FANTASY BUDGET

COMPETITION 2020

University College Cork

Niamh Clifford
Jeremiah Clancy
Avril Bergin

Table of Contents

Introduction

This report outlines some of the key measures introduced in Budget 2020 by Minister Paschal Donohue. We have analysed the impact of the change to the Capital Acquisitions Tax threshold to individuals and families; the increase in the Research &Development (R&D) credit for SMEs; and the implementation of new legislation regarding hybrids and transfer pricing largely affecting Foreign Direct Investment (FDI) in Ireland. In addition, we have outlined the taxation measure which we would have implemented as Minister for Finance to alleviate the housing crisis and encourage regional development - double deduction of rental expense for business purposes.

1. One key measure that impacted the individual/family

One key measure introduced was the change to the Capital Acquisitions Tax threshold. It has been increased from €320,000 to €335,000. This increase only affects the threshold for Group A. Group A applies where the beneficiary, the person receiving the benefit, is a child of the person giving it. This means that children will be able to inherit, or receive a gift, of an additional €15,000 from their parents free of tax. Capital Acquisitions Tax is charged at 33% on gifts or inheritances made on or after 6 December 2012. (Moneyguide Ireland, 2019)This only applies to amounts over the group threshold. No changes were made to either Group B threshold, which applies where the beneficiary is the grandparent, brother or sister, or nephew and niece, or Group C threshold, that applies to any relationship not included in Group A or Group B. (Citizens Information, 2019)

For example, if you receive gifts from your parents with a taxable value of €500,000, you only pay tax on the amount over the appropriate group threshold. Therefore, €165,000 is taxed at 33% whereas previously €180,000 was taxed at 33%, resulting in a net benefit of €4,950. This increase is set to cost the exchequer about €11.2 million on a full-year basis. (Reddan, 2019)

It had been suggested in previous budgets that the Group A threshold would increase towards €500,000 similar to the 2009 figure, the latest increase in the threshold is up by 4.7 per cent on the previous year. The threshold is still quite low by international standards, but it is a movement in the right direction according to Liam Lynch, tax partner with KPMG (2019). The tax-free threshold for benefits from parents to children peaked at €542,544 in 2009 and was slowly eroded in the following years. However, the last three budgets have all brought increases to this threshold so with continued growth we can hope to see this threshold return to its circa 2009 levels.(Reddan, 2019)

The relatively low level of the threshold means that the exchequer’s yield from capital acquisitions tax (CAT) has been soaring, and reached a record high in 2018, up to some €466.3 million on the back of soaring property prices and largely unchanged tax-free thresholds. This was up by 48% on the Celtic Tiger era in 2007, and by 10% on 2017.(Reddan, 2019)

It should be noted however, that Group B accounts for approximately 50% of inheritance receipts so it is clear to see that the Government has been clever in extending the threshold for group A claimants only, as the figures show this is not the big CAT earner.(Reddan, 2019)

Historical CAT thresholds

	2009 (up to 7 April 2009)	8 April 2009 to 31 December 2009	1 January 2010 to 7 December 2010	8 December 2010 to 6 December 2011	7 December 2011 to 5 December 2012	6 December 2012 to 13 October 2015	14 October 2015 to 11 October 2016	12 October 2016 to 9 October 2018	10 October 2018 to 9 October 2019
Group A	€542,544	€434,000	€414,799	€332,084	€250,000	€225,000	€280,000	€310,000	€320,000
Group B	€54,254	€43,400	€41,481	€33,208	€33,500	€30,150	€30,150	€32,500	€32,500
Group C	€27,127	€21,700	€20,740	€16,604	€16,750	€15,075	€15,075	€16,250	€16,250

2. One key measure that impacted indigenous Irish business

The long sought after amendments to the research and development tax regime is a measure which we believe has impacted indigenous Irish business. The R&D credit is being amended for micro and small companies to increase the 25% R&D credit to 30%. Furthermore, R&D relief will now be available for certain pre-trading expenditure against VAT and payroll tax liabilities. (Department of Finance, 2019)

This change follows criticism as to the ability of SME's to access this relief, with multinationals previously benefitting the most, accounting for 75% of the relief claimed. The R&D credit has often been seen as complex, with many claimant companies facing difficulties. (Irish Tax Institute, 2019)

According to KPMG's Innovation Monitor, which consisted of a survey carried out by Red C Research, of the 100 Irish SMEs surveyed, only 55% of the participants said that they had claimed the R&D tax credit since its introduction in 2004. All of these were in receipt of R&D grant funding from Enterprise Ireland, but of those who had actually claimed their R&D tax credit, 58% admitted that they had not claimed the credit for all those activities they were receiving the Enterprise Ireland grant for. (Flanagan, 2019)

Similarly, recent research by the ESRI found that only 7% of Irish owned companies surveyed in 2016 had invested in the critical areas of innovation and research and development. (Irish Tax Institute, 2019)

According to Caroline O'Driscoll, a tax partner at Deloitte, these amendments are "are a welcome step in the right direction in terms of supporting small, indigenous Irish businesses and allowing innovation to prosper within our start-up and scale-up eco-system. The relief is an important stimulus for investment and in creating new and sustaining existing employment."

The restriction on outsourcing R&D work has also been increased from 5% to 15% of R&D spend or €100,000 (whichever is greater), where the R&D provider is based in a third level institution. This applies to all companies regardless of size. (Pogatchnik, 2019)

This should act as a stimulant for collaboration between universities and businesses, as well as supporting those businesses who rely on outsourcing for R&D. It is hoped that it will encourage R&D activities in the third level sector and assist with future resilience and growth.

3. One key measure that impacted foreign investment into Ireland

In his Budget Day speech, Minister Donohue confirmed his continued commitment to take action on the measures outlined in the Department's publication in 2018 – Ireland's Corporation Tax Roadmap. The two areas of reform in this year's finance bill will be surrounding transfer pricing and anti- hybrid rules. (Kelly, 2019)

The new legislation will be implemented following the recommendations set out in the roadmap and the results of the Department of Finance Feedback Statement, which was issued in July following consultations with taxpayers. Irish policymakers are seeking to transpose the anti-hybrid provisions and transfer pricing rules in a way that will minimise complexity as much as possible. (Roche, 2019)

BEPS represents the biggest change in the global corporate tax system in a century. It seeks at its core to ensure that the companies' profits are aligned with the substance of their activities. (IBEC, 2019)

Ireland is required to introduce the new legislation in accordance with the EU Anti-Tax Avoidance Directive ("ATAD"). The anti-hybrid provisions essentially seek to prevent taxpayers from engaging in tax system arbitrage whereby a taxpayer seeks to exploit differences in countries tax systems to benefit either from a double tax deduction or a tax deduction without inclusion of the payment as taxable income of the recipient. (A&L Goodbody, 2019)

Ireland's transfer pricing rules will be amended to transcribe the OECD 2017 Transfer Pricing Guidelines into Irish legislation. The rules will also be extended to cover cross-border non-trading and material capital transactions, and to extend the application of transfer pricing rules to SMEs, subject to a Ministerial Commencement Order. (Chartered Accountants Ireland, 2019) The alignment of the Irish transfer pricing rules is a positive step given the increasing focus of "substance over form" underscoring BEPS Actions. (Kelly, 2019)

The Summary of Taxation Measures 2020 expects additional tax revenue of €10m for 2020 from the introduction of the anti-hybrid rules and the modernisation of the transfer pricing rules. (Government of Ireland, 2019)

However, it is important that guidance is given on this new legislation as it will have a significant effect on taxpayers. A key focus will be on ensuring that the scope of the legislation does not depart from the Directive unnecessarily and therefore threaten Ireland's competitiveness globally.

Ireland is heavily reliant on international companies' tax receipts. Ireland needs to aid companies in navigating the increasingly complex international tax environment. 45 percent of Ireland's corporate tax receipts come from ten companies, most of which are international. This dependence means that Ireland especially needs to ensure that through clarity and consistency in interpreting new directives, we remain an attractive country to do business in.

4. A measure that the Minister should have introduced

In Budget 2020, we would have introduced a tax incentive to encourage companies to expand and set up in regions outside of Dublin. We believe that this would help alleviate the current housing crisis which primarily impacts on Dublin and surrounding counties and attract further FDI to Ireland which is of particular importance in these economically uncertain times.

Our proposal is the introduction of a double tax deduction of rent for commercial buildings for companies that fulfil the below criteria;

- the above deduction is available to all companies that pay corporation tax in Ireland
- the property in question must be situated more than 100km from Dublin City Centre.
- the double deduction is available to existing companies who fulfil the criteria and also to companies who are opening new offices because of the incentive
- if the deduction results in a net loss before taxation for the company, this loss can be carried forward to offset against trading profits of future years.

Practical application of the above principle

A company has taxable profits €100,000. Corporation tax payable at 12.5% - €12,500.

Rent expense incurred €20,000.

Applying the proposed incentive, taxable profits are now €80,000. Resulting in a corporation tax liability of €10,000. Thus, an overall saving of 20% in Corporation Tax payable is incurred by the company.

We believe that this incentive is significant enough to have a real effect on a company's strategic decision making. The cost of a physical location is one of the highest expenses that all companies incur and even though the existence of virtual workspaces is emerging, this phenomenon is relatively new and the majority of companies still have a bricks and mortar location.

Anticipated Results

The housing crisis is of increasing concern to the country affecting every strata of society. We believe that this incentive through the creation of more jobs outside the pressure zone that surrounds Dublin will help alleviate the housing crisis.

Average rents for a property in Dublin were approximately €700 higher than in Cork in Q1 of 2019. It is estimated that the level of supply needed to keep Dublin rents at their current level is 1,000 rooms per week. The current level of supply is only 500 rooms per week, implying that rent prices in the capital will continue to soar.

Rent prices outside of Dublin are also on the rise, however not proportionally to the staggering upward incline which has been observed in Dublin over the last 5 years. If companies were to expand or relocate outside of Dublin and the surrounding commuter belt, it would be of great financial benefit to the employees.

From 2018 housing statistics, the most expensive property to rent in the country was in Dublin 2, where rent for a five-bedroom house averages €3,496 per month. In contrast, the average rent for a similar property in Kerry, was €869 per month. (Daft.ie, 2019)

Average rents, and year-on-year change, Q1 2019

- Dublin: €2,002, up 6.8%
- Cork: €1,331, up 10.0%
- Galway: €1,260, up 11.4%
- Limerick: €1,195, up 14.4%
- Waterford: €986, up 13.6%
- Rest of the country: €968, up 9.7%

(Hamilton, 2018)

The incentive could also aid existing companies situated in more rural areas to expand as excess cash flows would be present in the company due to a decrease in taxable income; further employment in rural regions which will help combat rural depopulation.

Many of our rural towns have vacated business premises falling into disrepair through non-use and this would have the potential to incentivise business to locate in these areas and regenerate the economy of rural Ireland.

Additionally, in complying with EU competition law, this incentive could also attract new companies to Ireland thus further increasing our economic stability.

The regeneration of struggling rural economies and the easing of the capacity pressures in Dublin and surrounding areas should be a “win –win” outcome for Ireland's economic development.

Similar to any taxation measures; the impact would need to be kept under review and revised as needed after any such review e.g. reduced VAT rate for the Hotel industry.

Bibliography:

A&L Goodbody, 2019. *Finance Bill 2019.* [Online]
Available at: https://www.algoodbody.com/insights-publications/finance-bill-2019
[Accessed 30 October 2019].

Chartered Accountants Ireland , 2019. *Corporation tax measurements (Budget 2020).* [Online]
Available at: https://www.charteredaccountants.ie/News/corporation-tax-measures-(budget-2020)?AspxAutoDetectCookieSupport=1
[Accessed 2019 October 28].

Citizens Information, 2019. *Capital Acquisitions Tax.* [Online]
Available at:
https://www.citizensinformation.ie/en/money_and_tax/tax/capital_taxes/capital_acquisitions_tax.html
[Accessed 15 October 2019].

Department of Finance , 2019. *Budget 2020 - Tax Policy Changes.* [Online]
Available at:
http://budget.gov.ie/Budgets/2020/Documents/Budget/Budget%202020%20Tax%20Policy%20Changes.pdf
[Accessed 22 October 2019].

Flanagan, D., 2019. *Budget 2020 and the R&D tax credit.* [Online]
Available at: https://home.kpmg/ie/en/home/insights/2019/09/budget-2020-and-the-rd-tax-credit.html
[Accessed 23 October 2019].

Government of Ireland , 2019. *Budget 2020 - Summary of 2020 Taxation Measures.* [Online]
Available at:
http://budget.gov.ie/Budgets/2020/Documents/Budget/Summary%20of%20Budget%202020%20Taxation%20Measures%20-%20Policy%20Changes.pdf
[Accessed 1 November 2019].

Hamilton, P., 2018. *Average rents reach all-time high of €1,304 per month.* [Online]
Available at: https://www.irishtimes.com/business/economy/average-rents-reach-all-time-high-of-1-304-per-month-1.3598655
[Accessed 2 November 2019].

IBEC, 2019. *The Budget 2020 Priorities,* s.l.: IBEC.

Irish Tax Institute, 2019. *Irish Tax Institute Pre-Budget Submission.* [Online]
Available at: https://taxinstitute.ie/wp-content/uploads/2019/08/ITI-Pre-Budget-2020-Submission-30Jul19-FINAL.pdf
[Accessed 20 October 2019].

Kelly, L., 2019. *Ireland Inc. and Foreign Direct Investment.* [Online]
Available at: https://www2.deloitte.com/ie/en/pages/tax/articles/budget-fdi-ireland-inc.html
[Accessed 26 October 2019].

Moneyguide Ireland, 2019. *Inheritance Tax in Ireland.* [Online]
Available at: http://www.moneyguideireland.com/inheritance-tax-in-ireland.html
[Accessed 17 October 2019].

Pogatchnik, S., 2019.*Micro and small firms get R&D credit boost from Budget 2020.* [Online]
Available at: https://www.independent.ie/business/budget/news/micro-and-small-firms-get-rd-credit-boost-from-budget-2020-38574581.html
[Accessed 24 October 2019].

Reddan, F., 2019. *Inheritance tax: Tax-free threshold set to rise by €15,000.* [Online]
Available at: https://www.irishtimes.com/business/economy/inheritance-tax-tax-free-threshold-set-to-rise-by-15-000-1.4043920
[Accessed 18 October 2019].

Roche, S., 2019. *What does Budget 2020 mean for FDI?.*[Online]
Available at: https://www.pwc.ie/budget-2020-ireland/fdi.html
[Accessed 20 October 2019].