EIS tax relief
My purpose in writing is to draw your attention to the situation pertaining to EIS tax relief. Currently an investor investing in an eligible SME gets 100% tax relief on their investment in the new business. (So for £100k invested at 45% income tax rate the investor gets a cheque from HMRC for £45k)

However, said investor can then sell the investment after three years and any profit is also tax free. So far so good for the investor.

But for the new SME it is a somewhat different story. Three years for the new company is absolutely nothing. It is still too early for regular dividends in the shares, which would give the investor an income. There is not yet enough money in the company to buy back the shares and what frequently happens is that the fledgling independent company is sold to a large group, often a competitor. Frequently the buyer is based abroad, so all the R&D, strategic management and profit is taken out of the country. The entrepreneur is no longer incentivised, and frequently the management team is broken up or reduced as it is subsumed into a bigger company, in the interests of efficiency and cost saving. And all the creativity of a new start company is subsumed into something much bigger, possibly being sold on to somebody else a few years later.

Much has been said about the German system of medium-sized usually family businesses which invest for the long term and are the backbone of Germany’s economy. The EIS system is the antithesis of such a system. What a new start company really needs is long term investors who will still be around 10, 15 or even 20 years later. This provides the stability for growth and allows the company to grow organically instead of continually being bought and sold, which is very destabilising.

I think attention should be given to amending the EIS scheme. As a minimum, the minimum period of investment should be considerably longer than three years. But I am sure a bit of creativity in the tax incentive department could produce positive incentives for an investor to put money into a new start for the long term, not the short term as at present. For example, instead of giving back the initial tax refund immediately it could be spread over several years, and perhaps even increased, with the balancing proviso that there was no longer any relief available on any profit when selling the shares.

The fundamental problem is that as currently designed EIS is an incentive for short term capital growth, not long term investment. In short, just a wee detail lever which could make a long term difference to SME start-ups in this country.

Micro distilleries duty
As you will be aware there is a scheme throughout the UK for microbreweries which discounts the alcohol duty to brewers which satisfy certain conditions inter alia size,
litres produced, ownership. In the US and Europe a similar scheme exists for micro distilleries, which has stimulated the sector considerably.

There has been very little growth in the whisky industry for decades and the barriers to new entrants to the sector are enormous.

The government should implement a micro distillery concession scheme, discounting the alcohol duty payable by 50% (similar to microbreweries). This would provide a long term stimulus to the sector, increasing new starts and innovation.

Existing players like Diageo will resist (as they have resisted minimum pricing) but this proposal is no threat to them. Indeed any broadening of the market at the niche end will probably only serve to expand the overall market which will benefit them more than anybody.

I hope you will give this your consideration.

**FCA rules around share offers**

In considering the economic future of Scotland I would like you to bear in mind the following.

Very small businesses can set up in a garage or off the kitchen table funded entirely by the founder(s) and their immediate family. Large businesses organise a share issue for which they have to receive approval from the FCA in order to make a share offer.

SME start-ups requiring more capital than available from immediate family can only sell shares following a request from a "sophisticated investor". This is because the compliance required by the FCA for a share offer is so involved and complex that it is extremely expensive and unless the project needs a lot more than £10 million in equity it is usually not a practical proposition. So for projects up to £10 million the options are not great. Either spend around £250-300k in compliance or await approaches from "sophisticated investors". Many projects simply fail to achieve the investment required because they are not allowed to advertise or otherwise make people aware of their wish to sell shares.

Bearing mind that these regulations were put in place to protect unsuspecting persons from uncontrolled risk of losses, and bearing in mind the banking sector’s recent failures in spite of this protection, perhaps it is time the FCA realised they cannot play god and decide which investments may be advertised and which may not. Many ordinary people lost eye-wateringly large sums of money in the recent banking crash, which would tend to suggest that no business can be free of risk. Accordingly surely the FCAs role should be limited to policing abuses, giving advice where required or requested, and allowing SME start-ups the means by which to make themselves known to the public.

The current situation simply means that the number of new starts is limited by the difficulties of access to investment. And that does not help anybody.

Peter Brown, February 2014