Alliance for Innovation

Budget 2024 Submission

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1. Introduction

This submission is being collectively made on behalf of the Alliance for Innovation (the "Alliance"), a coalition of five national organisations, all of whom have a shared interest in the growth of the indigenous high-growth tech start-up and scale-up sector in Ireland.

The Alliance comprises of **Scale Ireland**, which represents indigenous tech start-up and scaling companies; **HBAN**, Ireland's largest network of business angel groups 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 and Portugal, 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.

Following the Covid pandemic, 2022 and so far, 2023 have been challenging. The Russian invasion of Ukraine has sparked global supply chain issues and contributed to the rise of inflation, driven by increases in energy prices that have affected households and businesses in Ireland. This has exacerbated existing issues around housing supply.

The global tech sector has not been immune. There have seen significant job losses which have had an impact here in Ireland. The Alliance believes that the sector remains robust and will continue to make a significant contribution to the Irish economy. However, these developments reinforce our view that the expansion of our indigenous tech sector should be a high priority for the Government.

Tech start-ups and scaling companies are SMEs but have very different dynamics. They are innovators seeking to generate commercial value from high level research and are disproportionately capital intensive at an early stage of development, in many cases requiring significant investment before trading commences. They are, by definition, R&D focussed. These companies are also predominantly global in outlook - providing added value in the broader SME sector which the OECD suggests is insufficiently export orientated. These companies also have a huge demand for skilled workers in a sector that, notwithstanding its difficulties, remains hugely competitive. Tech start-ups and scaling companies generate high returns but are also viewed as high risk.

The Alliance welcomes the recognition of this sector and its challenges in two significant reports published last year. The Commission on Taxation and Welfare broadly supported the existing policies developed to assist the sector, and strongly favoured the targeted expansion and review of the state's offering where necessary. Similarly, the Government also published its first White Paper on Enterprise Policy in a decade, which is highly supportive and ambitious for the sector. It also provides further details relating to some of the Commission's recommendations.

The Alliance is also submitting its proposals against the backdrop of the collapse of Silicon Valley Bank, the long-term impact of which is unclear. The speedy intervention of the US and UK authorities to protect depositor funds was critical. Nonetheless, SVB played a significant role within the tech community, and its absence may particularly exacerbate the funding challenge for scaling companies.

While it is appropriate that tax incentives meet specific policy objectives, the take-up of reliefs should also be considered and facilitated in terms of ease of application and increased usage. The economic benefit flows from making the relief more accessible, not less so. Unfortunately, the introduction of a number of measures in recent years have been hampered by excessive caution and restrictions that have required well-intentioned Governments and officials to revisit legislative provisions in subsequent years.

In this pre-budget submission, we call on the Government to be more ambitious for the sector - and we support the Head of Enterprise Ireland Leo Clancy's ambitious statement that the indigenous sector will become a prime driver of our economy over the next twenty-five years.

Our Vision for Budget 2024

In Scale Ireland's annual **State of Start-Ups survey published in 2023**, we identified the key issues of concern to start-up and scaling companies. With 248 founders and CEOs responding, it is a representative sample. It shows that funding remains the key challenge for founders and CEOs, with 79.8% finding it either 'difficult' or 'very difficult' to attract private capital.

Ultimately, more than half of the CEOs and founders surveyed (51.6%) considered funding to be their biggest challenge in the last year, (up from 47% in 2021) as compared to recruitment and retention of staff (17% in 2022, compared to 25% in 2021) and the cost of doing business (12% in 2022, compared to 8.7% in 2021). Other issues included tax and regulation burdens and lack of expert advice and support.

In relation to the recruitment and retention of staff, 35% of start-ups said they found it more difficult to recruit staff in 2022, down from 45.7% in 2021. And while 40% of start-ups have lost staff in the last year, 22% of start-ups have let staff go.

The uptake of state supports remains unattractive with 83% of respondents not availing of the KEEP share options scheme (up from 77.8% in 2021), and 66% not availing of the R&D Tax credit (similar to 2021). While 73% of those who availed or looked at availing of the Employment Investment Incentive Scheme (EIIS) found the process difficult or not easy. Almost half (49%) found the R&D Tax Credit scheme complicated.

On a positive note, almost two thirds (62.5%) believe Enterprise Ireland's new PreSeed Start Fund will improve the environment for start-ups. Given the current situation, 12% identified the cost of doing business as the biggest issue facing start-ups. 65.7% said inflation or cost of living issues had impacted their businesses.

Finally, while some progress is being made by start-ups and scaling companies in relation to sustainability, 66.9% of founders/CEOs questioned did not have a sustainability plan, slightly down on last year (70.4%).

Overall, it is not surprising that raising capital is the dominant concern facing founders. Investment is the lifeblood of these companies. The **IVCA Venture Pulse Survey figures for Q4 2022** are a source of some concern. While year on year funding for 2022 is of a similar magnitude, the Q4 figures represent a significant drop on the same quarter in 2021, with a reduced level of international funding into the Irish ecosystem. The funding landscape has deteriorated since then and this has been confirmed in the recently published **KPMG Venture Pulse Survey**, which reported a year on year reduction of over 50% of investment into Irish businesses.

We believe the €90m Irish Innovation Seed Fund will play an important role in addressing some of the funding challenges for early stage companies. There is however, an immediate need to incentivise more private investment in start-up and scaling companies during this critical period, as well as addressing what the Government's *White Paper on Enterprise* has identified as a funding gap for scaling companies seeking to raise €3-10m funding.

Additionally, the take-up of targeted Revenue programmes designed to assist these companies is not reaching its full potential. The time and expertise required to apply for many of these schemes is an additional pressure or burden on many businesses that already suffer from time constraints and limited resources to engage third party advice.

The Alliance strongly welcomes the broad policy consensus on the sector and the importance of targeted supports as reflected in the Commission of Taxation and Welfare report and the White Paper on Enterprise. The focus now must be on ensuring these schemes (R&D tax credit, EIIS and KEEP) are more effective. While increasing take-up of these supports and schemes may not instinctively sit well with Revenue, it needs to happen.

At a broader level, the Alliance acknowledges that cost of living issues in Ireland, particularly with regard to housing, is acting as an impediment to business activity. We also acknowledge the efforts made by the Government to support individuals and employers through the worst of the energy crisis. Any additional measures taken by the Government to alleviate these difficulties can only have a positive impact on the broader business environment, and on the start-up community, which competes both domestically and internationally for skilled workers.

2. Summary of our Key Proposals

There are two specific recommendations in the Government's *White Paper on Enterprise*, and the report of the *Commission of Taxation and Welfare* which the Alliance would like to see progressed as a matter of urgency.

Review of the effectiveness of state supports

A consistent finding in Scale Ireland's State of Start-ups Survey 2023, is the poor take-up of existing reliefs to support start-up activity. It is not reaching its full potential because companies find the processes too onerous and costly. This point was acknowledged by the Taoiseach at Scale Ireland's Regional Start-up Summit (February 2023). It was also strongly emphasised in the Commission's report. Both the Commission and the White Paper on Enterprise commit the Revenue Commissioners and the Department of Enterprise to examining the issue with other state agencies. **It is imperative that this review takes place as soon as possible in relation to the KEEP share options, R&D tax credit and the EIIS schemes. The Alliance is also calling for a Scaling Division within Revenue to guarantee a better understanding of our sectoral issues.**

Review of Capital Gains Tax

The Alliance has long held the view that the comparative high level of capital gains tax in Ireland in comparison to most of our competitors, acts as a break on entrepreneurial activity. The Commission and White Paper both recommend a review of the CGT regime, specifically with regard to the need 'to reflect the risk premium involved versus investment in other assets'. We believe it is important that this review is established and there is an opportunity for sectoral consultation and engagement. **The Alliance supports the introduction of a lower 20% rate of CGT on gains arising on the disposals of investments in start-up and scaling companies. For instance, the introduction of a lower CGT rate on gains on investments in SMEs, whilst leaving the 33% rate in place for gains in investment property, should encourage private capital to invest in productive assets capable of delivering greater employment and economic benefit to the state.**

A. Finance

A.1 Employment Investment Incentive Scheme (EIIS)

The Alliance welcomes the recommendation in the Commission's report that the EIIS scheme should be 'extended and enhanced' beyond its current deadline of 2024. EIIS is an important tool to facilitate additional investment into start-up and scaling companies. The report correctly identifies the complexity around the EIIS process and calls for a further examination of the operation of the scheme. To ensure that EIIS can make a significant impact as a provider of risk finance to SMEs, we believe that the scheme should be reviewed. It is imperative that it is made more competitive with both UK schemes, which are presently being actively promoted here. The Alliance proposes:

- Enable loss relief on investments under EIIS.
- Seek an increase in investment limits under EIIS.
- Standardise the investment period to 3 years for all qualifying investments.
- Increase certainty for companies that they are eligible for EIIS and simplification of process.

A.2 Entrepreneur Relief

The Alliance welcomes the position of the Commission on Taxation and Welfare Report that Entrepreneur Relief has an important role in incentivising founders to start businesses. We believe that the relief should be modified to attract a wider pool of investors and support serial entrepreneurship. The Alliance Proposes:

- The extension of *Entrepreneur Relief* as recommended in the Commission's Report to facilitate the inclusion of angel investors;
- The replacement of the €1m lifetime limit relating to Entrepreneurial Relief with a €1m per venture cap to encourage serial entrepreneurship.

A.3 Measures to address the €3-10 million Financing Gap

The *White Paper on Enterprise* identified a funding gap for scaling companies seeking to raise €3-10m funding. The IVCA's Venture Pulse Report findings for Q4 2022 indicates a significant decline in international funding. This is a complex area that requires continuous review and a multi-faceted approach. The Alliance proposes the following measures:

- The extension and refocusing of the Enterprise Ireland Seed and Venture Capital scheme beyond 2024, with a view to also providing an additional focus and approach on deals in this €3-10m range;
- Increased focus by the *Ireland Strategic Investment Fund (ISIF)* on venture debt to support scaling companies where an equity deal may not be appropriate. Along with equity, the evidence suggests that venture debt can play a positive role in supporting scaling companies;
- Further support and an expansion of the *Strategic Banking Corporation of Ireland's* risk sharing programme to facilitate it supporting lending in this range.

A.4 Leverage Pension Fund Investment in Domestic Firms

The growth of the Irish tech ecosystem will depend on developing long-term access to financing for domestic scaling companies. This policy approach is being adopted by other EU Member States. The Alliance believes that the adoption by the state of the *Auto-enrolment Pension Scheme* provides an opportunity through the establishment of a vehicle to unlock private investment and enable investment by pension funds in indigenous companies.

The Alliance believes that any auto enrolment scheme should ensure that a portion of pension savings supported by the state, should be used to finance Irish jobs of the future. An established *Fund of Funds* will be critical to achieving this.

- **With the introduction of an auto-enrolment scheme, the State mandate should be extended to allow for pension funds directly in receipt of Irish State funding or indirectly through tax reliefs.** Any auto-enrolment scheme should ensure that a portion of pension savings supported by the state should be used to finance Irish jobs of the future. An established *Fund of Funds* will be critical to achieving this goal.

B. Retention and Recruitment of Staff

B.1 Tax Credit for Redundant staff

Given the wider job losses, the Alliance believes Ireland needs to ensure that these workers can still make an important contribution to our economy. We believe there is an opportunity to attract many of them to the indigenous tech sector.

- **The introduction of a specific 25% refundable tax credit to incentivise the hiring of redundant workers into the indigenous sector.** This proposal would mean that the new salary and benefits of the employee shall give rise to a tax credit of 25% of those benefits for a limited period. This could reduce corporation tax where the new employer is a company, or income tax where the new employer is a partnership of individuals, or sole trader.

B.2 Reform of KEEP share Options Scheme

The Alliance welcomed the changes to the KEEP Share Options scheme in the 2022 Finance Act. However, we believe further changes are needed before the scheme fulfils its objectives. We welcome the endorsement of KEEP in the Report of the Commission on Taxation and Welfare and the recommendation to expand and review the scheme. We propose:

- Increasing the value of the issued but unexercised shares from €6 million to €12 million, or to allow the awarding of share options in line with the growth in company equity, allowing companies to award options up to 20% of the value of the company;
- Removing the link between equity ownership and salaries under the KEEP scheme (S.128F, TCA 1997) and raise the cap on share options;
- Providing greater certainty in relation to tax treatment if a company grows under the KEEP scheme;
- Narrowing the list of excluded activities.

C. R&D Tax Credit Scheme

The Alliance welcomes the continuation of the R&D Tax Credit in light of the new global tax infrastructure in the 2022 Finance Act. However, we believe an opportunity was lost to benefit a larger number of start-up and scaling companies. *The Report of the Commission on Taxation and Welfare, while generally supportive of the Tax Credit, points out that while smaller companies represent the vast majority of claimants, they receive a much smaller quantity of the overall amount*. The *White Paper on Enterprise* sets out the ambition for Ireland to become an innovation leader and to increase our R&D activity. It notes that Ireland's R&D activity is below the rate in comparable advanced economies. The Alliance is calling for:

- A substantial increase in the fixed maximum cash reimbursement level in year one (from €25,000 to €125,000);
- Amend Section 766, TCA 1997 to ensure appropriate overhead and other relevant costs are permitted in the calculation of R&D tax credit claims;
- An increase to €125,000 in the science test exemption for companies in receipt of EI/IDA grants;
- Removal of the reference to internal spend and place the cap at €100k of subcontractor costs.

D. Sustainability

The Scale Ireland *State of Start-up Survey 2023* indicates that almost 70% of companies have not adequately considered sustainability as a challenge despite the range of supports available from various state agencies. The Alliance is advocating a number of measures, to both support the development of climate impact companies and encourage the wider community to embrace the critical sustainability challenge.

The Alliance proposes:

- The introduction of a €5,000 tax credit type scheme geared towards micro and SMEs to have a sustainability plan with KPIs. This must be achieved within 3 years of the company being set up. However, companies already established beyond that time period will be eligible to apply for the credit within a 2 year period of its introduction;
- That Enterprise Ireland should ringfence dedicated funding under its HPSU scheme for companies with sustainable solutions;
- Funding should be introduced for a campaign to highlight how Irish start-ups can access EU Green Bond funding.

3. Key Proposals

A. Finance

A.1 EIIS:

In the current funding environment, it is critical that more capital is provided to Irish-based companies to enable them to grow and scale. To achieve this, it is imperative to encourage more individual investors to invest their own capital in Irish companies. We believe that by providing loss relief on qualifying investments under EIIS schemes, investors may be more willing to make investments that they otherwise would not choose to make due to the higher risks. This recommendation would allow investors a form of loss relief on the loss making investment and would put such shares on a similar footing to losses made on non-EIIS shareholdings from a capital gains tax perspective.

We note the EU Commission's amendments to the General Block Exemption Regulation ('GBER rules'). This may have certain effects on the EIIS legislation. The press release accompanying the targeted amendment to the rules explains that the revised rules, among others, seek to clarify and streamline the possibilities for risk finance aid for small and medium-sized enterprises and start-ups. We would recommend that any changes brought about as a result of this do not add any further complexity to an already complex relief.

Proposal (i): Provide loss relief on investments made under EIIS

PROBLEM: Investors know that if their investment in an EIIS company succeeds, then any gain arising on the disposal of their investment would be subject to tax. However, unlike other shareholdings, there is generally no relief for any loss arising on disposals of EIIS shares, where the investment is not successful. Therefore, EIIS shares are treated less favourably from a capital gains tax perspective than other investments. As you will be aware, CGT loss relief is provided for under the UK's EIS scheme.

SOLUTION: Introduce CGT loss relief on failed or loss-making EIIS investments.

IMPACT: This would remove the difference in CGT treatment between EIIS and other investments. This would also make EIIS investments more attractive to potential investors, thereby increasing the supply of capital to Irish based companies.

Proposal (ii): Increase maximum allowable investment under EIIS

The aim of this proposal is to ensure that funding sources available to companies are maximised. This should assist companies in streamlining the number of investors they need to attract to fund their development, and may enable them to raise more meaningful amounts to accelerate their growth. This would also likely reduce the costs associated with raising EIIS funding.

PROBLEM: The current maximum allowable investment in an EIIS company is €500,000, which has a 7-year retention period. The UK's EIS has a maximum allowable investment in an EIS company of €1m, with a shorter retention period. This difference in investment levels makes Ireland's regime less competitive and more difficult for companies to raise significant funds through EIIS; we discuss the retention periods in a separate point.

SOLUTION: Increase the investment limits to €1m per investor.

IMPACT: This would remove some of the differences between the Irish and UK systems and should enable companies to raise more significant amounts with fewer investors and lessen the administrative burden. It would expand the cohort of investors prepared to invest in companies under an EIIS, again increasing the pool of investors willing to invest in Irish scaling companies.

Proposal (iii): Standardise investment period to 3 years for all qualifying investments

PROBLEM: The Finance Act 2019 amended the annual limit an investor can make from €150,000 per annum to €250,000 and €500,000. Where an investment of greater than €250,000 is made, the investor must retain the qualifying shares for seven years. The increase in the annual limits was welcomed by the Alliance. At present, there is a limited appetite by investors to lock in a substantial investment for a seven-year period. Where an SME is fortunate to attract an investor that can invest greater than €250,000 in a year, the seven-year retention period acts as a substantial barrier to investing.

SOLUTION: To incentivise investors to make investments greater than €250,000, we are recommending that the investment period for all qualifying investments up to €500,000 is adjusted to three years. It should be noted that as an alternative to investing €500,000 which attracts a seven-year retention period, investors can make an annual investment of €250,000 per annum for two years. As the investment amount is €250,000, the qualifying investment period is four years. As such, the investor can obtain the same quantum of relief of €500,000 over a two-year period but reduce the total investment period from seven years to five years. However, in the current environment with the shortage of liquidity for SMEs, it is important that businesses obtain the maximum funding upfront.

IMPACT: Reducing the investment period from seven years to three years, for investments up to €500,000, will incentivise investors to make a greater upfront investment. This would result in efficiencies regarding administration and the additional cost to the exchequer should be negligible, on the basis that it is simply bringing forward the relief to the investor. This will also give companies the certainty required to execute their strategy knowing that the required funding is in place.

Proposal (iv): Greater certainty for eligible companies and simplify the process

PROBLEM: We support the Commission on Taxation's concerns about the complexity of EIIS which it states 'can act as a deterrent for potential claimants". The need for certainty is essential in the operation of any tax relief. Currently, investors do not have certainty that investee companies will be able to retain EIIS status as they are subject to audit in subsequent years.

A key issue for early-stage start-ups is the cost of capital. In Ireland, the cost of capital is unacceptably high. For start-ups, their cost of capital is driven by the terms of investment and the time, effort and opportunity cost required to secure and manage the investor. As such, a streamlined EIIS process has the potential to reduce the cost of capital to innovation-driven enterprises and would be highly desirable. In the UK, tax advisers typically charge between £500 and £3,000 for completing an EIS application depending on the complexity of the company's circumstances, whereas in Ireland, the cost is on average €10,000 which is a deterrent to companies. In addition, a simplification and review of the rules around connected persons could be considered as part of the wider simplification process, and would bring about further certainty for applicants.

SOLUTION: To provide companies with certainty, we are recommending that a company is provided with a final confirmation that it is eligible for EIIS investment where the information provided to the Revenue Commissioners is correct and complete. Separately, the Indecon report states that "an amended enterprise investment scheme should involve a simplified application process to facilitate efficient decision making and approval should focus on confirming the eligibility of companies". It goes on to state that "a simplified process involving less restrictive conditions should apply for start-ups that are raising limited investments". We also believe the 108 page Revenue guidance document on EIIS needs to be simplified.

IMPACT: This would only involve one stage in the Revenue approval process and would increase the confidence of investors. Reducing costs involved in an EIIS application would incentivise more investments into early-stage tech companies and ensure more companies avail of the government incentives. The simplification of the guidance would facilitate more start-ups accessing the scheme.

A.2 Entrepreneur Relief

Proposal (i): Extension of Entrepreneur Relief to Angel Investors

PROBLEM: The most significant issue for all start-up and scaling companies is the attraction of early stage capital. This is identified as the number one issue facing company founders in the Annual Scale Ireland *State of Start-ups survey 2023*. In its report, the Commission on Taxation and Welfare accepted that the attraction of early stage investment is critical to the well-being of young start-up and scaling companies.

SOLUTION: Addressing the capital shortfall issues, the Commission recommended the extension of ER relief to angel investors. This will require the relaxation of working time conditions in the current tax statute. The Commission's recommendations are accompanied by a number of recommendations which the Alliance would be happy to discuss in the context of the Finance Bill.

IMPACT: In addition to providing young companies with access to necessary capital, the Alliance believes that such a move would also act as an incentive to the community of angel investors. A healthy and burgeoning angel investor cohort is a key component of a healthy and maturing ecosystem.

Proposal (ii): Replace €1m lifetime cap with a €1m per venture threshold

PROBLEM: The current cap on a gain eligible for Entrepreneur Relief at 10% is €1m over a lifetime. The Alliance believes this mitigates against a healthy ecosystem by discouraging serial entrepreneurship.

SOLUTION: The Alliance supports the replacement of the €1m lifetime threshold, with a per venture threshold of the same amount to encourage entrepreneurs to found new companies contributing further to the economic well-being of the state in terms of increased revenue, exports and employment.

IMPACT: The establishment of additional start-up and scaling companies.

A.3 Measures to increase funding in the €3-10m range

PROBLEM: The *White Paper on Enterprise* identifies a funding gap in the market in the €3-10m range. This view is shared by the Alliance. Last year the Department of Enterprise, Trade and Employment initiated a consultation into the finance challenges facing scaling companies. This funding gap represents a fundamental challenge to scaling companies. The IVCA Venture Pulse Survey for Q4 suggests a deteriorating investing market with a significant reduction in international funding.

SOLUTION: State intervention is critical to sustaining scaling businesses when there is a serious decline in investment. The Alliance recognises that this is a complex issue and that there is not a single silver bullet that will meet all of these challenges. We also believe that there is capacity for solutions involving both equity investments and venture debt. The latter is relatively underdeveloped in the Irish market. The Alliance is asking the Government to develop solutions to these serious funding challenges, as well as mobilising policies to incentivise private capital into the sector. These include:

- **The extension and refocusing of the Enterprise Ireland Seed and Venture Capital scheme** with a view to also providing an additional focus and approach on deals in this €3-10m range.
- **Increased focus by the Ireland Strategic Investment Fund (ISIF) on venture debt to support scaling companies** where an equity deal may not be appropriate. Along with equity, the evidence suggests venture debt can play a positive role in supporting scaling companies.
- **Further support and an expansion of the Strategic Banking Corporation of Ireland's risk sharing programme** to facilitate it supporting lending in this range.

IMPACT: Resolving this issue is critical to ensuring a scaling path for Irish companies which are expanding. Different solutions may suit different companies but a healthy Irish ecosystem should be in a position to address these varied needs. Finance is always the key priority of start-up and scaling companies. We need to ensure that there is finance available for every stage of a growing company's journey at this critical time.

A.4 Leveraging pension fund investment in domestic firms

PROBLEM: A mature scaling ecosystem should be able to draw on sources of funding from various sectors of the Irish economy. The Alliance believes that Ireland should be looking at expanding the sources of funding into the scaling tech sector.

SOLUTION: This proposal seeks to create a fund for investment in the indigenous tech sector by allowing payees in the state's new auto-enrolment system to designate certain proportions of their savings to funds geared at supporting local companies. Funds in receipt of state support through EI and other agencies are mandated to support Irish businesses. In the UK the authorities are actively engaged in ensuring that the proceeds from their auto-enrolment scheme help support UK businesses. Similarly, the Alliance argues that as part of the design of the proposed Irish Auto-enrolment scheme, this State mandate should extend to pension funds directly in receipt of direct Irish State funding or indirectly through tax reliefs.

IMPACT: We believe that over time pension fund savings could develop as a further source of capital to support indigenous economic development to the benefit of both investors and the wider economy. If there are more varied sources of capital, it will result in a more resilient ecosystem in the face of global shocks.

B. Retention and Recruitment of Staff

B.1 Redundancy Tax Credit

Given the recent job losses, it is critical that we seek to maintain those that have lost their positions within the Irish ecosystem. We believe that a targeted tax credit will facilitate the smaller scale indigenous tech sector to compete in the global recruitment market for this talent. We believe that a targeted tax credit will facilitate the smaller scale indigenous tech sector to compete in the global recruitment market for this talent.

PROBLEM: Despite the recent job losses, the recruitment and retention of staff remains the second main challenge for scaling and start- up companies according to our recent survey. Meanwhile, recruitment remains a challenge for scaling and start-up companies.

SOLUTION: The Alliance is proposing a short term 25% tax credit to start-up and scaling companies who take on an employee who has been made redundant from a company in the last 12 months. This would be time limited. While similarities exist between the sectors, there are significant cultural differences in terms of employment that might make companies reluctant to actively pursue these hires. We believe the credit is an appropriate short term response to encourage companies to recruit. Where the new employer has insufficient tax payable to cover the credit then any excess of the credit over tax payable, if any, would be refundable to the new employer. Thus the credit acts as an effective grant to the new employer in connection with the new hire.

IMPACT: This is potentially a double win for the state - facilitating redundant workers to gain new jobs, and facilitating recruitment into a critical sector of the economy.

B.2 KEEP/Share Options

Proposal (i): Increase the value for issued but unexercised shares from €6m to €12m or 20% of company equity (whichever is higher)

PROBLEM: One of the issues which has faced the successful implementation of the KEEP schemes are the narrow parameters in which it operates. While it might notionally work for early stage start-ups, it becomes problematic for scaling companies very quickly. These companies are then propelled into the same stock option environment as large multinational companies where the risk versus reward environment is entirely different. The Alliance has welcomed the changes to KEEP in last year's Budget but believes if KEEP is to meet its objectives in driving forward start-up and scaling companies, then we need to go further.

SOLUTION: There are two options being put forward by the Alliance. The first seeks to double the new threshold from €6m to €12m, in a manner consistent with the existing legislative framework. However, a preferred option might be to allow the awarding of share options in line with the growth in company equity, allowing companies to award options up to 20% of value.

IMPACT: Stock Options are critical in allowing start-up and scaling companies to be competitive in a difficult hiring environment. A functioning stock option environment is essential to a healthy ecosystem. Continued reform of KEEP until it meets the needs of the start-up and scaling companies is essential.

Proposal (ii): Remove the link between equity ownership and salaries under the KEEP scheme (S.128F, TCA 1997) and raise the cap on share options

PROBLEM: Cash-constrained start-ups 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 start-ups 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.

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. This would allow companies to utilise the scheme to attract the services of NEDs and key advisors.

IMPACT: This should allow the 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 (iii): 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 €6,000,000 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 start-up 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 6 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 (iv): The KEEP Scheme must be simple, clear, and easy to implement

PROBLEM: Early-stage start-ups 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 start-up 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.

C. R&D Tax Credit Scheme

C.1 Increase the cash reimbursement cap in year one

ISSUE: Monetisation of the tax credit is an important part of the R&D tax credit regime for start-up companies. The changes introduced in last year's Finance Act allow companies to claim up to €25,0000 or 50% of a claim in year one. The Alliance believes that the cash threshold has been set too low to be of substantial benefit to scaling companies.

SOLUTION: Increase the cash ceiling five fold up to €125,000.

IMPACT: This would act as a further incentivisation of R&D in line for SMEs with stated Government policy. It would also facilitate start-ups which are concentrated on R&D, but often have cashflow difficulties as they invest their solutions.

C.2 Amend Section 766, TCA 1997 to ensure appropriate overhead and other relevant costs are permitted in the calculation of R&D tax credit claims

ISSUE: Revenue has taken the position that rent and many other overheads do not necessarily qualify in calculating the R&D Tax Credit. The concern appears to stem from the reference in S.766, TCA 1997, to qualifying expenses being expenses "incurred wholly and exclusively in the carrying on of R&D". This position has developed over time and it is now necessary to address the matter as it 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: Delete the reference in S.766, TCA 1997, to expenses *"incurred wholly and exclusively in the carrying on of R&D" and replace it with something along the lines of* ***"expenses incurred in performing R&D".***

IMPACT: This change would introduce an important clarification in the R&D scheme and reflect the real cost of R&D undertaken.

C.3 An increase to €125,000 in the science test exemption for companies in receipt of EI/IDA grants

ISSUE: The existing provision within Revenue guidance that allows companies in receipt of IDA or Enterprise Ireland innovation grants up to the value of €50,000 is a valuable and possibly underused provision of the R&D code. We believe there is the potential to considerably reduce the administrative burden on scaling companies and help de-risk the R&D scheme from their perspective.

SOLUTION: To further enhance the value of these provisions and to support companies growth potential in the sector we would like to see the cap pertaining in this area increased to €125,000 which would bring it in line with the average relief amount afforded to companies.

IMPACT: This would simplify the application process enormously for a cohort of companies and encourage additional R&D activity which has been identified by the government as a key target in its White Paper on Enterprise.

C.4 Cap on eligible subcontractor costs

ISSUE: The 2019 OECD review identifies the limits on credits for spending on third party subcontractors and third level institutions as mitigating against SME involvement. The allowable credit in this respect was increased to 15% in the 2019 Finance Act. However, this increase only benefits large companies with an internal R&D spend of greater than €666k and does little to incentivise the majority of claimants who fall way below that threshold. For SMEs, the cap is in reality €100k or, if their internal spend is less than that, the cap is the internal spend. While we acknowledge that the purpose of the regime is to promote employment in STEM across the state, for SMEs, it is very difficult to compete.

Multinationals availing of the credit can offer far greater salary and job security to the specialist R&D staff required. Quite often SMEs need to develop at least a minimum viable product to get funding and then be able to commit to full time employees. They spend a far greater amount on contractors as a result, in the earlier stages of their life, and the regime needs to be adjusted to ensure these companies are given the opportunity to achieve those employment targets as time goes on. The legislation should also be adjusted to provide for the possibility to fully outsource a project which is currently not possible.

SOLUTION: Remove the reference to internal spend and place the cap at €100k of subcontractor costs. Given the nature of scale-up companies, the founders and core technology specialists often draw no salaries. Therefore although their effort is 100% R&D their internal spend can be close to zero resulting in them being excluded from the regime entirely. This would improve the regime for the SME sector while resulting in no claim increases among larger claimants. The Alliance sees no intrinsic reason why such a limitation should apply to subcontracting credits, as long as the activity subcontracted is consistent with the underlying purpose of the scheme.

IMPACT: Once again, this change would incentivise additional R&D activity in the sector in line with the Government's ambition for greater levels of innovation.

D. Sustainability

D.1 The introduction of a tax credit scheme geared towards micro and SMEs to have a sustainability plan with KPIs

PROBLEM: Despite the range of supports being offered by various state agencies to companies to develop sustainability action plans, (supports actively promoted by Scale Ireland), the importance of sustainability planning is still being crowded out by the myriad of time based challenges facing start-up founders. This clearly is not good for the environment. It is also not helpful for companies that will face ESG related issues later in their company's journey when investors focus on their environmental supply chain.

SOLUTION: The Alliance believes that a carrot of a tax credit should be offered to companies who have put goal orientated sustainability plans in place. Whether a company had availed of the credit could become a useful test for investors to apply in making investment decisions. The plan must be put in place within 3 years of the company being set up. However, companies already established beyond that time period will be eligible to apply for the credit within a 2 year period of its introduction.

IMPACT: Early adoption of sustainability planning will be of benefit to companies in an increasingly green economic system and to broader public policy sustainability goals.

D.2 Enterprise Ireland should ringfence dedicated funding under its HPSU scheme for companies with sustainable solutions

PROBLEM: Climate tech is one of the fastest growing sectors of the tech industry. **The State of European Tech report for 2022** indicated a four fold increase in investment levels over the 2018 figures. Climate tech attracts more investment than any other SDG related goal. It is critical that Ireland plays a key role in this sector and the Alliance acknowledges the work already being done by state agencies like Enterprise Ireland and the Irish Strategic Investment Fund. We believe that additional support for climate impacting entrepreneurship at an early stage sends a strong signal to founders that Ireland is ambitious about leading in this space.

SOLUTION: The Alliance proposes the establishment of a separate Climate Impact Fund by Enterprise Ireland at the HPSU level, which would send a signal to the market that we want more start-ups in this space. We also want to support entrepreneurs that are already active in this space. We believe such a fund would make a declaration of intent on the part of the state that it sees climate innovation as a key element of Ireland's climate mitigation, sustainability and biodiversity challenges.

IMPACT: This approach will help embed climate mitigation (and adaptation) at the heart of Ireland's climate migration and innovation strategies.

D.3 Raise awareness of European and Green financing options for SMEs

PROBLEM: Green financing is increasingly becoming a core element of financing options for scaling and more mature companies. Globally, the taxation of financing products is becoming increasingly linked to their sustainability performance. In 2021 the European Union signed off on a new Green Bond standard with a view to augment and raise the standards in the green bond industry. Awareness, however, of these initiatives in Ireland is at a relatively low level.

SOLUTION: The Alliance believes that green financing will become an increasingly important opportunity for start-ups and scaling companies in the years ahead. We wish to see Irish companies avail of these opportunities for both environmental and business reasons. It is an area we will be giving increasing attention to in the future. As a first step, we are calling on the relevant state agencies to develop an Irish policy on green financing, making founders and companies aware of the opportunities available to them and the advantages of green bonds.

IMPACT: Green financing has an important role to play in the development of sustainable companies and standards. Ireland needs to position itself as a leader in the development and utilisation of these products.

Conclusion

Budget 2024 presents an important opportunity to start our ambitious journey, as reflected in the recent statement of intent from Enterprise Ireland, to position indigenous enterprise to be the prime driver of growth in the Irish economy. We need to support this by ensuring that Irish tax policy supports Irish businesses at every step of their journey and that it accelerates the creation of strong indigenous enterprises from a base firmly rooted in Ireland. A dynamic, efficient, and fit for purpose Irish tax policy can facilitate the provision of resources, talent and capital for Irish enterprise to enable them to start, scale, innovate and internationalise their business.

Budget 2024 is set against a backdrop of start-ups facing significant funding challenges, as well as issues relating to recruiting and retaining staff and accessing key state schemes. It is imperative that positive measures are introduced to overcome these challenges which may prevent indigenous start-up and scaling companies from reaching their full potential in terms of expanding their operations and workforce, to the benefit of the Irish economy and society.

The Alliance believes that the proposals outlined in this document will play a role in achieving this and nurture start-ups and scale-ups by giving them the appropriate environment and supports to position them to become global players whilst creating valuable IP, talent pools and revenue generating activities in Ireland. It will create a resilient cohort of companies built to thrive for generations to come and play a key role in the future economy, taxation intake and employment levels in Ireland. Our shared objective is for Ireland to be a great place to start, scale and internationalise a business.