dublinchamber of commerce

Submission to Department of Finance Consultation on the Employment and Investment Incentive (EII) and Seed Capital Scheme (SCS)

9 May 2014

Employment and Investment Incentive

Dublin Chamber welcomes the opportunity in the past to work with the Department of Finance as a leading advocate of reform of the Business Expansion Scheme into to the Employment and Investment Incentive (EII) scheme.

When the EII was introduced the Chamber welcomed the wider range of qualifying sectors that the changes brought. Since the EII's introduction, the Chamber has sought to highlight positive changes that could be made that would address the poor uptake of the scheme, not withstand the difficult economic situation it was introduced during.

The Chamber welcomes the Government's commitment to seek to extend the EII and appreciates that this process includes approval from the European Commission, which makes amending it much more difficult. However, in light of the low uptake (~€40m in 2013), the Chamber believes there is an opportunity to significantly increase that number to peak levels with some changes.

One change, that the Minister has already made, which the Chamber has welcomed publically, was the abolishment of the limits on high earners investing in EII, as recommended by the Chamber in its Pre-Budget 2014 Submission. The decision was made possible as existing protection from tax avoidance was already in place in the legislation. The past year has seen significant increase in EII, with an approximate 25% rise in investment due in part to the change and examples of the maximum limit of investment being achieved.

There are five amendments that would significantly increase uptake of the EII, in order of priority:

1. Increase the period of investment from three to five years;
2. Remove the restriction related to expansion capital for businesses in non-assisted areas;
3. Remove the phased nature of the relief and allow full relief from the start;
4. Help address the complexity of the EII legislation by including deeming conditions (such as being an Enterprise Ireland client) to clarify which companies qualify; and
5. Allow subsidiaries in a group to apply for EII.

The overall cost of the amendments suggested would be marginal given that the costing built into past Budgets remains largely unspent. These changes will help to realise the growth and employment potential of these SMEs.

Three to five year investment period

As part of the changes made in the transition from the Business Expansion Scheme (BES) to the Employment and Investment Incentive (EII) scheme, the investment period was shortened from 5 years to 3 years. Based on our engagement with members, Dublin Chamber believes that this period is too short for companies to have accrued a cash flow benefit sufficient to pay back EII investors. This limits the company's eligible to more likely be at a later stage of the company's development, which is counter to the aim of the EII's objectives.

The Chamber appreciates that the objective of the change was to make the scheme more attractive for investors by shortening the investment period. While this can be more attractive to investors, the benefit is marginal as most investors are rolling over such investment in any case.

The acceleration of the period means that many companies that would benefit from EII would not have a viable financing plan within the 3 year period. This involves securing the funds, putting the investment to work, adjusting the business model, and generating a return sufficient to repay the investment.

The Chamber would rate the shift back to a five year investment period as a major priority for reform of the EII. To illustrate the value it would have the Chamber has prepared with our member companies, a number of case studies based on a real companies but presented in on a no name basis.

Case Study #1
Company sector: Food Manufacturing and Services sector

Actual results for the year ended 31 December 2013
Turnover: €11.2 million
Net profit: €144,000
Net assets: €599,000
Number of employees: 30

Notes:
- The Company applied for €600,000 in EII Scheme funding at the start of 2014 to finance growing working capital requirements and part finance the expansion of the company's production facility to allow the company to avail of a specific growth opportunity within the domestic market.
- It is projected that the company turnover would increase by c. 25% to €14 million in 2015 as a result of the EII Investment
- The opening cash balance was €18,000
- Finance includes bank loans, finance leases and €600,000 EIIS Investment.
- As funding was for the start of 2014, the cash flow requirements arise at the end of 2016.

	Projected cash flows by year under 3 year EII (€’000)				
	2014	2015	2016		
Trading	480	713	1,169		
Working Capital	(631)	(258)	(574)		
Interest & Tax	(93)	(121)	(176)		
CapEx	(980)	(335)	(225)		
Net Financing	1,743	(154)	(663)		
Closing cash	**537**	**382**	**(87)**		
	Projected cash flows by year under 5 year EII (€’000)				
	2014	2015	2016	2017	2018
Trading	480	713	1,169	1,557	1,775
Working Capital	(631)	(258)	(574)	(467)	(927)
Interest & Tax	(93)	(121)	(176)	(222)	(252)
CapEx	(980)	(335)	(225)	(344)	-
Net Financing	1,743	(154)	(63)	172	(782)
Closing cash	**537**	**382**	**513**	**1,209**	**1,023**

The above detailed projected cash flow for 3 years after investment shows a negative cash flow position on repayment of the €600,000 with a negative closing cash balance of €87,000. Therefore, this EII investment would not go forward to investors.

However, when a 5 year period is used as recommended for EII, the company would be in a positive cash flow position with a positive cash balance of €1,023,000 after the repayment of the €600,000. In this case, the positive cash balance would mean the investment would go forward.

Case Study #2
Company sector: Engineering and Tooling sector

Results for the year ended 31 December 2011
Turnover: €4.5 million
Net profit: €155,000
Net assets: €438,000
Number of employees: 36

Notes:

- The company applied for €600,000 in Ell Scheme funding in 2012 and the purpose of the finance was to fund an expansion of its production capacity to meet increased Irish and export demands. The increase in production capacity includes new machinery and finance for stocks and working capital.
- It is projected that the company's turnover would increase by c. 48% to c. €6.6 million in 2015 as a result of the increased production capacity.
- The opening cash balance was €55,000.
- Financing includes loss in grants, bank loans and finance leases.

	Projected cash flows by year under 3 year EII (€'000)					
	2012	2013	2014	2015		
Trading	282	393	431	467		
Working Capital	(72)	(358)	(135)	(72)		
Interest & Tax	(43)	(53)	(55)	(57)		
CapEx	(703)	-	(180)	-		
Net Financing	590	(48)	27	(726)		
Closing cash	**109**	**43**	**131**	**(257)**		
	Projected cash flows by year under 5 year EII (€'000)					
	2012	2013	2014	2015	2016	2017
Trading	282	393	431	467	506	521
Working Capital	(72)	(358)	(135)	(72)	(74)	(47)
Interest & Tax	(43)	(53)	(55)	(57)	(62)	(64)
CapEx	(703)	-	(180)	-	-	-
Net Financing	590	(48)	27	(126)	(84)	(684)
Closing cash	**109**	**43**	**131**	**343**	**629**	**355**

The above detailed projected cash flow for 3 years after investment shows a negative cash flow position on repayment of the €600,000 with a negative closing cash balance of €257,000. Therefore, this EII investment would not go forward to investors.

However, when a 5 year period is used as recommended for EII, the company would be in a positive cash flow position with a positive cash balance of €355,000 after the repayment of the €600,000. In this case, the positive cash balance would mean that the investment would go forward.

Case Study #3
Company sector: Manufacturing sector

Results for the year ended 31 December 2011
Turnover: €1.39 million
Net profit: €147,000
Net assets: €871,000
Number of employees: 21

Notes:

- The company applied for €500,000 in Ell Scheme funding in 2012 and the purpose of the finance was to purchase equipment to scale up its operations.
- It is projected that the company's turnover would increase by c. 130% to c. €3.2 million in 2015 as a result of the scale up in operations.
- The opening cash balance was negative €31,000.

	Projected cash flows by year under 3 year EII (€'000)					
	2012	2013	2014	2015		
Trading	208	283	346	424		
Working Capital	(157)	(182)	(324)	(69)		
Interest & Tax	(12)	(25)	(35)	(41)		
CapEx	(417)	(36)	(100)	(67)		
Net Financing	500	-	-	(500)		
Closing cash	**91**	**131**	**18**	**(235)**		
	Projected cash flows by year under 5 year EII (€'000)					
	2012	2013	2014	2015	2016	2017
Trading	208	283	346	424	403	447
Working Capital	(157)	(182)	(324)	(69)	(47)	(46)
Interest & Tax	(12)	(25)	(35)	(41)	(44)	(50)
CapEx	(417)	(36)	(100)	(67)	-	-
Net Financing	500	-	-	-	-	(500)
Closing cash	**91**	**131**	**18**	**265**	**577**	**429**

The above detailed projected cash flow for 3 years after investment shows a negative cash flow position on repayment of the €500,000 with a negative closing cash balance of €235,000. Therefore, this EII investment would not go forward to investors.

However, when a 5 year period is used as recommended for EII, the company would be in a positive cash flow position with a positive cash balance of €429,000 after the repayment of the €500,000. In this case, the positive cash balance would mean that the investment would go forward.

Remove the phased nature of the relief and allow full relief at the start

Under the Employment and Investment Incentive Scheme, an investor's relief is provided at the marginal rate of tax (41%) but it is granted in two tranches – unlike the Business Expansion Scheme.

The first tranche of relief is provided at 30% of the amount invested and is permitted in the year of investment.

The second tranche of 11% is available in the year after the three year investment period has elapsed (subject to the company meeting at least one of two criteria: (1) increasing employment numbers and maintaining average remuneration; or (2) increasing expenditure on research and development).

In practice there are two types of investors – institutional & individual, the EII is presented as a 30% relief to individual investors. The additional relief is not emphasised to potential investors due to the complexity and risk that the qualifying conditions may not be achieved. Investment in companies using these schemes is inherently risky, and recognised as such by the European Commission (which supports the relief on the grounds of market failure).

The two tranche phasing was designed to address concerns of a major take up of the programme. However, the results from 2012 demonstrate that such a concern has not materialised. Therefore, Dublin Chamber recommends the full 41% relief be granted from the investment date. The release of the additional 11% would add to the attractiveness of investing in Irish businesses and support employment growth.

Remove the restriction related to expansion capital for businesses in non-assisted areas

The restriction in relation to the use of EII scheme by Medium enterprises based on the geographic location of the operation is reducing the opportunity of businesses in Dublin to grow and hire new staff. The Chamber is aware of Dublin companies that would have been able to make major capital investments using the EII scheme but due to their location they were not eligible and in so that job creation opportunity has been lost entirely.

The restriction in place for non-assisted areas (Dublin, Meath, Kildare, Wicklow and Cork) is not benefitting other regions. The investment in a potential EII company is diverted to another often non-job creation rich investment opportunity. Removal of this restriction will require consultation with the European Commission but it is worth the energy necessary to have it removed.

Address the complexity of the EII legislation to simplify the process for businesses

The EII legislation has a requirement for the company to be trading. However, for companies in the tech sector, for example, there is a high level of product development that takes place prior to the company beginning trading. This can take up to three years. Dublin Chamber recognises that there is a requirement to prevent abuse. Therefore, it is suggested that, in addition to the existing criteria, a deeming condition be included in the legislation which would recognise companies that are not trading but are in receipt of an Enterprise Ireland grant, enrolled in a recognised Incubator/Accelerator or other relevant deeming condition.

Amend to allow subsidiaries in a group to apply for EII

EII legislation that has been carried over from the Business Expansion Scheme prevents some subsidiary companies from being able to apply for EII. Even though the scope of companies which can avail of funding under the EII Scheme has been widened, the old legislation – still in place – is very restrictive to companies operating a group structure. In such cases, subsidiary companies must satisfy restrictive criteria in order for the holding company/group to qualify. It is quite common for companies to have a group structure and in reality it is unlikely that all entities will be qualifying companies. Therefore, the current legislation is preventing what would otherwise be eligible companies from availing of EII funding. A review and amendment of this part of the legislation is necessary prior to renewal with the European Commission.

Seed Capital Scheme

The Seed Capital Scheme (SCS) aimed at encouraging individuals currently or formerly in employment to establish new business ventures is welcome for its support of new business start-ups. The scheme formally received approval from the European Commission in November 2011. Similar to the Employment and Investment Incentive, the Seed Capital Scheme is not being taken up at the levels anticipated. Dublin Chamber believes Government should increase the effectiveness of the Seed Capital Scheme by:

- Clarifying the process by which this scheme can be used;
- Simplifying the means by which a start-up company is deemed eligible;
- Setting precise timelines for the processing of applications under the scheme; and
- Promoting the scheme more widely.

Dublin Chamber believes that a revised scheme will offer a great opportunity to nascent entrepreneurs, which in turn will develop employment opportunities. However, it is difficult to give more precise feedback due to the general low uptake of the programme, with no members of the Chamber having been involved in either side of the use or potential use of the SCS. The Minister for Finance's written reply (16419/14) stated that the total number of companies that used the SCS in 2013 was limited to 65.

It is worth comparing the uptake to the UK's Seed Enterprise Investment Scheme, which has a similar objective. In December 2013, it was reported that over £82,000,000 in funding was raised for approximately 1,100 companies since its introduction in April 2012.