene and that entrepreneurs are not unduly impacted by the Covid-19 crisis.

2. *Make Relief More Attractive to Investors*

The EII tax reliefs are modest compared to similar regimes in the likes of the UK. In addition to income tax relief, in the UK investors also get relief from Capital Gains Tax on the disposal of investments. In Ireland, investors are not only subject to a very high 33% capital gains tax charge on the disposal of investments, but losses on EII investments are restricted for capital gains tax purposes. The relief could be substantially enhanced as an incentive for angel investing if these shortcomings were improved. This could be achieved through lower CGT rates applying to EII investments or the removal of the restriction on losses for CGT purposes. If an EII investment is disposed of within a 4-year period, the tax relief is lost in its entirety. This

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[4] Revenue, Tax & Duty Manual Part 16-00-10, The Employment & Investment (EII) Relief for Investment in Corporate Trades, p. 6, https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-16/16-00-10.pdf#page=6

[5] European Commission, Guidelines on State aid for restructuring non-financial undertakings in difficulty, para. 21, https://ec.europa.eu/competition/state_aid/legislation/rescue_resctructuring_communication_en.pdf; Revenue, Tax & Duty Manual Part 16-00-02, Relief for investment in corporate trades as it applies to companies, p. 10, https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-16/16-00-02.pdf#page=10

can result in a very harsh outcome for an investor who for example, might invest in a company, but that company is taken over after say 3 years and 11 months. Consideration should be given to **allowing the tax relief to vest over the 4 period** so that say, the clawback would only be 75% of the relief if there is an exit after more than a year of ownership, 50% if after two years of ownership and 25% if after three years of ownership.

Consideration should be given to **raising the life-time maximum limit from €15 million to €20 million**. Ireland needs to show ambition to be creating highly successful growing SMEs so EII should cater for the requirement of companies to potentially raise substantial amounts of capital over their first few years.

3. *Flexibility*

To meet the objectives of sustaining and increasing employment, the **EII Scheme should be flexible and adaptable so that it can enable the enterprises to adjust to changes in circumstances outside of their control** which may be causing trading difficulties. Brexit and COVID-19 are two current factors that enterprises are having to deal with.

Given the substantial uncertainties faced by early-stage companies, measures could be introduced to facilitate the saving of failing companies. For example, where an enterprise which has received EII funding and subsequently falls into trading difficulty, the EII rules should be amended to allow the EII shareholders to put together a rescue plan which may include them taking control of the business. Under current rules, the EII relief would be withdrawn in the event of the EII shareholders acquiring control of the company. The purpose here would be to avoid collapse of the company and hence to sustain employment. The clawback of their EII relief, if they rescue a genuinely failing company, is a material impediment to angel investors stepping in to provide emergency resources to keep the company in operation.

4. Improving Investor Participation

If the EIIS is to fulfil its potential and be truly effective for start-ups, the **number and range of individuals participating in scheme needs to be broadened and increased in a meaningful way**. Ireland does not yet have the kind of vibrant angel ecosystem when compared to that in other jurisdictions. Along with improving the Scheme, the State should also actively promote the EIIS as a vehicle for societal good and social investment. Further, the Department should also explore whether it is possible to open the Scheme up to a much wider range of investment vehicles, such as limited liability partnerships and specialist regulated venture funds. It would be important that these Funds/individuals could attain the EIIS benefits whilst simultaneously having the opportunity to invest and support a diversified portfolio of SME and early-stage ventures (rather than having single company risk). Feedback articulated by our member has noted that this **expansion and diversification** could be a key catalyst in helping to build a healthier angel and early-stage venture ecosystem to support entrepreneurs and the wider business community.