June 2023

Pre-Budget 2024 Submission

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About the Irish Tax Institute

The Irish Tax Institute is the representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 32,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, the Taxation Institute of Hong Kong, and the South African Institute of Taxation. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

Introduction

Despite the extraordinary resilience of the Irish economy in the face of a succession of unprecedented crises over the last five years, there is no room for complacency. As the Government's background papers for this year's National Economic Dialogue pointed out, geopolitical tensions, rising protectionism, inflation, and supply chain challenges are reshaping the world economic order. As a small, highly globalised, advanced economy, Ireland is at the mercy of these forces without any capacity to control or influence them.

These external risks amplify well documented internal economic vulnerabilities such as the over dependence on a small number of multinational companies for employment and tax receipts, emerging budgetary pressures as the population ages, and the cost of meeting the country's climate targets.

Against this precarious backdrop, the Government will need to do all it can to make the economy more resilient. Attracting foreign direct investment (FDI) will remain key but the second prong of a balanced and sustainable growth strategy must be a laser-like focus on building productivity and innovation in the indigenous sector.

Tax is central to both these objectives and unlike the external forces buffering the Irish economy, there is much policymakers can do to enhance the Irish tax system and make it more competitive in a post-Pillar Two[1] world.

Building Productivity and Innovation in the SME Sector

Over-reliance on the multinational sector is, by common consent, a top risk to the resilience of the Irish economy. The most sustainable strategy for mitigating that risk is to build an innovative, productive, and competitive indigenous sector.

That was the purpose of the range of enterprise tax measures introduced by successive governments over the last decade. But despite some welcome amendments in recent years to the Employment Investment Incentive Scheme (EIIS), the Key Employee Engagement Programme (KEEP), the R&D Tax Credit and CGT Entrepreneurial Relief, these vital supports for Irish businesses are still not working as intended.

[1] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

The Institute welcomes the commitment by the Minister for Finance, Michael McGrath T.D., to take a fresh look at the tax measures and we hope that changes can be made to make them more accessible and effective for Irish SMEs.

In our Pre-Finance Bill Submission[2], we have set out in detail the legislative and administrative changes that we believe need to be made to each scheme. But there are some underlying issues that beset the whole suite of measures, which, if addressed by the Minister's review, could unleash their potential to provide a significant boost to productivity and innovation in the indigenous and create synergies with the multinational sector.

Administrative complexity

Notwithstanding recent amendments to both the EIIS and the R&D Tax Credit, the administrative burden involved in both schemes continues to be a significant barrier for small and micro businesses. We know from business owners that the administration involved in availing of the EIIS is extraordinarily onerous and time consuming. A streamlined process that uses non-mandatory template forms (for business plans, cashflows etc) could make the process much easier for small companies who need this support to access much needed finance.

In the case of the R&D Tax Credit, the current 'one size fits all approach', irrespective of the claimants' size, is not working. Small companies do not have the experience nor the capacity to document their costs and processes to the same standard as larger companies operating in highly regulated sectors like life sciences and financial services. Yet the same accounting test applies. We believe simplified documentation requirements that would not be such a drain on resources would improve the uptake of the R&D Tax Credit among start-ups and SMEs.

We also recommend the introduction of a pre-approval process by Revenue for first-time R&D Tax Credit claims by small and micro companies. This would reduce uncertainty and the risk of an expensive Revenue audit for these companies.

The impact of non-compliance can be disastrous for small companies. For instance, in the case of the EIIS, administrative errors or delays in the reporting process can result in a full clawback of relief on the fundraising company. Penal sanctions like this are disproportionate and make the risk involved for small companies not worth the trouble and expense.

In general, the complexity involved in the administration of SME measures demonstrates a singular lack of understanding of the pressures business founders face in getting a business off the ground and the ongoing management of that business.

Barriers to development

The effectiveness of the full suite of existing SME supports is hampered by restrictions to a greater or lesser extent. For example, Start-Up Relief for Entrepreneurs (SURE), the income tax refund for those who start their own business is restricted to former PAYE workers. It is difficult to fathom why new business founders who were previously self-employed should not be able to benefit from this refund.

The EIIS does not allow capital losses to be offset and only allows investors to exit by way of a share redemption or a trade sale. The connected party rules have been amended but they continue to curtail investment by non-executive board members and key employees who can play an important part in the development of early-stage companies.

2 Irish Tax Institute Pre-Finance Bill Submission to the Minister for Finance - 31 May 2023.

Meanwhile, Revenue guidance issued in July 2020 only allows the rent of specialised premises such as a laboratory or clean room to qualify as an allowable expenditure under the R&D Tax Credit. The idea that R&D work can be carried out at a desk in an office is not countenanced under the rules of the credit and suggests a narrow understanding of the nature of R&D undertaken in a technology driven world.

The requirement that an investor must spend at least 50% of their time over three years working for the company in which they invest in order to qualify for Entrepreneur Relief effectively rules out angel or venture capital investors for SMEs. Such investors typically support several businesses at the same time and are not interested in fulfilling an onerous working time requirement.

At a time when start-ups are having difficulty raising funds, it makes no sense for the country's entrepreneurial incentive to lock out external investors who provide invaluable advice as well as finance to business founders.

The Institute welcomed the amendments to KEEP enacted in Finance Act 2022 which addressed some key limitations of the scheme. These changes have yet to get State aid approval but even if they were to come into effect, KEEP remains a heavily restricted measure.

As pointed out in two consultations over the last four years, linking the amount of share options that can be awarded under KEEP to the employee's annual salary deprives high potential start-ups, who typically pay lower salaries in their early-stage development, of the opportunity to attract valuable talent.

In the current spate of redundancies in the multinational tech sector, it is unfortunate that KEEP acts as a barrier rather than an enabler for small companies seeking to recruit talented workers who might have an appetite to join the indigenous tech sector.

Out of step with the start-up economy

Requirements relating to company structures loom large in the difficulties experienced by companies seeking to avail of the SME reliefs:

- The EIIS excludes holding company structures.
- Entrepreneur Relief is not allowed where there is a dormant company in the group or where a company is party to a joint venture and holds less than 51%.
- Despite recent amendments to the KEEP, we believe that the revised definition of a "qualifying holding company" and a "qualifying group" in the legislation will continue to prevent certain companies from availing of the scheme.

The fact is that the requirements of the SME measures often do not reflect the way in which enterprises evolve and develop in a modern start-up economy. Companies can grow out of a variety of commercial arrangements, sometimes as a result of partnerships or joint ventures arising from incubator programmes. In some cases, the structure can be a legacy from a previous failed venture.

While this variety in company structures is not reflected in the legislation and Revenue guidance, it is recognised and accepted by other arms of Government who provide funding to SMEs and start-ups including Enterprise Ireland. At the very least, there needs to be a joined-up approach across Government on eligibility criteria for funding and tax measures for the SME sector.

In this context, the Institute strongly agrees with the recommendation of the Commission on Taxation and Welfare that Revenue, the Department of Enterprise, Trade and Employment and Enterprise Ireland should develop a mechanism which provides an assurance to small enterprises that they are eligible for tax incentives like the EIIS, KEEP and the R&D Tax Credit.

This would take the risk and uncertainty out of the process and allow entrepreneurs to concentrate on their businesses while benefiting from the incentives that were introduced to help them develop and grow.

The 12.5% Rate

The low corporation tax rate that applied across all businesses in Ireland over the last 20 years was critical to the success of the Irish economic model. The 12.5% rate which applied to a broad base of corporate income was compelling in its simplicity and in the certainty it offered to the numerous multinationals that have made this country their home over the last four decades.

It also forgave shortcomings in the Irish tax code and now that it is no longer available to these large multinationals, a spotlight has been shone on uncompetitive elements of the country's corporation tax regime that put Ireland on the back foot in the intensifying battle for global investment. In this submission, the Institute outlines the areas of the code that we believe require immediate attention and a strategy for enhancing Ireland's reputation as an attractive location to do business in a post-Pillar Two era.

A Territorial System of Taxation

The Government's immediate priority must be to retain the multinational businesses that are well embedded in the Irish economy and to attract new entrants to locate their operations here. That requires, at a minimum, that the corporation tax code is aligned with other EU Member States and in one significant respect, Ireland is very much out of step.

Ireland's worldwide system of taxation requires the foreign earnings of multinational companies based in the State to be assessed here for tax purposes. The rules which, in turn allow these entities to claim relief from double taxation on these earnings, are complex and difficult to comply with. Even though it has been acknowledged that the tax yield from this administratively burdensome exercise is negligible because of Ireland's extensive network of double taxation agreements.

In the past, the policy rationale for not adopting a territorial system of tax was the absence of rules to prevent the artificial diversion of profits to other jurisdictions. But the introduction of an array of anti-base erosion measures over the last five years, such as CFC rules, extended transfer pricing rules, the ATAD Interest Limitation Rule (ILR) and anti-hybrid rules have dealt conclusively with those concerns.

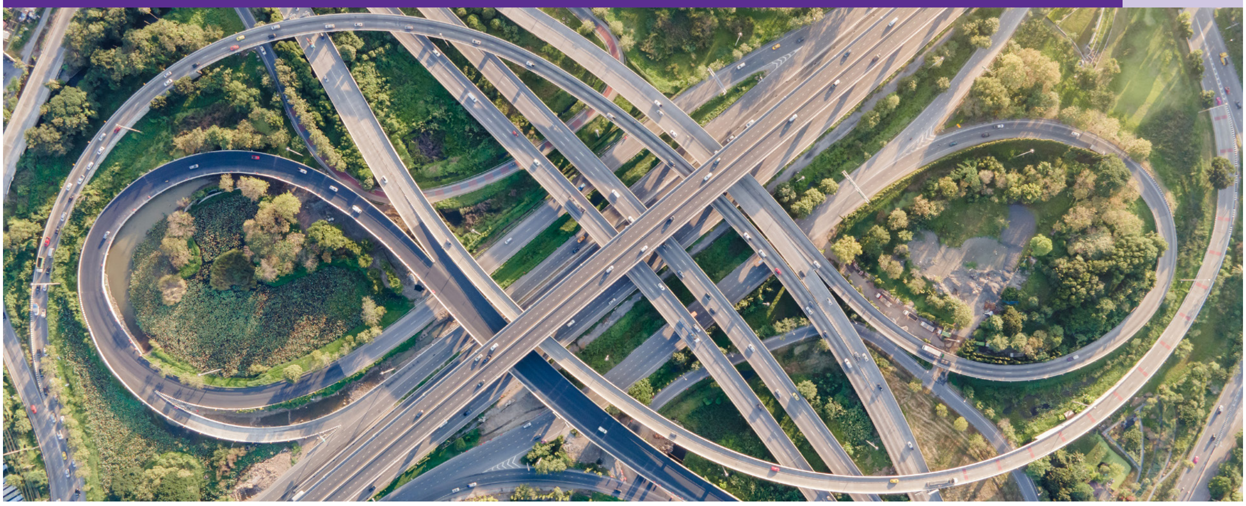
We have outlined in detail in our Pre-Finance Bill Submission, the key elements of a participation exemption for dividends and a foreign branch exemption which we believe are necessary to ensure that Ireland continues to attract foreign investment.

At present, multinational groups located here are evaluating the potential impact of Pillar Two on their businesses and making decisions on how to structure their operations. Ireland is now the only EU member state not to allow a participation exemption for foreign dividends and the Institute is aware through its members that competitor countries are seeking to exploit this gap in the country's corporation tax code.

To ensure Ireland remains a compelling location for these businesses, it is essential that at the very minimum, the Government introduces a participation exemption for foreign dividends in tandem with the implementation of the Pillar Two Minimum Tax in the forthcoming Finance Bill.

Now that Ireland can no longer differentiate itself on its corporation tax rate for larger multinational groups, ensuring the Irish tax code is on an equal footing with the tax regimes of international competitors has never been more important.

A Simplified Tax Code



Over the last decade, the proliferation of anti-avoidance measures arising from the OECD BEPS Project and the EU Anti-Tax Avoidance Directives (ATAD1[3] and ATAD2[4]) have added complexity and administrative burden to tax systems across the EU.

Achim Pross, Deputy Director of the OECD's Centre for Tax Policy and Administration has recently acknowledged the duplication that has occurred as tax rules have evolved and suggested that countries could do a "spring clean" of anti-avoidance rules to "declutter" their regimes.

[3] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

[4] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

The Irish tax code would certainly benefit from a rigorous spring clean and the first area to be decluttered should be interest deductibility provisions. The ATAD Interest Limitation Rule (i.e. 30% of EBITDA ratio rule), introduced in Finance Act 2021, was simply layered on top of existing, already comprehensive interest deductibility provisions. As a consequence, Ireland now has one of the most complicated and onerous interest deductibility regimes within the EU.

We believe retaining two separate interest limitation regimes on a permanent basis will increase the cost of borrowing for Irish businesses. We recommend the reformed interest deductibility provisions should reflect a broad base for interest deduction against both trading and non-trading income, using the protection of the ATAD Interest Limitation Rule against base erosion risks.

The Institute believes that a review of these provisions must be the top priority of an overall project of simplification. The current extraordinarily unwieldy regime is out of kilter with what is offered to taxpayers by our European counterparts and is a risk to the country's reputation as a location for business.

Complex and burdensome rules can hinder trade and investment and breed distrust among taxpayers. A strong focus on tax simplification and reducing compliance complexity would greatly enhance Ireland's ability to offer tax certainty and consistency to both domestic and multinational businesses, thereby boosting its competitiveness. Appropriate resources would need to be allocated to the Revenue Commissioners to undertake this simplification project.

Incentivising Sustainability

The imperatives of climate action have moved sustainability to the top of the agenda for businesses. Multinational companies are under shareholder pressure to decarbonise and to embed environmental, social and governance (ESG) targets in their business strategies.

Meanwhile, new rules requiring Irish SMEs to account for their environmental and social impact come into effect next year. The emission reduction targets set out in the European Commission's European Green Deal have been enshrined in Irish law and the Government's White Paper on Enterprise Policy, published last December, has set a target of 35% reduction in emissions from the manufacturing sector by 2030.

Robust climate action policies, including supports for green initiatives, have become key considerations for investors. Many jurisdictions are using tax incentives to support businesses in reducing their carbon emissions and to attract investment in green enterprises. In the Institute's view, Ireland's current offering needs to be more competitive. We have provided a list of the changes we recommend in our Pre-Finance Bill Submission, a selection of which are outlined below.

- The scope of the existing Accelerated Capital Allowance for Energy Efficient Equipment should be broadened to cover whole buildings that receive a recognised accreditation for overall energy performance as well as new product categories that meet recognised performance criteria.
- Existing business tax measures such as the EIIS should be amended to support green energy projects. For example, we believe there should be a carve out in "qualifying trading activities" for green or energy efficient specific projects that would permit companies that would not normally qualify for EIIS, to raise EIIS finance to invest in such projects and help their business to become carbon neutral.
- Expanding the corporate tax deduction available for expenditure incurred on the purchase of EU Emissions Trading Scheme (EU ETS) to include carbon offsets in the voluntary sector.

Apart from assisting businesses to decarbonise their operations, the tax system should be leveraged to take advantage of the new business opportunities emerging from the drive towards renewables and green tech.

- For example, the R&D Tax Credit should be enhanced to target green technologies and eco-product design. EU countries such as Spain, Portugal and Italy have customised their R&D regimes to favour the green sector.
- If Ireland wants to achieve the much-vaunted ambition of becoming a hub for green financing activities, the Government urgently needs to update Ireland's holding company regime to recognise the realities of the start-up economy where products and services are developed from scratch and significant investment is needed before trading can commence. The capital commitments required to develop early-stage renewable energy projects are considerable and companies undertaking them will often seek funding from private investors by selling a portion of their equity interest. Competitor jurisdictions such as the Netherlands and Luxembourg have reformed their systems to recognise the critical role this sector plays in climate innovation. Ireland needs to catch up.

The Personal Tax System

The personal tax system and the cost of employment is a key competitive factor for all businesses. In a post-Pillar Two world, the focus of multinational companies has moved to Ireland's comparatively high rates of income tax. In our view, if Ireland is to attract and retain FDI, the marginal cost of employment must be reduced for individuals and the businesses that ultimately bear the cost of employment.

The cost of employment is also a critical factor for indigenous companies and in an already tight labour market, the relatively high tax burden on middle income earners makes it difficult to attract talented workers. The Institute supports any measure that reduces the burden on middle-income earners without adding complexity to the system.

Reform of PRSI

The extraordinarily complicated PRSI system is unacceptably opaque and in urgent need of reform. In our view, the PRSI base should be aligned over a phased period with that of the USC and ultimately, merged with the USC as a social charge, notwithstanding the difficulties involved.

Consideration should be given to capping the level of earnings to which PRSI would be applied in the overall determination of a merged rate. In the meantime, any move by Government to increase PRSI must factor in the overall impact on the marginal tax rate and on the cost for employers of employing people in Ireland.

Broadening the base

The Institute has been drawing attention to the narrowness of Ireland's personal tax base for over a decade and we endorse the concept of base broadening in the Report of the Commission on Taxation and Welfare. We particularly welcome the Commission's finding on the importance of the principle of reciprocity which requires that everyone of working age who can work should pay income tax and PRSI according to their capacity. At a time when demand for public services is growing, it is not sustainable that this year, one-third of income earners will pay neither income tax nor USC.

Fairness and Equity

The Commission on Taxation and Welfare has said in its report that the 3% USC surcharge, which applies to self-employed income over €100,000, does not comply with the principle of horizontal equity and should be removed. The Programme for Government also accepts that it is unfair and contains a commitment to ameliorate it over time if resources allow. Now is the time to deliver on that commitment.

The CGT Rate

The tax that matters most to investors is capital gains tax (CGT) and the Irish CGT headline rate, at 33%, is one of the highest in Europe. This rate has remained unchanged since it was increased during the financial crisis.

The unwillingness of successive governments to reconsider the rate may be an understandable legacy of the property collapse in 2008 that precipitated the financial crisis and subsequent bailout. But, in our view, there is a strong argument for reducing the rate to 25% for active business assets. We believe this would encourage more mobility in business ownership resulting in increased innovation and productivity in the indigenous sector. It would also likely increase the yield.

Conclusion

Tax is not the only factor impacting the country's competitiveness and indeed, the lack of housing and infrastructure are emerging as major constraints on economic growth. Nonetheless, over the last 30 years, successive governments have made Ireland a compelling proposition for investors by fostering a business-friendly environment, investing in education and skills, and by providing a stable political system characterised by strong social cohesion.

The latest IMD World Competitiveness[5] rankings placed Ireland as the second most competitive overall among a group of 64 global economies that includes all main competitors. The rise from eleventh place last year and thirteenth, the year before is remarkable and is largely attributable to the very successful performance of the Irish economy for which we were awarded first place.

Among the categories that make up the IMD rankings is Government Efficiency for which Ireland was ranked third. But within that category, the competitiveness of the country's tax policy was ranked eighteenth out of 64. Tax policy is only one measure of competitiveness, but it is an important one. Few business decisions are taken without regard to their tax implications, and, unlike many other factors, the Government has the power to change it.

[5] IMD World Competitiveness Yearbook 2023 – Ireland.

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