

Alliance for an Innovation Driven Recovery

Budget 2022



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1. Executive Summary

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.

The Alliance comprises of **Scale Ireland**, which 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, Italy, The Netherlands, Norway, Portugal and the UK; and **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.

As Ireland emerges from the pandemic, a key focus will be on rebuilding our economy, and creating new jobs to replace the ones that were lost. Indigenous tech start-up and scale-up companies will play a vital role in our economic future over the next decade, and it is vital to create the right conditions and environment to ensure the sector can thrive and create innovation, high-quality jobs and exports. There are currently more than 2000 indigenous tech start-up and scale-up companies employing 47,000 people around the country. "For each additional job in the average high-tech firm, five additional jobs are created outside that firm in the local community".¹

These companies are located across the country, with 188 high innovation-driven companies based in Cork, 151 in Galway and 87 in Limerick. Several companies are also located in counties Clare, Kerry, Kildare, Louth and Waterford. The vast majority of these companies focus on export markets. The OECD 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.

In the Programme for Government, the coalition expressed its commitment to continuing to support entrepreneurs and investors in high-risk innovative start-ups, and to review our existing supports in light of Covid-19. It also commits to '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'.² It also recognises the need to 'support the role that venture capital can play in driving growth in the indigenous economy by ensuring a stable long-term funding landscape.'³

Throughout the pandemic in 2020, early-stage indigenous tech start-ups struggled to attract private investment, which they needed to grow and expand. Coupled with this, an analysis of the three schemes (BES, EII and SCS) over a ten-year period up to 2018, found a majority of the total investment (€816 million) has been focused on lower-risk businesses (71% / €579M) as distinct from higher-risk, high-growth start-ups and scale-ups (29% / €238M).⁴

The Alliance for an Innovation Driven Recovery has broadly welcomed the review of EIIIS by the Department of Finance and participated in the two-day public consultation. In Budget 2022, we hope the Department will introduce measures to restore investor confidence in early-stage indigenous tech start-ups and to foster a viable long-term culture of private investment in Ireland - as recognised by the SME Taskforce in its recommendations, which were published in January 2021.

Two of the key enablers for companies to scale are access to finance, and talent. Both are mobile and competition is international. The success of Ireland Inc is inextricably linked to enabling our Irish companies to remain based in Ireland and compete internationally for these resources. They need government support to do so.

¹ The New Geography of Jobs (Houghton Mifflin Harcourt, 2012) by Enrico Moretti

² Programme for Government (16th June 2020), p.22

³ Ibid p.22-23

⁴ Review of EIIIS Support for high-growth start-ups and scale-ups (11th November 2020) by TechIreland and the Alliance.

It is vital to expand the sources of finance available to high-innovation driven companies in Ireland, and also to facilitate those who have accrued savings during the pandemic to reinvest into the economy. Wider participation from private investors would be more forthcoming, if EIS was made more accessible and user-friendly for both individuals and companies. This would help Irish companies to raise capital to scale faster, increase their exports in international markets, and create a positive impact on the Irish economy.

Another key challenge facing indigenous start-up and scale-up companies is their ability to retain and attract talent. Reform of the KEEP share option scheme is vital in order to allow indigenous start-up and scale-up companies to compete for staff with companies in other countries, as well as multinational companies that are based here.

We also need to address sustainability within the sector. We are proposing a number of cost-neutral policy changes. Our recommendations would result in a greater focus on sustainability within the sector, which has huge potential in terms of innovative sustainable solutions, in line with the Economic Recovery Plan.

2. Summary of our Key Proposals

2.1 Reform of EIS

In order to ensure that EIS 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 EIS.
2. Seek an increase in investment limits under EIS.
3. Allow other investment vehicles, including venture fund partnerships, to qualify for designated investment funds for EIS 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 EIS 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 strong investment.

2.2 Reform of Share Options

1. Equity ownership under the KEEP scheme should not be linked to annual salary and the cap should be raised.
2. The KEEP scheme needs to provide greater certainty in relation to tax treatment if a company grows.
3. The KEEP Scheme must be simple, clear, and easy to implement.

2.3 Research and Development Tax Credits

1. The Finance Act 2019 changes for small and micro companies have yet to be enacted, including increasing the R&D credit from 25 per cent to 30 per cent for micro and small companies. Other measures to be implemented under the Act include: Introduce a new provision to allow micro and small companies to claim the R&D tax credit on qualifying pre-trading R&D expenditure before commencing to trade, while pre-trading, the credit will be limited to offset against VAT and payroll tax, increase the current limit to third level institutes of education from 5 per cent to 15 per cent.
2. Monetisation of the R&D tax credit in one year and the cash flow impact.
3. Increase the 15% subcontractor cap to 50%, particularly for small and micro companies.
4. Allow the application of R&D credit to rental costs.

2.4 Sustainability

1. To explore the possibility of Scale Ireland and Enterprise Ireland working together to help educate HPSUs to form a sustainability agenda, which should be aligned with the UN SDGs.
2. To promote best practice in the sector, Enterprise Ireland could establish a *Sustainability for Growth Programme*. This would involve early stage start-ups who receive EI funding, gaining access and participating in the programme. As part of this initiative, Scale Ireland and Enterprise Ireland could work together to help start-ups learn about KPIs in general and also in relation to sustainability.
3. Enterprise Ireland to publicly promote best practice with a clear sustainability statement, with specific targets in line with SDGs.

3. Key Proposals

3.1 Reform of EIIS

Early stage start-up companies have struggled to attract private investment. The *KPMG Venture Pulse – Q4 2020 - Report on Global VC Investment* report found 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...*”

“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.”⁵

The Irish Venture Capital Association’s investment figures for 2020 showed 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. **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. 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. The overall number of rounds fell by 18% in 2020, compared to 2019.**

TechIreland carried out a review of EIIS Investments over a ten year period from 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).^{6,7} **Under 27% of investments have gone to High-Growth Start-ups and Scale-ups.**⁸ 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.

⁵ [KPMG Ireland Press Release dated 1st February 2021](#)

⁶ [Revenue review of BES/EIIS/SCS shares issued 2007-2018](#)

⁷ [EIIS Statistics 2011-2018](#)

⁸ [Revenue.ie: BES/EIIS/SCS shares issued on or after 1st January 2007-2018](#)

Proposals to Reform EIS

The Alliance for an Innovation-Driven Recovery made an extensive submission to the Department of Finance in relation to its public consultation on EIS. The Alliance also attended a two-day public consultation on reform of the scheme to help early stage start-ups attract vital private investment, and also to nurture a stronger culture of Angel and institutional investment in innovation-driven enterprises, which have huge potential in terms of innovation, exports and regional enterprise. Our full submission can be accessed [here](#). We have also outlined our key proposals below:

1. Provide loss relief on investments made under EIS
2. Seek increase in investment limits under EIS
3. Allow other investment vehicles to qualify for tax relief on EIS investments
4. Standardise investment period to four years for all qualifying investments
5. Enhanced relief for investing in micro-companies
6. Increase certainty for companies that they are eligible for EIS and simplification of process

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 EIS.*

3.2 Reform of Share Options

KEEP (Key Employee Engagement Programme) is a share option scheme introduced in Finance Act 2017 specifically for employees and directors of certain qualifying SME companies. It is subject to no income tax, USC or PRSI at the date of grant or exercise.

Generally, a key employee must hold the option for 12 months prior to exercise and may exercise it at any time up to 10 years after the date of grant. Therefore, 2019 is the earliest year in which individuals may exercise their options to acquire shares in the qualifying companies.

The aim of the KEEP scheme is *“to help SMEs attract and retain talent in a highly competitive labour market.”*^[2] It was designed to help early-stage Irish companies successfully compete with Multinationals to attract and retain key employees. Since start-ups are highly cash constrained, they rely on their ability to offer share options and ownership to attract talent.^{9,10}

So far, the KEEP scheme is failing to achieve its goal, and take-up of the scheme has been very low. Based on Scale Ireland’s research, as well as interviews with other stakeholders, we’ve identified how the KEEP scheme can be modified to better help startups compete for key employees:^{11,12}

The latest figures from Revenue (October 2019) show that companies granted qualifying share options to 87 key employees under the Key Employee Engagement Scheme during 2018 (the first year of the scheme). 2019 is the earliest year in which individuals may exercise their options to acquire shares in the qualifying companies.

In addition to the proposals below, we would encourage the Government to give effect to the provisions in relation to KEEP contained in Finance Act 2019, which are yet to be the subject of a commencement order by the Minister for Finance. This should be a priority matter.

Proposal 1: Remove the link between equity ownership and salaries under the KEEP scheme and raise the cap on share options

Problem

Cash-constrained startups already pay below market salaries and cash compensation. Offering equity ownership is how they compensate for relatively low cash remuneration. Tying the market value of KEEP share awards to already low cash compensation and capping annual awards only ensures that the equity awards will also be below market, and therefore ineffective in helping startups compete for top talent. By enacting this rule, the government has guaranteed that Irish companies will never be able to compete for talent on a level playing field with bigger companies. Of course, if the compensation of such individuals is significant then that could bring about increased KEEP rewards, but that is not the case with start-ups.

Solution

It is recognised that KEEP brings about reduced taxation for the employee and therefore an unlimited amount of remuneration in the form of KEEP compensation would not be appropriate. Therefore consideration should be given to introducing a greater cap, ultimately limiting share options to 20% of the total equity of a company for employees, and 2% of the total equity of a company for individuals that could be granted (on the date of granting) to employees under the KEEP scheme. It should not be linked to annual remuneration and the scheme should also be widened to include key people who play a pivotal role in a company and work less than 25 hours in a week. This would allow companies to utilise the scheme to attract the services of NEDs and key advisors.

Impact

This should allow Irish start-ups to compete for technical and management talent at home and abroad. Further it would bring about a simplicity of explanation of compensation structures in attracting talent. Under the current KEEP scheme rules, the government has put domestic start-up enterprises at a disadvantage in their ability to compete for critical talent both inside and outside Ireland.

Proposal 2: The KEEP scheme needs to provide greater certainty in relation to tax treatment if a company grows.

Problem

Current rules limit the value of KEEP share option awards such that the total market value of the issued but unexercised qualifying share options does not exceed €3,000,000 per company. This may punish company growth, which is entirely counter to the government's goal of supporting the growth and development of a strong domestic startup ecosystem.

Solution

Consideration should also be given to increasing the limit of share awards available to a qualifying company to 20% of the total equity of the company. Further clarity is also needed on the 3 million cap under the scheme.

Impact

This would give certainty around the scheme as a company grows, make larger Irish companies eligible under the scheme, and therefore more attractive to employees.

Proposal 3: The KEEP Scheme must be simple, clear, and easy to implement.

Problem

Early-stage startups do not have the appropriate staff, or the appropriately sized legal and accounting budgets to set up and implement a complex scheme like KEEP. For example, determining the market value of the shares is critical to the implementation of KEEP, but there is no clear or safe harbour guidance about how a startup can determine the value.

Solution

Allowing for standard industry practices such as relying on the valuation of the most recent round of financing would give founders the simplicity, clarity, and certainty they need to implement KEEP. Alternatively, the valuation requirement should be replaced with a limit of 20% of the equity of the company that could be granted (on the date of granting) to employees.

Impact

Replacing the current valuation method will provide greater clarity to founders and will make the scheme more accessible to target businesses.

Proposal 4: Narrow the list of excluded activities

Problem

The current definition of excluded activities excludes companies engaged in defined ‘professional services’, which appears to conflict with policy intent to promote the location in Ireland of higher value services, e.g. FinTech, InsurTech, and more generally trading activities which draw upon the skills of employees with professional services qualifications.

Solution

Narrow the scope of excluded activities to align with the Government’s understood policy intent of promoting Ireland as a location for higher value services, e.g. FinTech, InsurTech, BioTech, professional services, etc.

Impact

Allows a wider scope of businesses to be eligible to provide KEEP shares to employees, and compete with international employers for talent.

Proposal 5: Lack of liquidity in employee shares

Problem

To compete with international employers for talent whose shares are readily traded on a stock exchange, SMEs require assurances that any arrangements to provide liquidity in the employee shares in the case of non-listed shares and to buy back shares in tranches from employees continue to be eligible for capital gains tax (CGT) treatment and are not inadvertently brought within the scope of income tax by reason of failure to meet the technical requirements of the share buyback provisions at section 176, TCA 1997 and related sections.

Solution

Provide certainty that private companies can provide for share buy-out arrangements for KEEP shares held by employees other than a share buyback by the issuing company (which may not always be possible).

Impact

Providing certainty to employees that the shares are eligible for CGT treatment upon disposal and allowing employers to buy back shares in tranches will allow SMEs to genuinely compete with international employers for talent.

3.3 Research and Development Tax Credits

Proposal 1: The Finance Act 2019 changes for small and micro companies have yet to be enacted.

Issue

- The R&D tax credit rate for small and micro companies was due to increase from the standard rate of 25 percent to 30 percent as per section 766(2) TCA 1997.
- The more favourable methodology to calculate the refundable R&D tax credit amount for small and micro companies as per section 766B(3)(c) TCA 1997.
- New section of legislation (section 766C TCA 1997) to enable small and micro companies to claim the R&D tax credits.

Solution

These changes will make the R&D Tax Credit more attractive for start-up companies and reduce some of the barriers to claiming the credit. We would like to see firm timelines as to when these changes are expected to be implemented.

Proposal 2: Monetisation of the R&D tax credit in 1 year and the cash flow impact.

Issue

Monetisation of tax credit is an important part of the R&D tax credit regime for start-up companies, as in many cases they are in the initial development phase. Access to the R&D Tax Credit is an important part of the cash flow resources to these companies. The temporary measures to accelerate 2021 R&D tax credit instalment payments was appreciated.

Solution

Rather than a monetised payment in 3 instalments, it would be beneficial for small and micro companies if there was scope to pay out the tax credit in a more condensed manner, potentially in 1 year rather than 3 years.

Proposal 3: Cap on eligible subcontractor costs.

Issue

Many start-up companies don't have the level of internal labour resources required in relation to their development and have to engage contractors as part of their research and development work. At the moment, the R&D tax credit legislation only allows an amount of contractor costs based up to the greater of 15% of the company's qualifying internal R&D spend or €100,000.

Solution

It would be beneficial if the 15% cap could be increased to 50%, particularly for small and micro companies.

Revenue has disallowed the inclusion of rental costs in R&D tax credit claims.

Impact

Revenue has taken the position that rent does not generally qualify as an expense “incurred wholly and exclusively in the carrying on of R&D”. This is inconsistent with the treatment over a long-standing period of time. It is also inconsistent with the Department of Finance’s references as part of the prior R&D tax credit consultation processes on how the Irish R&D tax credit regime allows indirect costs incurred wholly and exclusively in the carrying on of R&D including building costs.

Solution

The inclusion of general rental costs must be allowed under the scheme. This is particularly relevant to start-up companies where the work is generally undertaken in a rented office environment, which Revenue have now provided that rent is not a qualifying cost for R&D tax credit purposes.

3.4 Sustainability

The Alliance wants to ensure that start-up and scale-up companies have the opportunity to pursue best practices in relation to sustainability. To achieve this, we have made the following proposals which will involve a cost in terms of resources for Enterprise Ireland.

- To explore the possibility of the Alliance and Enterprise Ireland working together to **help educate HPSUs to form a sustainability agenda**, which should be aligned with the UN SDGs.
- To promote best practice in the sector, **Enterprise Ireland could establish a Sustainability for Growth Programme**. This would involve early stage start-ups who receive EI funding, gaining access and participating in the programme. As part of this initiative, the Alliance and Enterprise Ireland could work together to help start-ups learn about KPIs in general and also in relation to sustainability.
- **Enterprise Ireland to publicly promote best practice** with a clear sustainability statement, with specific targets in line with SDGs.

