The Rt Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

11th January 2021

Dear Chancellor,

I am writing to you ahead of your forthcoming Budget to offer the views of the Enterprise Investment Scheme Association (EISA).

The Enterprise Investment Scheme Association (EISA) is an independent, not for profit, organisation, which exists to assist the flow of capital and resources to British smaller, growing companies through the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS).

Our comments reflect the representations received from members of the Association. The EISA's 160 strong membership represents a broad spectrum of interested parties: EIS fund managers, entrepreneurs, angel investors, solicitors, accountants, platform operators, financial intermediaries, independent financial advisers and other service providers closely involved in the operation of the EIS and SEIS and supporting the SME sector.

The EIS was introduced to incentivise private investors to risk funds by investing in smaller businesses which otherwise struggle to raise equity finance. Since its introduction, every Chancellor improved and/or widened the scheme prior to the 2015 changes, recognising its value to the UK economy. Investment by members of the EISA, or where members have advised on or facilitated investment, covers the broad spectrum of smaller company investment – mostly early stage or preprofit investment - throughout the United Kingdom. Companies in a wide variety of industries have received investment under the EIS including healthcare, technology, life sciences, the creative industries, environmental, leisure and hospitality, manufacturing and many more. We believe the EIS could now be expanded to:

- Support and boost the post Covid economic recovery
- Ensure the UK remains an attractive place to start and scale up a business;
- Help achieve the Government's levelling up agenda

We would be delighted to discuss our recommendations in due course.

Kind regards

Mark Brownridge　　　　Lord Howard Flight

Executive Summary

The EIS scheme provides the UK's most innovative and progressive startups and scaleups with access to long-term capital and by doing so benefits the UK economy, creates jobs, supports the growth of businesses across the UK and been responsible for the launch of new products and services and increased competition. Our recommendations:

- Support and boost the post Covid economic recovery
- Ensure the UK remains an attractive place to start and scale up a business;
- Help achieve the Government's levelling up agenda by supporting entrepreneurs, wherever they are based or operating in the UK, with an essential source of funding in a post Covid environment:
- Create jobs in significant numbers
- Bridge the gap from startup to scaleup

Our recommendations on how the UK can achieve these objectives are summarised in this letter with more detail included in the Appendix.

Key recommendations

The Enterprise Investment Scheme (EIS) has been vital to start and scale up businesses who struggle to gain access to funding for over 25 years. EIS (and in 2012, the Seed Enterprise Investment Scheme, SEIS) were introduced to incentivise private investors to risk funds by investing in smaller businesses and have helped over 31,000 SMEs raise over £22Bn in that time[1].

Since their introduction, the schemes have created a compelling economic rationale and every subsequent Government has sought to maintain, embellish and focus the schemes recognising their value to the UK economy. Indeed, the recent Conservative Manifesto stated that "*Some of our work has been spectacularly successful—such as the Seed Enterprise Investment and Enterprise Investment Scheme, which we will continue in the next Parliament.*"

Legislation changes to the schemes introduced by the Government in 2015 and 2017 have refocused the schemes to support companies who are growth, innovation and technology orientated and since that time the schemes have delivered funding to theses sectors in line with the Government's policy intentions. But we believe with the backdrop of the Covid19 pandemic more could be achieved with the focus on supporting entrepreneurs.

Funding continues to be an issue for companies seeking to start and scale up, particularly in the regions and market failure is still apparent and has been exacerbated by Covid19 (see our recent report in the section labelled, EISA 2020 Research Report – Reigniting the entrepreneurial ecosystem which provides an in depth statistical analysis), particularly at the seed and earliest stages of a company's development. To address this, our primary recommendations are:

Immediate recommendations

- An increase in the SEIS lifetime allowance from the current £150,000 to £250,000

Recommendations for consideration at Autumn Budget

- Replace the "age restriction" on eligible recipients of State Aid with a more appropriate threshold, particular to help companies in all regions of the UK

- Ministerial assurances that every effort will be made to ensure the continuation of the EIS and SEIS schemes, particularly beyond the current sunset clause of 2025
- Further investigation into how money held in pension funds can be used to fund EIS and SEIS qualifying companies
- Commitment to further improve the administrative processes concerning authorising SEIS and EIS companies and granting tax relief for investors.
- Support to raise the profile of EIS and SEIS both to companies seeking much needed equity finance including involving a far wider range of business support agencies such as LEPs, Universities and the IOD and to potential investors.

There is also a technical amendment required to be considered immediately to provide more clarity. Where an EIS company acquires another EIS company after the three year period has expired, the EIS relief continues. But it is not the same where a SEIS company is taken over. So we recommend that s.150E(11) TCGA 1992 also includes where the acquiring company has issued an EIS compliance statement under s.203(1) ITA 2007.

The Post Covid economic recovery must start now

With the Government seeking to rebuild the economy post Covid19 and put the technology, AI and life sciences sectors at the forefront of this, EIS and SEIS can lead the charge as these are exactly the sectors the schemes aim to, have and will continue to support. Building back better can be partly achieved by simply preserving and maintaining the EIS and SEIS schemes in their existing format but much more can be achieved if the political desire was present to make more substantive changes. Additionally, as the Government considers new economic measures and funding programmes, EIS and SEIS must play a part alongside these not be replaced or watered down by them.

Our recommendations are more relevant than ever in light of the Covid19 pandemic situation. In order to give detailed, statistic based evidence, EISA has spent the last few months researching the UK early stage business funding ecosystem and this has highlighted the following funding gaps that currently exist. Our recommendations reflect these gaps and offer solutions to address them.

- Seed stage - £768m
- Venture stage - £1.45Bn
- Growth finance - £4.45Bn
- Northern regions, East Midlands, Yorkshire and Humberside, West Midlands, and the North West, have the largest shortfalls.

Our analysis additionally shows that as a result of the pandemic, EIS fundraising was hit hard in 2020 resulting in small businesses losing out on £341M of potential investment due to the pandemic. Entrepreneurs need access to funding to fulfil their ambitions once they have recovered from the pandemic and they should be at the heart of any recovery or rebuilding plans. This is why our recommendations focus on their needs so strongly.

Levelling up

Finally, our report highlights clearly during the analysed period, London, the South East and the East of England regions received in the analysed period 69% of all equity deals in the UK. This represents 79% of all invested amounts and if the trends continue, the concentration in the London region and

the South East is going to increase further. The permitted maximum age requirement introduced in 2015 has exacerbated this trend. As a result there are significant funding shortfalls outside of these area particularly in the northern regions. With a Government focus on the ”levelling up” agenda, this recommendations also helps direct funding to regions outside of London and the South East. Companies in these areas tend to have an older age profile so would benefit proportionately more from the removal or increase in the age restriction rules.

Our detailed recommendations can be found below.

The proposals put forward are designed to be revenue-neutral or beneficial to the Exchequer. It is estimated that the EIS benefits pay for themselves at least twice over in increased PAYE and National Insurance, corporation tax and VAT. Where there are costs to the exchequer they are kept to a minimum.

Conclusions

All political parties have recognised that Britain has the potential to be the best country in the world to start and grow a business – a place where entrepreneurs know they can build on their ideas and find success. Our hope is that by acting upon our recommendations, every great entrepreneurial management team across all parts of the UK will be able to obtain the finance it needs to develop their ideas into major global businesses and employers. In turn, helping to reset our economy post Covid.

The EIS and SEIS schemes have delivered a 25 year track record of success, as directed by Government policy, delivering much needed equity funding to entrepreneurial, small businesses across the country and by broadening and widening the schemes as outlined above, economic growth, productivity, employment and tax revenue can all be boosted.

EISA 2020 Research Report – Reigniting the UK's entrepreneurial ecosystem

The research has been undertaken by EISA with the help of Beauhurst and Professor Nick Wilson (University of Leeds), with support from a broad ecosystem of investors, business and industry. It has been focussed upon identifying the funding gaps and market failure when businesses seek to access finance and to address the UK's early stage funding needs. To date, much of the research has been on breathing life into later, scaleup stage companies. But companies can't graduate to scaleup stage without first being a startup or early stage and these companies supply the pipeline for future scaleup companies. Both stages are of course vital and its important they work in harness. Our focus however is on the early stage end of the funding ecosystem.

We believe that with Brexit, the 2021 Budget and as a response to Covid19, this is an opportunity to address the early stage UK funding gap which existed before Covid19 but has been widened as a result and to which our report looks at in detail. Furthermore, the report identifies, the need for the UK to be look at the regional imbalances in funding, the importance of the schemes to knowledge innovation in key sectors such as zero carbon, AI, medtech, biotech and the success of the schemes as engines of job creation.

We advocate that public and private sector partnerships will be increasingly important going forward. Addressing the issues we have identified will need to adopt a collaborative which the Government has the ability to kickstart, and it must also include the private sector - particularly as we seek to address regional imbalances that existed pre Covid19 but have now been exacerbated by it.

Jobs are also clearly a priority and our report highlights that EIS and SEIS investment in an early stage business help it employ more people. Our survey discovered that:

- Average employment growth for EIS funded companies is 86%.
- On average, companies employed 6 additional people as a direct result of their EIS investment.
- Within a year of investment, each £1M invested in EIS creates 4 jobs

Just short of 4,000 companies received EIS funding in 2018/19 meaning the schemes can justifiably claim to have created 24,000 jobs in that one year alone. Expanding the schemes can multiply that figure even further and keep our young, entrepreneurial companies on the path to growth. In addition, for every £1 invested into EIS qualifying companies, those companies deliver back £2 in additional revenue.

Additionally, the UK has a well developed VC market that raises capital from private individual investors and invests it in UK based start-up and scale-up businesses. These individuals are long-term investors, investing in early stage, unlisted companies for around three to seven years, and are committed to building lasting and sustainable value in the businesses they invest in. These are schemes not only with a long and distinguished track record of delivering targeted equity funding to companies who otherwise struggle to access much needed finance but are also designed to motivate investors through the tax reliefs to invest into high risk, early stage companies when otherwise they may not. Such individuals are an important but often overlooked source of equity funding.

However, our report highlights that Covid19 saw large falls in funds being invested by such individuals exacerbating the funding gap identified above (See bullet points below.) The important point to make here is that falls in funds being raised by individuals results in the knock on effect that fewer companies have access to lower amounts of equity funding:

- EIS eligible deals represent over 70% of the total number of deals and around 40% of the total value of deals (investment value) since 2011
- The number of investments in EIS eligible companies decreased by 29% in Q2 2020 compared to the previous quarter and 33% compared to the same quarter in the previous year.

The full report can be found here - Reigniting the UK's entrepreneurial ecosystem - EISA

Recommendations in detail

Increasing the SEIS limit from £150,000 to £250,000

It is striking that our survey found that 60% of EIS/SEIS eligible companies think they will not be able to operate longer than 12 months if current circumstances persist. Our analysis shows that the vast majority of these companies are in the seed and venture stage of development. Additionally, over 35% of EIS/SEIS eligible companies were turned down when asked for bank finance or government Covid-19 support and have had the least level of support from existing measures resulting in a £768M funding gap. Our report identifies a "flight to quality" whereby investors and funders have shifted away from risky assets to reduce potential risk of loss. This behaviour has observed venture capital investment shifting to larger (announced) deals and follow-on funding for the more established firms and/or those deemed likely to better weather the crisis at the expense of earlier stage, first round investments. We believe increasing the SEIS limit to £250,000 would help close this gap.

The benefits of this approach are clear. Companies that receive equity investment are more likely to grow faster, particularly in terms of turnover. More of the companies with turnover growth of more than 100% each year have used equity financing than those growing less quickly. Similarly, more of the companies with employment growth of between 80% and 100% annually have taken an injection of equity.[4]

However, as is well known, the OECD ranks the UK as 3rd in terms of start-ups but 13th for scaleups and the proportion of UK start-ups which scale into large businesses lags significantly behind countries such as the US. This indicates that many UK-based businesses are unable to reach their full potential and either remain "stuck" in a stage of slow growth, accept a trade sale as the most convenient exit, or move abroad to access deeper pools of capital. All of which are ultimately to the detriment of the UK economy, tax receipts and job creation.

The Patient Capital Review did a good job in refocusing where EIS and SEIS investment should be focused. But both schemes remain subject to caps and rules which create an inefficiency in the market as companies raising under SEIS find it difficult to obtain follow-on tax-efficient investments

In 2018/19, a total of c.£1.8bn was invested via EIS and SEIS. It is estimated that up to £500M of additional capital could be raised annually through expanding or removing the cap on lifetime investment in particular for SEIS investments, especially given the enduring popularity of the schemes amongst investors.

For SMEs and investors, independently commissioned research highlights a number of positive outcomes that could be multiplied if increasing/removing the existing SEIS limit.

- Over 89% of surveyed companies feel that relaxing SEIS/EIS rules would lead to a rise in equity funding available to businesses from investors.
- Almost 97% (121 out of 125) of the surveyed companies agreed that EIS/SEIS investments were important for the growth and development of their company. In turn, 103 out of 125

surveyed companies reported increased revenue as a result of EIS/SEIS investment. Nearly 70% of them reported revenues increasing by more than 50%.

- As far as the government support in the current situation is concerned, the majority of the surveyed companies said that the measures enabling the access to finance would be the most helpful while other types of support such as tax cuts, fewer bureaucratic hurdles or more flexible labour laws were much less important.

- 84% of companies agreed or strongly agreed that investments under the EIS/SEIS also have an important impact on employment. 119 out of 125 companies reported hiring more employees as a result of EIS/SEIS investments. Further analysis shows the average number of employees hired is 6 per company. Overall, average employment growth was 86%. Every £1M invested in EIS creates at least 4 jobs within a year of investment. 4,000 companies received EIS funding in 2018/19 meaning the schemes can justifiably claim to have created 24,000 jobs in that one year alone

- Companies perceived that without the schemes it would be difficult for them to find other financing for the company. The investors have a positive impact on revenue or employment and are key to financing their further investment

- For investors, loss aversion was a particularly important factor in decision making. The reliefs meant that the value of their investment could effectively fall by a substantial amount before investors would start to lose money, which made them more willing to invest. Additionally, certain investors said they would have invested regardless of the tax reliefs but pointed out that they were able to afford to invest a higher amount due to the reliefs. Similarly, certain investors said they had made more risky investments than they normally would due to the tax reliefs, which is in line with the policy intent of the schemes.[5]

Finally, the Government should leave the market to decide investments are made. Governments "need to learn that when it comes to innovative initiatives, it's usually impossible to pick the big winners from the losers early on…. to drive significant long-term growth, they need to invest in a large number of innovation initiatives, and fail in most of them, to be able to find the few that pay for the rest – with interest."[6]

Previously, expanding or removing the SEIS investment caps would require additional government funding to be made available would require further revision of the European Commission's state aid clearance decision for the EIS schemes. With the UK's departure from the EU now ratified, we hope this barrier may be removed. Further economic modelling will be required to evaluate the most effective way to raise this additional investment through tax incentives, considering also the returns available from other tax incentivised investment opportunities such as pension funds and ISAs. However, there is clear evidence that tax advantaged schemes help offset the risk of taking an equity position for an individual investor and they are an important pool of privately funded investment relieving funding pressure from central government agencies.

We believe that increasing the threshold for SEIS investment, will encourage follow-on investments, and could help smooth the transition into nontax-incentivised investments.

SEIS Technical Amendment

Section 150E(10) and (11) TCGA 1992 allows an SEIS company to be acquired by another SEIS company in a share for share transaction after the three year termination date for the SEIS shares in

the target company, such that the shares received in the acquiring company continue to enjoy exemption from capital gains tax on a disposal.

Similarly section 150A TCGA 1992 allows an EIS company to be acquired by another EIS company in a share for share transaction after the termination date for the EIS shares in the target company, such that the shares received in the acquiring company continue to enjoy exemption from capital gains tax on a disposal.

Our members have highlighted some examples of companies which have raised SEIS funds, and are past their three year restricted period, and which have received offers from companies which have previous raised EIS funds, but not SEIS funds. The companies include a professional advisory services technology platform and a business with an application platform for real time social sharing. In each case the acquirers are independent third parties with similar businesses who believe that enlarged groups would bring significant economies of scale and would drive growth.

The companies assumed that as the acquiring companies were companies which had raised funds under the EIS, that the SEIS benefits would continue, and you can see why this would be a reasonable assumption. However section 150E(11) refers only to the acquiring company having issued certificates under section 257EB(1) ITA 2007 (ie SEIS certificates), but there is no specific reference to EIS certificates.

We believe there is a good case for amending the legislation to allow SEIS benefits to continue for shareholders who exchange their shares in the SEIS companies for shares in the acquiring EIS companies, and likewise for EIS benefits to continue for shareholders who exchange their shares in the EIS company for shares in an acquiring company which has only received SEIS funding. We believe it is potentially a barrier to the long term development of businesses like these. SEIS/EIS investors are more likely to want a cash exit, if their capital gains tax exemption cannot continue beyond the acquisition, and so making this change would help preserve investment in these companies for a longer time.

Amending the EU's State Aid and Risk Finance Guidelines

Northern Ireland Protocol

As we understand the situation currently, following Brexit, the UK has the liberty to make changes to the EIS and SEIS schemes based on the Trade and Cooperation Agreement (TCA). The TCA brings a new subsidy regime from 1 January 2021 and it replaces the State aid controls formerly applicable to the UK when a member of the EU.

Under the TCA the UK's tax advantaged venture capital schemes, the Enterprise Investment Scheme (EIS) and the Venture Capital Trust scheme (VCT), both of which were classified as EU State aid, are not treated as subsidies and are therefore not regulated by the TCA.

The UK has repealed all EU State aid regulations from the UK domestic law from 1 January 2021 and the 2014 Risk Finance Guidelines (RFG) which derive from Article 107(3)(c) of the Treaty on the Functioning of the European Union (TFEU) will cease to apply.

The removal of State aid fetters gives the opportunity to increase the scope of the proven benefits of EIS to the UK economy. We would be happy to receive further guidance on our understanding in this area.

EU State Aid Considersations

The tax reliefs received by investors under the EIS are deemed to represent State aid. We understand the UK Government will regain control of its subsidy regime following our withdrawal from 31st December 2020 and would recommend the following changes to the legislation to as it currently stands.

When the Risk Finance Guidelines were adopted in 2014 to replace the Risk Capital Guidelines, the Commission recognised that the previous Guidelines "proved to be too restrictive both in terms of eligible SMEs, forms of financing, aid instruments and funding structures." The modernisation of State aid rules launched by the Commission in 2012 had three main, closely linked objectives:

1) Foster growth in a strengthened, dynamic and competitive internal market;

2) Focus enforcement on cases with the biggest impact on the internal market;

3) Streamlined rules and faster decisions.

The Competition Policy Brief published in January 2014 at the time of the introduction of the Risk Finance Guidelines stated:

"Following extensive consultations with Member States and stakeholders, the Commission is now taking a bold step by setting up a simpler, more flexible and generous state aid framework for the provision of risk finance to SMEs and midcaps. The new rules should attract and channel private financing to support the public policy goals of economic growth and job creation, which is particularly important in times of economic crisis."

The Competition Policy Brief continues:

"SMEs are by and large still heavily dependent on traditional bank lending. Lending is, however, still limited by the refinancing capacity, risk appetite and capital adequacy of banks. The financial crisis has exacerbated problems flowing from such overreliance on bank lending - approximately one third of SMEs were unable to receive the necessary finance in recent years. Such a failure in finance markets translates into a "funding gap", which hinders companies during the seed and start-up stages, and later during their development and growth stages. The Commission is boldly reacting to changing market realities. New State aid rules will permit a more rapid and generous distribution of risk finance aid to SMEs and mid-caps. This is an important contribution to the European Union's efforts to re-launch economic growth during difficult times for many SMEs."

However, since the publication of the Competition Policy Brief in 2014 Europe remains in difficult economic times and the funding gap for SMEs and mid-caps persists.

The EIS primary legislation is very long and highly detailed, and contains many restrictions which are viewed as uncommercial, but we are advised that they are necessary to meet State aid Risk Finance Guidelines. The complexity of the EIS legislation illustrates the potential to streamline further the State aid Risk Finance Guidelines.

Further liberalisation of the State aid rules could be a precursor to Member States applying the regime with fewer unnecessary restrictions on investment and with a reduced administrative burden. This would lead to faster deployment of funds raised from individuals to provide greater support for SMEs and knowledge-intensive mid-caps. This would enhance the effectiveness of the Risk Finance Guidelines to deliver development capital to SMEs and innovative mid-caps.

Replace the age limit

The EISA recommends that consideration is given to replacing the "age restriction" on eligible recipients of State aid with a different threshold. Instead, we propose a gross assets test, of say £20 million, be used instead to determine eligibility for the recipients of State aid Risk finance. The EIS scheme, for which Commission approval has been given, has an existing gross assets limit. This has the advantage of facilitating a clear assessment of eligibility. Deciding what level of gross assets to apply (within a threshold set by an updated Risk Finance Guidelines) in relation to individual applications for State aid approval, would, of course, be subject to a full market failure analysis. The size of the investee company or group would be a suitable measure for rapidly directing investment where the funding gap is most significant.

Doing so would particularly benefit companies outside of London and the South East who tend to have an older age profile and are more impacted by the existing age restriction and therefore often do not meet the qualification criteria for EIS and SEIS.

We note that the EU SME definition, according the European Commission's User guide to the SME definition published in 2016 stated:

"SMEs are the engine of the European economy. They drive job creation and economic growth and ensure social stability. In 2013, over 21 million SMEs provided 88.8 million jobs throughout the EU. Nine out of every 10 enterprises is an SME, and SMEs generate two out of every three jobs. SMEs also stimulate an entrepreneurial spirit and innovation throughout the EU and are thus crucial for fostering competitiveness and employment. Given their importance to Europe's economy, SMEs are a major focus of EU policy. The European Commission aims to promote entrepreneurship and improve the business environment for SMEs, thereby allowing them to realise their full potential in today's global economy."

The User Guide to the SME definition quotes from Jean-Claude Juncker, President of the European Commission:

'Jobs, growth and investment will only return to Europe if we create the right regulatory environment and promote a climate of entrepreneurship and job creation. We must not stifle innovation and competitiveness with too prescriptive and too detailed regulations, particularly when it comes to small and medium-sized enterprises (SMEs). SMEs are the backbone of our economy, creating more than 85 % of new jobs in Europe and we have to free them from burdensome regulation.'

The User Guide continues:

"SMEs require assistance that other enterprises do not. Compared with other enterprises, SMEs are confronted with a unique set of issues.

Market failures: real SMEs often face market failures that make the environment in which they operate and compete with other players more challenging. Market failures may occur in areas such as finance (especially venture capital), research, innovation or environmental regulations; SMEs may be unable to access finance or invest in research and innovation or they may lack the resources to comply with environmental regulations.

Structural barriers: SMEs often must also overcome structural barriers such as a lack of management and technical skills, rigidities in labour markets and a limited knowledge of opportunities for international expansion."

SMEs are less likely to trade across borders. They are, by definition, less likely to be significant participants in specific EU geographic or product markets. Their capacity to distort the internal market is, by definition, minimal.

The EISA believes that the reforms in the Risk Finance Guidelines did not achieve a streamlined system because of this focus on the "age" of the investment instead of its size.

The age of company test, as implemented by the UK, where the investee company is a group imposes an onerous obligation to ascertain when the first commercial sale of the investee group took place. This task is complicated because subsidiaries, which themselves may have acquired businesses, have either joined or left the investee company group. The test also takes into account a line of business which may have ceased long ago. This requires extensive due diligence and is a barrier to receiving investment.

Establishing the age of a business can be particularly difficult where companies or businesses may have been disposed of by the investee group prior to the State aided investment and the investee company no longer has access to the relevant information or staff members.

The guidance issued by HMRC in relation to this aspect of the test illustrates the difficulties:

"The rules look at all the businesses of every company that has ever been a member of the investee company's group including businesses or parts of businesses acquired by any of the companies and take the earliest possible date of all those companies and businesses as the date of the first commercial sale. In determining a company's first commercial sale, it does not matter that it or its subsidiaries may be, or may have been, carrying on different activities."

If an investment is made in a company which subsequently turns out to have failed the age limit test, for example, because at one time the investee company had a subsidiary, which it subsequently disposed of, which had acquired a business with an earlier date of first commercial sale, then means that the investment is non-qualifying. The potential severity of the consequences of making a nonqualifying investment can deter individuals from making the investment.

The age of a company, in itself, is not a robust indicator of whether or not it has the capacity or knowledge to scale up its production and therefore may not act as a proxy for its ability to secure bank financing. Indeed, market changes may create the opportunities for expansion for companies that have previously been operating for a number of years which require external finance. This is confirmed by paragraph 73 of the Risk Finance Guidelines which states:

"The General Block Exemption Regulation covers SMEs which receive the initial investment under the risk finance measure before their first commercial sale on a market or within seven years following their first commercial sale. Only follow-on investments are covered by the block exemption beyond this seven-year period. However, certain types of undertakings may be regarded as still being in their expansion/early growth stages if, even after this seven-year period, they have not yet sufficiently proven their potential to generate returns and/or do not have a sufficiently robust track record and collaterals. This may be the case in high-risk sectors, such as the biotech, cultural and creative industries, and more in general for innovative SMEs. Moreover, undertakings that have sufficient internal equity to finance their initial activities may require external financing only at a later stage, for instance to increase their capacities from a small-scale to a larger scale business. This may require a higher amount of investment than they can meet from their own resources."

Consequently, the EISA recommends that the age of company test should be replaced with a test based on size of the investee company. The EISA recommends that that size should be the gross assets of the investee company.

The EISA also recommends that size should not be determined by reference to employment, since the focus of risk finance investment should be on creating employment regardless of the age of company, in line with EU employment targets.

Committing to EIS and SEIS beyond 2025

A provision in each of the 2015 Summer Finance Bill schedules (a condition for state-aid approval) introduced the inclusion of a sunset clause, intended to restrict tax relief to shares issued before 6 April 2025. There is a provision which allows that date to be amended by Treasury order.

We seek ministerial assurances that every effort will be made to ensure the continuation of both reliefs and provide maximum advance publicity to any enforced shortening of the life expectancy of the two reliefs. Tax incentive design should recognise that governments rarely, if ever, have the necessary resources and information to successfully target support to specific firms, sectors or technologies. Instead, tax incentive design should target entrepreneurial firms based on a number of criteria, such as age and size (financial and headcount)[4]. EIS and SEIS fulfils this aim as recognised by the EU who studied 46 tax incentive schemes across Europe. The benchmarking component of this study ranked all tax incentives observed in the country sample according to good practice in their design in order to inform policy discussion on best practice. The two highest ranked schemes are United Kingdom's Seed Enterprise Investment Scheme and Enterprise Investment Scheme.[5]

Reduce the admin burden

In short, there is a case for improving the administrative processes around authorising SEIS and EIS companies, and granting tax relief for investors. As the Office of Tax Simplification noted, "The OTS is aware that legislative changes about the nature of companies in which investments can be made is expected to streamline the processes, which is to be welcomed. However, digitisation and relaxation of legislative inflexibilities could also contribute to faster turn-arounds, which in turn would better enable companies to attract venture capital. Complexities built into the SEIS/EIS legislation often catch out unwary companies, either at the time of application or after SEIS/EIS status has been granted. This can cause good businesses to lose necessary venture capital, or result in relief being denied or withdrawn some time after the investors have made their investments. Some of the rules may be necessary to properly target the reliefs, but a review of these complexities to remove unnecessary ones, or to build in de minimis thresholds (for small companies) would be useful."[7]

Focusing on the administration and paperwork involved in EIS investments would also be beneficial. The scheme is far too complicated for most private investors to understand and can leave a negative impression after making an EIS investment. EIS investors have experienced delays in being able to claim income tax relief when investing through EIS approved and unapproved funds and only being able to claim relief on the amount invested in the underlying company, which, due to management fees and other costs, is not 100% of their subscription to the fund. Under current rules, relief for EIS investment through an EIS approved fund is given only after 90% of funds have been invested when most investors have already closed their tax affairs for the relevant tax year and paid the tax. They then have to make a backdated claim one to two years later. Again as the OTS notes, "Although HMRC approve straightforward cases quickly, initial investors in SEIS, EIS and VCT schemes often have to wait a long time to receive the documentation needed to claim the relief on their tax returns. There are a number of stages in the process of obtaining this documentation, and the OTS considers that this area would benefit from an in-depth review with a view to identifying options to streamline

the process. As a result of the lengthy process, individuals' tax returns sometimes have to be submitted before the documentation has been received to meet filling deadlines. This means that the tax relief cannot be claimed at that point. Investors may have to amend their tax returns later and submit additional forms to claim the relief once they receive the relevant documentation." Introducing a simplified fund investment process where tax relief is received far quicker and with only one certificate required. Consistency in the administration of these funds by regulators would provide more certainty and a better environment for investors. This would reduce the time it takes to get cash into companies, and would reduce the resources HMRC has to dedicate to the service. Consideration of a vehicle that provides upfront tax relief that helps investors with the timing of their investment and more certainty over when they can expect to receive tax relief.

Raising consciousness amongst entrepreneurs and investors of EIS and SEIS

The British Business Bank's Small Business Finance Survey 2019[7] shows encouraging signs that awareness amongst SMEs of external forms of finance increasing as is awareness of who to approach for specific funding but there is still work to do to ensure entrepreneurs are properly educated about all the available funding options open to them. In 2017, the Business, Energy and Industrial Strategy Committee recommended that "the Government directs resources towards promoting the SEIS, EIS and VCT schemes. This includes the British Business Bank working with HMRC to consider how to improve promotion of the schemes." Whilst the British Business Bank and the Government committed to explore ways to raise awareness of the schemes, we believe more can be done to raise the profile of EIS and SEIS to companies seeking much needed equity finance including involving a far wider range of business support agencies such as LEPs, Universities and the IOD.

Awareness of alternatives to traditional finance for small businesses has continued to grow, with 52% of small businesses aware of peer to peer lending, 70% aware of crowdfunding platforms and 69% aware of Venture Capital (up from 47%, 60% and 62% respectively in the previous year)[8]. But more can be done.

Additionally, 37,350 individuals invested in EIS in 2017/18[8]. Yet there are estimated to be a quarter of million taxpayers earning in excess of a quarter of a million pounds a year and almost 350,000 earning more than £150,000 per annum. Because tax incentives reduce the effective marginal cost of investing in smaller companies, in theory, more individuals should be willing to invest more capital to smaller companies through EIS and SEIS thereby benefitting from tax incentives, and at lower before-tax expected rates of return if they are aware of the schemes. The potential therefore for more individuals' capital to be deployed in EIS and SEIS is huge and represents a significant, untapped source of investment. More should be done to promote the schemes to High Net Worth individuals and Independent Financial Planners.

Appendix - Understanding the early stage access to finance environment

Many SMEs would never be financed by larger funds because they are too small, too niche, too high risk, etc. yet many of these businesses are launched or grow on the back of angels, friends and family and individual investors or small funds using EIS. Other capital sources struggle to or don't have the appetite to reach these areas or do not do so effectively and yet these areas are often the areas where funding is most needed and where high growth is often achieved. A main root cause holding back effective deployment of and demand for patient capital is the inability to recycle capital efficiently as a growth company grows and develops. As a generalisation, a seed investor may invest in multiple rounds but not usually beyond a series A round, preferring to exit at this stage if possible so that his capital can be reinvested in more seed investments rather than washed out in later rounds of the original investment. By contrast, very large investment funds take little interest in seed investments because their performance, however good, is unlikely to make much impact on the overall

performance of the very large investment funds. An efficient market needs both types of funds (and intermediates) so that capital can be recycled and employed efficiently according to the expertise of the investor; and that expertise differs very widely from the investor working with his local university and the manager who orchestrates international global fund raisings to support the global expansion of the next unicorns. Without the seed investors, the global investors might never find worthwhile 'new to market' investments. Without the very large investors the seed investors might be trapped and washed out. Both are needed for the ecosystem to work at its best.

A Post Brexit, Post Covid19 economy

The UK is already a great place to start and grow a business. There are over 600,000 small businesses in the UK and they account for 99.9% of all businesses, 60% of employment and 52% of GDP [2]. Starting new businesses is important but scaling them up is equally important. They create jobs outside of the public sector, provide people with an income and generate tax revenue for the Government that funds for vital public services.

Instrumental in developing and funding a thriving UK start-up and scale up community are successful government policy interventions such as the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment scheme (SEIS). Over £22 Billion has been raised from retail investors through the schemes and they have played an important role in providing early stage funding for a wide range of innovative, productive companies who without the schemes would not have been able to start and scale their business.

The intention behind both schemes is to address an ongoing market failure where growing UK businesses are unable to access the capital they require to scale up. Whilst this has been acknowledged by the European Commission in its 2015 amendment to the state aid clearance decision for EIS schemes, the full extent of this lack of capital continues to be underestimated, and growing UK businesses still struggle to secure investments of between £50,000 and £20m.

If the UK wishes to further strengthen its position as the best place to start and grow a business, as stated in all the major political party manifestos at the 2019 election, particular focus need to be given to not only funding early stage business start up businesses but also the transformational development of some of these start-ups into large-scale businesses.

1 Enterprise Investment Scheme Seed Enterprise Investment Scheme and Social Investment Tax Relief, May 2019, Statistics on Companies raising funds, HMRC - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/804455/May_2019_Commentary_EIS_SEIS_SITR_National_Statistics.pdf

2 https://www.fsb.org.uk/uk-small-business-statistics.html

3 Scale Up Institute, "Annual Scale Up Review 2018". Available from: http://www.scaleupinstitute.org.uk/wp-content/ uploads/2018/11/SUI_Review_2018.pdf, p. 72.)

4 Scale Up Institute and Beauhurst, Scale Up Index 2019. Available from: about.beauhurst.com/wpcontent/uploads/2019/11/ScaleUp-Index-2019-SUI-WEB.pdf

5 (The use and impact of venture capital schemes - February 2016 – HMRC Research Report 355)

6 Alexander Osterwalder, https://thinkgrowth.org/why-cant-nestle-produce-another-nespressoe2aeb3a5e086

7 Office of Tax Simplification, Business Lifecycle Report: Simplifying the taxation of key events in the life of a business file:///C:/Users/mark%20brownridge/OneDrive%20-%20The%20EIS%20Association/Tax%20and%20Tech%20committee/OTS_Business_Lifecycle_report_final.pdf

8 British Business Bank, Small Business Finance Survey 2019 - https://www.british-businessbank.co.uk/wp-content/uploads/2019/02/British_Business_Bank_Small-Business-Finance-Report2019_v3.pdf

9 Business, Energy and Industrial Strategy Committee, Small businesses and productivity, Fifteenth Report of Session 2017 https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/807/807.pdf