Written evidence submitted by Enterprise Investment Scheme Association (EISA)

The Enterprise Investment Scheme Association (EISA) is an independent, not for profit, trade association, which exists to assist the flow of capital and resources to smaller, British, growing companies through the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS). EISA's 270 strong membership represents a broad spectrum of interested parties: entrepreneurs and small business founders, EIS fund managers, promoters, solicitors, accountants, platform operators, financial intermediaries, financial advisers, and other service providers closely involved in the operation of the EIS and SEIS.

Does the current suite of tax reliefs represent good value for money?

Post Brexit Britain will prosper only if it is hospitable to innovation and entrepreneurship. It was reassuring to hear the Chancellor's commitment to making this a "nation of entrepreneurs" and his recognition of the UK's "unbounded entrepreneurial drive"[1]. The EIS and SEIS play a vital role in encouraging entrepreneurs across the UK to start businesses and commercialise their ideas. The SEIS and EIS also bring significant additional benefits often not seen in institutional investing. Many of the private investors who invest in companies through these schemes bring experience and expertise which provides guidance and mentoring to entrepreneurs at a critical stage in the development of their businesses.

The EIS and SEIS empower and encourage the private investors who can focus on different areas of interest and may have different risk appetites, thereby supporting young businesses across a very wide array of sectors from artificial intelligence and the metaverse to cancer treatment and gene therapy to the creative industries.

We believe the UK is one of the best places to start and grow a business, and this is in no small way due to the tax-advantaged investment through the SEIS and EIS, and to the complementary investments by Venture Capital Trusts (VCT). Talent has been attracted to the UK, and many entrepreneurs would not have grown their businesses without the funding which the SEIS and EIS facilitate. We have a thriving start-up community, recognised around the world, providing financial support at the earliest stages of starting a business by encouraging investment in small, unquoted trading companies. A 2020 report[2] collating data on general economic factors ranked the UK as the second-best country in Europe for start-up businesses.

According to a recent report by the BVCA, "PE and VC-backed businesses delivered £102 billion of GDP in 2021. This is approximately 5% of UK GDP. In terms of jobs, PE and VC-backed businesses employed 1.9 million workers last year. That represents 6% of the total jobs in the UK, and half a million more than the NHS. In other words: the share of jobs backed by private capital is greater than its contribution to national wealth. What is particularly encouraging is that these jobs are spread across the length and breadth of the UK: over 50% are based outside of London and England's Southeast, and nearly 10% of PE and VC-backed jobs are in North West England".[3]

[1] https://www.gov.uk/government/speeches/the-growth-plan-2022-speech
[2] https://www.nimblefins.co.uk/best-countries-europe-startups#rank
[3] https://www.bvca.co.uk/Portals/0/Documents/Research/2022%20Reports/EY-BVCA-Economic-Contribution-Report-2022.pdf

The UK economy depends on these high growth small businesses, which contribute greatly in terms of productivity, job creation and tax revenues. They are not without risk, however, which is why the government provides tax advantaged money to leverage private investment. Significant sums have been raised from the UK's retail investors through the SEIS and EIS.

The SEIS and EIS play a huge role in developing world class UK businesses that help establish the UK as both the start-up hub, and tech hub, of Europe. The money raised to date has played an important role in providing early-stage funding for a wide range of innovative, productive companies who, without SEIS and EIS, would not have been able to start their business. These companies employ hundreds of thousands of people in the UK. SEIS and EIS funded companies are also at the forefront of innovation pioneering new technologies across the board ranging from early-stage cancer diagnosis to creating sustainable alternatives to plastic from seaweed.

Since their inception, 52,000 start-ups have used the SEIS and EIS to secure nearly £27billion of investment. It is thanks to EIS and SEIS that the UK has such a vibrant start-up scene, and many founders believe that they would not have got the private investment needed to grow their businesses without the schemes. The SEIS and EIS are the leading schemes of their kind. They are crucial to patient capital and have helped to position the UK as a world leader in innovation and entrepreneurship. The SEIS and EIS attract significant talent to the UK and many founders choose to start their businesses in the UK, over other European Countries, as a result of these schemes. The economic value of, and the soft power associated with, the UK being a global leader in entrepreneurship and innovation should not be underestimated.

Not only are these companies driving economic growth through innovation but they are also contributing significantly to the UK through tax receipts including through corporation tax, national insurance and VAT amongst others. It has been estimated that EIS and SEIS are revenue generating for HMRC, once revenues for newly created jobs are considered. It has been suggested that £1 million of EIS investment would need to create just nine additional jobs in order to generate a profit for HMRC[4].

> *"This assumes jobs are created for three years and have an average remuneration of £35,000. Here's how we worked out the numbers: the cost of EIS investment to the Treasury, taking into account the upfront tax relief, is £300,000 on an investment of £1m. If nine jobs were created for three years, with an average remuneration of £35,000 for each job, the Treasury would receive £305,000 in tax over the three years based on 2019/20 rates (each person would pay £11,302.94 in income tax and national insurance).*
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> *Since most jobs in EIS-funded companies are held for much longer than three years, it is likely that in the long term the Treasury stands to receive a profit on its outlay. What's apparent is that the rewards of offering these tax breaks can quickly outpace the costs."*[5]

Do "cliff edges" in the structure of tax reliefs lead to problems for taxpayers, businesses or for the wider economy?

[4] https://www.cityam.com/eis-has-cost-government-3bn-tax-relief-so-why-has-become/

[5] Ibid

The EIS contains many "cliff edges". By nature, these cliff edges limit which companies are eligible for SEIS or EIS at a given point. To give but one example, a company whose trade is 6 years and 364 days old can receive EIS investment, whereas if the trade were 7 years and 1 day old, it would ordinarily be prohibited from receiving EIS investment. This is arbitrary, and particularly prejudicial to businesses outside of London and the South East. Whilst we recognise that younger companies are likely to need more support, the permitted maximum age limit contains many anomalies, and focuses on the age of the company rather than on the age of the business being funded. We recommend that this aspect of the EIS should be reconsidered.

Are tax reliefs being used in a way that Parliament or Government intended?

The Patient Capital Review in 2017 enabled the Government to articulate and clarify their intentions behind the EIS and SEIS. This has been well received by industry and, in particular, the addition of the 'risk to capital' principle has successfully ensured that the EIS and SEIS are being used to help high risk, early stage start ups secure the vital investment needed to help them grow.

The demand for, and success of, SEIS, EIS and VCT investment has also been consistently noted by a series of independent reports over the last five years:

1) As the Patient Capital Review found in 2017, the "popularity of these schemes has contributed significantly to the development of a vibrant UK start-up scene"[6]. That review led to the introduction of enhanced limits to prioritise investment in 'knowledge intensive' companies undertaking research and development, thus strengthening the ability of these high growth small businesses to access capital.
2) The Future of Growth Capital Report, published by the Scale Up Institute in 2020, found that "approximately 80% of total investment in angels' investment portfolios were made through these [EIS and VCT] schemes in 2015[7], and the British Business Bank's Angel Market research report of 2018 revealed that 86% of total investment in angel investment portfolios were made through these schemes in 2017".[8]
3) The Kalifa Review of UK Fintech, commissioned by the current government and published in 2021, found that there is still a growing need for this support and that they are valuable tools which proved much needed private capital. A survey showed that "97% of founders have used tax-incentivised investment schemes including EIS, SEIS and VCT."[9]
4) The Number 10 Taskforce on Innovation, Growth and Regulatory Reform found that the EIS and SEIS had "incentivised significant investment in early stage companies".[10]

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[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661397/PCR_Industry_panel_response.pdf

[7] ERC (2015). A Nation of Angels. Assessing the impact of angel investing across the UK. https://www.enterpriseresearch.ac.uk/wp-content/uploads/2015/01/ERC-Angels-Report..pdf

[8] Future of Growth Capital Report 2020 - Scale Up Institute, https://secureservercdn.net/160.153.138.71/g8r.bcb.myftpupload.com/wp-content/uploads/2020/08/The-Future-of-Growth-Capital-August-2020-1-1.pdf

[9] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971371/KalifaFintechReview_ExecSumm.pdf

[10] FINAL_TIGRR_REPORT__1_.pdf (publishing.service.gov.uk)

We also note that on 16 August 2022 the previous Permanent Secretary to HM Treasury wrote to your committee to say: "The Government has made changes to the schemes to ensure they continue to address the market failure. A recent example of this is the Risk to Capital conditions, introduced in 2018 to counter evidence of tax-planning and capital preservation practices using the schemes. These changes have moved investment towards higher-risk firms with genuine growth ambitions and capital intensive, highly innovative firms. The Government continues to ensure that the reliefs are well targeted, deal with market failures and meet their objectives fairly and effectively". From our experience we wholly concur with this statement.[11]

What problems do tax reliefs cause, whether in relation to the tax system including tax evasion or avoidance, or the wider economy? In answering this question, please identify particular reliefs and where possible, quantify the problems caused.

Please outline potential reforms to the system of tax reliefs, whether related to:

- **Adding additional tax reliefs**
- **Removing or reforming current tax reliefs**

We were delighted to hear the Government's commitment to extending the EIS beyond the 2025 sunset clause. Whilst the exact legislation is still to be published, it sends a powerful message to entrepreneurs, giving them some important reassurance at a time of so much economic uncertainty.

"Sunset clauses are provisions that determine the expiry of a law or regulation within a predetermined period. Through their use, legislation or a section of legislation automatically ceases in its effect after a certain time"[12]. Sunset Clauses are commonly included in emergency legislation, such as the Coronavirus Act (2020), as a way to protect democracy when exceptional emergency powers are used[13].

In the case of the EIS, a sunset clause was included because it was a stipulation by the European Union under State Aid rules. Given that the United Kingdom is no longer a member of the European Union, there does not appear to be a requirement for the scheme to have a sunset clause going forwards. Furthermore, sunset clauses are often used in cases where the legislation concerned is seen as temporary or only applicable in the short term. The EIS was created in 1994 and has been supported by every government since. The EIS has proved central to supporting entrepreneurs in the UK for nearly 30 years. The EIS addresses a market failure in the provision of capital for early stage, high risk start ups and, in a recent letter to this committee, the Treasury explained that "recent independent reports, such as the Rowlands report (published in 2009) and the Patient Capital Review (2017), both concluded that the market failure, and therefore the case for intervention, persists."[14]

As we have seen over recent months, the existence of the sunset clause on the EIS had caused significant concern to entrepreneurs and investors across the UK. This had manifested in written warnings being included on industry publications as well as significant time and concern being spent

[11] https://committees.parliament.uk/publications/28530/documents/172231/default/
[12] https://www.prospectmagazine.co.uk/other/coronavirus-parliament-sunset-clauses-legislation
[13] https://www.politicalsettlements.org/wp-content/uploads/2021/08/Approach_with_Caution.pdf
[14] https://committees.parliament.uk/publications/28530/documents/172231/default/

by entrepreneurs and investors on understanding the implications of the sunset clause, what exactly it applied to and what it would mean for their businesses. This is time that founders could otherwise have spent focusing on growing their businesses. The negative impact on confidence should not be underestimated and the sunset clause created significant uncertainty in an already fragile market. At its worst, the looming sunset clause deterred investment into UK start ups at a time when entrepreneurs were already facing challenging economic conditions. For example, entrepreneurs outlining their medium-term funding plans had to accept that (prior to the Chancellor's 23rd September statement) the EIS would not exist after April 2025 and that therefore their chances of securing equity investment after that time would be dramatically reduced. This, in turn, had a negative impact on their ability to secure investment now, as any investor had to factor in the reduced likelihood of the company securing future investment post 2025.

The Chancellor's announcement that the Government would extend the EIS beyond 2025 was fantastic news for entrepreneurs across the UK. In just a few days, we have already seen a positive impact on confidence, and this is likely to translate into a significant boost for entrepreneurs, particularly when coupled with the improvements to the SEIS.

It is the EISA's strong recommendation that the EIS should be put on a permanent footing, like it's sister scheme the SEIS. The exact details of the extension have yet to be outlined however replacing this sunset clause with a later dated sunset clause is likely to create the same challenges further down the road.

The Chancellor's September 2022 statement seemed to emphatically signal a major commitment to start ups and a determination to make the UK "a nation of entrepreneurs". Abolishing, rather than extending, the EIS sunset clause would be a clear way to illustrate the strength of this commitment.

Those who support the existence of sunset clauses often argue that they give an opportunity to examine and assess the impact of the scheme. However, the 2017 Patient Capital Review showed that the EIS can be evaluated at any time, irrespective of a specific sunset clause. Furthermore, a government may choose to repeal a piece of previous legislation without the existence of a sunset clause.

The evidence suggests that there is no clear benefit from the existence of a sunset clause. Assessment of the success of certain schemes and their impact can and should be ongoing, as has been illustrated by the Patient Capital Review and the recent extensions to the SEIS. This is something that HMRC also already provides through its annual published analysis as well as it's internal data collection. Sunset clauses are commonly used in cases of short term, emergency legislation where democracy is a concern. This is not something that applies to the EIS which has been central to supporting entrepreneurs in the UK for nearly 30 years. The dates of sunset clauses are often arbitrary and cause significant concern, uncertainty and disruption to both founders and investors. Whilst the negative impacts will be more keenly felt as the key date approaches, the very existence of a sunset clause in the first place will always cause some disruption.

- **The administration of tax reliefs, including reforms to reduce complexity or cost of administration**

The EIS and VCT schemes have long been unnecessarily fettered by their inclusion in the EU State aid regime. Post Brexit the EIS tax reliefs are not subsidies for the purposes of the Trade and Cooperation Agreement ("TCA"), and indeed prior to notification to the EU (on 30th May 2007) neither the EIS, VCT, nor the EIS predecessor the BES (Business Expansion Scheme, 1984 onwards) had been subject to any form of State aid or subsidy regulation.

The UK now has the ability to take advantage of being outside of the EU State aid rules to unlock higher levels of investment in more businesses, supporting them further as they grow.

The Number 10 Taskforce on Innovation, Growth and Regulatory Reform[15] published a series of recommendations calling for the EIS and VCT regimes to be expanded in order to unlock investment outside of London and the South East as part of the levelling-up agenda. In particular the maximum permitted age limit is prejudicial to companies in the regions as generally it takes longer for such companies to reach a stage where they are seeking external finance. We support the findings of the TIGRR report and we welcome the Chancellor's recent announcement that the age limit for SEIS will be increased from 2 to 3 years and that the investment limit will be increased from £150,000 to £250,000. This is excellent news for entrepreneurs from across the whole of the UK and will mean that many more innovative, fast growing companies will be able to use SEIS to secure crucial investment.[16] We recommend that the age limit for EIS should also be reconsidered. There may be better ways of measuring whether a company should be eligible for tax advantaged investment, such as size and asset base. Removing the age limit would reduce the complexity of the requirements; in our experience small companies find it difficult to understand the application and relevance of the way in which the permitted maximum age limit applies.

The maximum lifetime limit on the amount of risk finance State aid has been fixed since 2015, and this ought to be increased with inflation. This limit is universal irrespective of industry types; sectors such as life sciences need much more support than this in order to reach commercialisation. We welcome the increase in the amount of SEIS investment a company may receive, and we recommend that the limits for EIS should also be reconsidered.

It is recognised that there is a challenge due to the terms of the Northern Ireland Protocol in maintaining the EU State aid jurisdiction within Northern Ireland and its potential "reach back" across the UK; the province is however a small part of the UK economy and in our view the expansion of the EIS should not have any significant distortion in the market in Northern Ireland or the other parts of the UK.

Whilst the procedure for claiming EIS tax relief is somewhat cumbersome, we believe this process is necessary to ensure that the tax relief is given appropriately. Before a claim can be made, HMRC must review each investment before issuing the necessary tax certificates. At present this is largely a manual process, with the forms having to be completed online (but they cannot be saved during preparation), downloaded and sent by email to HMRC.

[15] FINAL_TIGRR_REPORT__1_.pdf (publishing.service.gov.uk)

[16] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1105989/CCS207_CCS0822746402-001_SECURE_HMT_Autumn_Statement_2022_BOOK_Web_Accessible.pdf

We welcome HMRC's work on digitising the process with the view to submissions being made fully online.

- **The Government's analysis and transparency around tax reliefs.**
- **Means testing and targeting**

More than 52,000 companies have received investment through the EIS and the SEIS since 1994. Many of these businesses have become household names and have greatly contributed to the day to day lives of people living in the UK. These companies vary greatly in terms of what they do and are based across the whole of the UK. Many founders believe that their companies would not exist without SEIS and EIS investment and some examples below illustrate how important the EIS and SEIS are to the UK's position as a world leader in facilitating the creation and growth of innovative, fast growth, early-stage companies.

- *"Without the EIS/SEIS we would have not secured the funds for our pre-seed round and perhaps we would have not existed today."* – Dr Darko Matovski, Founder and CEO of causaLens, an AI company on track to employ 100+ people in the UK this year

- *"The SEIS and EIS scheme has been essential in enabling my company to exist and grow. The SEIS/EIS scheme breaks down barriers for individual investors and provides start-ups with precious - and rare - seed capital. The value of individual investors goes well beyond the cash that they inject. Their interest in the company, the doors they can open, the guidance they provide can be empowering for founders and transformative for early-stage companies. The UK Government should not underestimate the importance of the scheme, it sets the standards globally for supporting and accelerating entrepreneurship."* – Sabrina Del Prete, Founder and CEO of KoreLabs. Sabrina is an Italian Entrepreneur who chose to base her company in the UK. She is also on Innovate Finance's Women in FinTech Powerlist 2021.

- *"We'd never have raised the capital to expand into new premises and grow the team without the support of the Enterprise Investment Scheme. It's a critical scheme to help small start-ups."* Paul Rostand, CEO, The Artful Baker, Dorset, May 2022.

- *"EIS has been absolutely critical in helping our business raise the finance needed to fuel our growth, as well as connecting us with experienced investors that have helped us on our journey."* - Carlo Fedeli, CEO & Founder, FlexSea, an innovative, truly compostable biopolymer material derived from seaweed and other natural, sustainably sourced products.

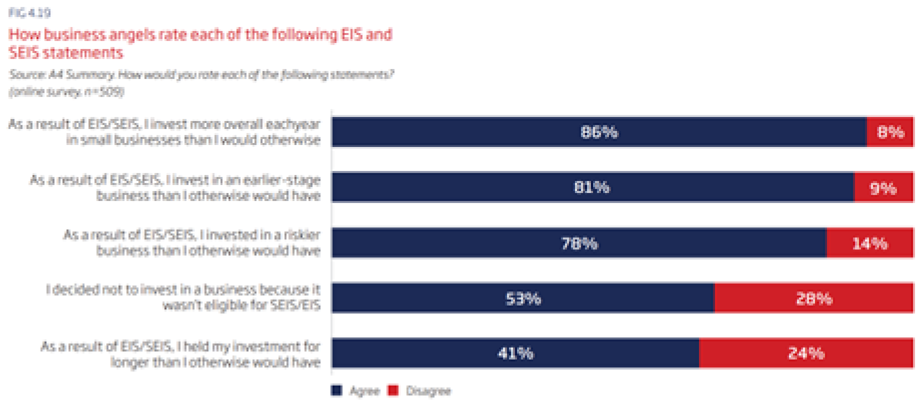
- *"Raising EIS investment has been fantastic for Homethings, as not only has it provided us with vital funding needed to grow the business, but it has also connected us with investors that we believe can help further accelerate that growth too".* Tim Keaveney, Founder, Homethings, powerful, planet-positive products that make sense, keeping your home (and our planet) clean.

- *"Had it not been for SEIS/EIS we would not have been able to launch Revving, it's as simple as that".* Chris Pettit, CEO and Co-founder, Revving Ltd, capturing sales data at source to provide payment advances ahead of invoicing.

- *"The Enterprise Investment Scheme has not only helped find us more capital, but it's connected us with a network of investors who want to help you build a great business".* Stella Smith, CEO and Co-Founder, pirkx, providing affordable wellbeing benefits for everyone.

Many founders do not think they would have secured investment into their start up without the SEIS and the EIS.

Surveys have also shown that the EIS is extremely successful in achieving its aim of influencing investor behaviour. A 2018 survey of business angels from the British Business Bank (BBB) and the UK Business Angels Association (UKBAA) provided evidence that the “EIS and SEIS have an impact on the investment behaviour of angels. A clear majority of angels report that they invest more in small businesses because of the EIS and SEIS schemes (86%). Both schemes encourage investment, with 81% of angels saying that they invest in earlier-stage businesses and 78% saying that they invest in riskier businesses because of it. Around half of the angels (53%) say they do not invest in businesses because they are not eligible for the EIS and SEIS schemes (figure 4.19).”[17]



This data suggests that the EIS successfully encourages greater amounts of investment into riskier start ups at an earlier stage. It also suggests that the majority of this investment would not happen without the existence of the EIS. The experiences of many entrepreneurs also support this as, for many founders, they would not have been able to secure the investment into their business without the SEIS and the EIS.

In any responses, the Committee would particularly welcome international comparisons and relevant measures and data.

SEIS and EIS are key to the UK’s global competitiveness in, and reputation for, a thriving and vibrant start up scene. These schemes genuinely draw entrepreneurs to the UK and lead to them start companies here, rather than elsewhere in Europe, bringing with them jobs, investment, and growth.

There are several examples where countries have created similar schemes to EIS, notably the Employment and Investment Incentive Scheme (EIIS) in Ireland[18] and the Employee Share Scheme (ESS) in Australia. Representatives from the French Ministry of Economy and Finance have also visited EISA in the past to learn more about how they could replicate EIS. The UK is considered the gold standard and Australia’s leading publication for entrepreneurs noted that “international comparisons – with the United Kingdom’s system for example – demonstrate how Australia’s tax relief for start-ups and innovative companies has some way to go.”[19]

[17] https://www.british-business-bank.co.uk/wp-content/uploads/2018/06/Business-Angel-Reportweb.pdf
[18] https://info.sapphirecapitalpartners.co.uk/blog/comparing-eis-eiis
[19] https://www.smartcompany.com.au/startupsmart/advice/business-planning/what-australian-can-learn-about-startup-taxation-from-the-uk/

SEIS is the leading scheme of its kind in the world. The European Commission published a report in 2017 comparing the effectiveness of tax incentives in fostering investment into SMEs and start ups[20]. The report noted that "venture capital and business angel investment has been shown to generate a number of positive macroeconomic effects, such as job creation and productivity gains."[21] The 46 tax incentive schemes observed by the study were benchmarked according to the principles of good practice. "The top three highest scoring tax incentives are, in descending order, the United Kingdom's Seed Enterprise Investment Scheme (SEIS), the United Kingdom's Enterprise Investment Scheme (EIS), and France's "Madelin" tax reductions scheme."[22]

October 2022

[20] https://ec.europa.eu/taxation_customs/system/files/2017-06/final_report_2017_taxud_venture-capital_business-angels.pdf
[21] Ibid
[22] Ibid