Submission on the Review of the Employment & Investment Incentive

February 2021

Dublin Chamber is the representative body for businesses in the Greater Dublin Area and is committed to maintaining and improving the economic competitiveness of the city region. Our diverse and multi-sectoral membership spans the spectrum from small start-ups to major multinationals, providing strong insight into the needs of both investors and the start-up community. Entrepreneurship has long been part of the Chamber agenda, and in recent years we have been vocal in respect of the need to improve the environment for equity investment in Irish businesses.[1] Dublin Chamber recommends that a renewed focus on Ireland's indigenous enterprise environment should take place to establish entrepreneurship and SME growth at the centre of Ireland's economic strategy post-Covid-19, alongside continued success in attracting and retaining foreign direct investment. Global economic and political volatility also makes this a strategic imperative; Ireland must remain attractive to international investors while also taking action to avoid excess reliance on a small number of highly mobile firms.

The Employment & Investment Incentive Relief can provide a valuable means of accessing finance for start-ups. Dublin Chamber welcomes the present review and offers the following recommendations for consideration in relation to three headings contained in the consultation document.

1. Enhancing support for start-ups under EII

To improve the support that the EII scheme provides for start-ups, inappropriate barriers to qualification for the scheme should be addressed where possible, while the relief itself should be enhanced so that it is more attractive, both to investors and to companies with ambitions for growth.

1.1. Address inappropriate barriers to qualification

- **Administrative Burden:**
  EII relief is intended to be a relief for early-stage start-up companies raising funds. However, the detailed tax provisions are extraordinarily complex, and this complexity creates a reluctance or fear of availing of the relief by many young companies. EII

[1] E.g. Dublin Chamber Submission on Budget 2021, https://www.dublinchamber.ie/DublinChamberofCommerce/media/banners/Dublin-Chamber-Submission-on-Budget-2021.pdf

fundraisings are typically for modest amounts, and in this context potentially requiring the procurement of expensive tax advice to determine if EII will be available acts as an unnecessary inhibitor to claiming the relief for companies which might otherwise stand to benefit.

- **Self-certification**

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 approvals slowed, causing the operation of the EII tax relief to grind to a halt in many cases. However, the resultant requirement for start-up companies to self-certify that they qualify for the relief, combined with the aforementioned complexity of the EII legislative provisions is an inhibitor to early-stage companies claiming the relief. This could potentially be dealt with by introducing a new certification process whereby companies could obtain clearance that fundraisings qualify for the relief. This would greatly alleviate the implications of the complex legislation referred to above. It would be critical, however, that the certification process could not be blocked in the manner that it was previously by Revenue; strict timelines would have to be imposed on responses to applications. Consideration may also be given to allocating any certification process to the Department of Enterprise, Trade & Employment as opposed to Revenue.

- **Undertaking in Difficulty**

To qualify 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.[2] This criterion should be reconsidered in light of the fact that the technology and life science sectors are the main areas 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.[3] The existence of such losses precludes the availability of bank debt and most venture capital funds will not invest in pre-revenue company. EII funding has the capacity to fill this void at a critical stage of development for early stage SMEs, but if an SME has been in existence for more than 3 years, the undertaking in difficulty criterion acts to preclude the availability of EII funding. The Chamber has received inputs from SMEs on this specific point; it is proving to be a material problem for companies that have been in existence for in

[2] 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

[3] 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

excess of 3 years as it amounts to a competitive disadvantage for such entities in raising funds.

This has been further accentuated by the impact of Covid-19 as the crisis has resulted in many such enterprises incurring increased expenses, delayed revenues, and missed funding rounds. Start-ups have passed the 3-year threshold as a result. To reflect this reality, the EII relief should be amended to ensure that more start-ups remain eligible. Dublin Chamber proposes 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 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.

1.2. Improve the attractiveness of the scheme

- **Treatment of losses/disposals**
  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 CGT purposes. The relief could be substantially enhanced as an incentive for angel investing if these shortcomings were improved upon by either of or a combination of lower CGT rates applying to EII investments and 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 can result in a very harsh outcome for an investor who might, for example, invest in a company which is then taken over after, say, 3 years and 11 months. Thought should be given to allowing the tax relief to vest over the 4 period so that the clawback would only be, for example, 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.

- **Lifetime limit**
  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.

2. Responding to the changing environment in which EII operates

To meet the objectives of sustaining and increasing employment, EII regulations should be flexible to meet the needs of the economy and enable the enterprise concerned to adjust to changes in circumstances which may be causing trading difficulties. Brexit and Covid-19 represent two major challenges that enterprises are currently struggling with. The implications of Covid-19 in respect of the Undertaking in Difficulty concept, for example, are referred to above. One implication of Brexit is that the more attractive UK regime of angel investor supports could become increasingly attractive to mobile entrepreneurs, and suggestions in respect of this have been made in section 1.2. above.

- **Provide for company rescue**
  Given the substantial uncertainties faced by early-stage companies, measures could be introduced to facilitate the saving of failing companies. Where an enterprise which has received EII funding 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 of this would be to avoid collapse of the company and hence to sustain employment and future capacity in the economy. The threat of clawback by the State of EII relief as a result of the rescue of a genuinely failing company is a material impediment to angel investors stepping in to provide emergency resources to keep the company in operation.

3. Improving Investor Participation

To fulfil the potential of the EII to be truly effective for start-ups, the number and range of individuals participating via the scheme needs to be increased in a meaningful way. Ireland does not yet have a vibrant angel ecosystem comparable to that in other jurisdictions such as the UK, and this is a distinct competitive disadvantage. Consequently, as well as improving the incentives, the State actively promoting and marketing EIIS as a societal good via impact investing would be very desirable initiative in of itself.

- **Widen the range of investment vehicles**
  Opening up a much wider range of investment vehicles such as limited liability partnerships and specialist regulated venture funds by which individuals could attain the benefits of EII whilst simultaneously gaining access to invest in and support a diversified portfolio of SME and early-stage ventures (rather than having single company risk) would be a key catalyst in helping to build a healthier angel and early-stage venture ecosystem to support entrepreneurs and the wider business community.