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24 April 2025

Consultation on the development of the Department of Enterprise, Tourism and Employment's Statement of Strategy 2025-2028

Dear Minister

The Irish Tax Institute is grateful for the opportunity to share our ideas and recommendations as you embark on the development of your Department's Statement of Strategy for the next three years.

The economic context could not be more uncertain or hostile: Ireland's leading trading partner has upended the global trading order that fostered this country's economic success and now looks set to impose punitive tariffs on Ireland's highly productive and employment-rich pharma sector.

Worsening geopolitical tensions in response to President Trump's tariffs could quickly develop into a full-blown global trade war. Negotiations with the US administration and the postponed introduction of further punitive tariffs, will be led by the European Commission. But Ireland can and should work to influence the EU's response to ensure it inflicts the least possible damage on the European economy.

As the EU Member State most vulnerable to President Trump's America First Trade Policy, it is no exaggeration to say that any increase in US tariffs would be an existential threat to the

Irish economic model. Responding to that threat and seeking to mitigate it will be the defining challenge for the Government. The role of the Department of Enterprise, Tourism and Employment will be to ensure that businesses adapt and adjust so that they can compete in whatever trading environment emerges from the current state of disarray.

We welcome your recent announcement that the Government's Action Plan on Competitiveness and Productivity is being accelerated, and we look forward to its publication in advance of the Ministerial Summit on Competitiveness in July. We also welcome the measures you have taken to address increases in business costs, which have been especially difficult for the domestic sector.

Creaking public infrastructure and the shortage of housing are tangible constraints that are damaging Ireland's reputation as a destination for investment. They must urgently be addressed for the benefit of all citizens. But it is critical that policymakers do not lose sight of the reality that tax is a key consideration for prospective investors in any economy. It is also one of the few variables that the Government can control in a small, open economy like Ireland. The Institute would like to draw your attention to tax related proposals that we believe could boost the resilience of the economy in the face of this latest and potentially most damaging global crisis.

Protect Ireland's position as an attractive place to do business

Ireland has a world class record in attracting multinational investment, most of it from the US. As the Trump administration turns its back on free trade, we have no option but to join the race already underway among global economies, to build new trading links and reduce Ireland's over-dependence on the US.

We welcome your Department's recent announcement of measures to enhance international trade promotion and market diversification. But agility is essential. The Government must now use all the levers at its disposal to attract inward investment from new markets while ensuring that the many multinational businesses located in the State remain here.

Enhance the R&D Tax Credit

A key deciding factor in investment location decisions is the available incentive regime for R&D. Welcome as it was, the increase of the R&D Tax Credit rate to 30% in Budget 2024 merely maintained the value of the credit following the introduction of the Pillar Two global minimum 15% tax rate for large multinational companies. It did not improve the overall competitiveness of Ireland's offering, which has remained flat.

Meanwhile, competitor countries are either improving their regimes or introducing new incentives. The latest IMD World Competitiveness rankings, in which Ireland was placed 4th overall, highlights the comparative weakness of Irish investment in R&D: out of 67 countries, Ireland was ranked 31st for total expenditure levels.

It is also clear from the number of firms availing of the R&D Tax Credit, that it is not effective an as an incentive. The most recent statistics published by Revenue show that 1,631 companies claimed the credit in 2022 - only 88 more than the number of claimants in 2012.

The Programme for Government contains a commitment to examine options to enhance the R&D Tax Credit. That examination should get underway immediately, and action must quickly follow. Given the mobility of R&D investment, reform is urgent. In the current highly competitive trading environment, continuous benchmarking of Ireland's offering against key competitor jurisdictions is critical to maintaining existing and attracting future, high value investment in the Irish economy.

The Institute is currently preparing a detailed response to the Department of Finance's public consultation on the R&D Tax Credit and options to support innovation in which we will set out examples of approaches in other jurisdictions that could be adopted in Ireland. Once completed, we will share our recommendations with your officials.

Simplify the Irish corporation tax code

The clarity and simplicity of Ireland's iconic 12.5% corporation tax rate was fundamental to the creation of the modern Irish economy. It also forgave much in the tax code that has become increasingly complex over the last decade as a consequence of the OECD BEPS reform process.

At the Institute's Annual Dinner in late February, the Minister for Finance, Paschal Donohoe T.D. reiterated the Government's commitment to simplifying the tax system with a view to enhancing the country's competitiveness. Delivery of this commitment is critical. As the Department of Finance has warned, Ireland is vulnerable to increased competition for FDI within the EU, which could trigger a subsidies race in which smaller countries would lose out to the deeper pockets of larger Member States.

A simplified, transparent, innovative and competitive corporate tax system would be the single biggest advantage the Government could bestow on Ireland as the fight for foreign direct investment in new markets grows more competitive. We set out below the tax simplification measures that the Institute believes must be delivered in the next budget

Extend the geographic scope of the participation exemption

The Institute welcomed the introduction of the participation exemption for certain foreign distributions in Finance Act 2024. However, some improvements are needed to make the measure more competitive.

Limiting the geographic scope of the participation exemption to dividends received by Irish companies from their subsidiaries resident in the EU/EEA and tax treaty jurisdictions puts Ireland at a disadvantage to many of its competitors.

In addition, the restrictive qualifying conditions are likely to discourage taxpayers from claiming the exemption, thereby undermining the competitive objective of the measure.
It is important that these conditions are reviewed as a matter of urgency.

Adopt a foreign branch exemption

As Ireland does not have a foreign branch exemption at present, there can be significant differences in the timing and measure of taxable income for Irish companies between the head office and their foreign branches. This gives rise to tax uncertainty and complexity.

The Institute had strongly argued for a foreign branch exemption to be introduced in tandem with the participation exemption. However, the Department of Finance has said its review of the potential merits of a foreign branch exemption will be a multi-year project. We believe the time has come for the Department to set out a timeline for the introduction of a foreign branch exemption as a matter of urgency.

Reform Ireland’s interest deductibility provisions

Ireland has one of the most complicated interest deductibility regimes within the EU. In our view, it is damaging the reputation of the country as a location for investment. The Department of Finance concluded a wide-ranging public consultation at the end of January.

We are concerned that there is still no clarity on the timeline for completion of the Department's review and no indication of the prospects for reform.

We believe the Government must now set out a clear statement of intent to overhaul the legislative provisions to recognise that debt, and the payment of interest thereon, is a normal commercial reality and legitimate cost of doing business. In addition, a roadmap should be published outlining the changes envisaged with clearly defined milestones signposted.

Reduce the cost of employment

The cost of employment is a key consideration in investment decisions and over the last two budgets, good progress has been made in reducing the income tax burden on middle-income earners, in particular.

The Institute welcomed those reductions but at 52.1%, the effective marginal rate on salaries of €70,044 and above remains too high. We believe a marginal rate of tax (including social insurance contributions) set at 50% would make Ireland a more attractive location for inward investment and strengthen its capacity to compete for highly skilled and mobile labour.

The Special Assignee Relief Programme (SARP) is a critical part of Ireland's competitive offering to attract investment and the relocation of high-value employment to the State. It is important that the SARP is continually benchmarked against key competitor countries to enable Ireland to compete for talent on a global stage.

Given the high cost of employment in Ireland, it is vital that the benefits associated with existing share-based remuneration schemes are retained. Furthermore, it is essential that the complexity and administrative burden associated with operating such schemes in Ireland is minimised.

Support growth and innovation in the SME sector

Your Department plays a crucial and effective role in supporting the indigenous sector. In that context, you understand the critical importance of tax measures in building productive, innovative, and sustainable businesses that can compete in export markets and bring balance to the Irish economy.

In the current economic environment, we have no option but to move at pace to bridge the productivity and innovation gap between Ireland's MNE sector and its comparatively underperforming SME sector.

In our view, that requires a shift to a more supportive mindset across all parts of Government and public administration that will enable decision-makers to engage positively with business. There needs to be an understanding that risk is an integral part of any enterprise and that those who take it must be rewarded.

Ensure existing tax reliefs for SMEs achieve their policy objective

Over the last decade, successive governments have introduced a suite of tax reliefs and incentives aimed at building innovation, encouraging investment, and supporting business founders who take the risk of starting a small business.

It is fair to say that despite the best intentions of the administrations that introduced and subsequently enhanced them, these measures continue to fall short of their intended impact on the indigenous sector.

We have consistently called for legislative changes to make the reliefs less restrictive and more accessible to SMEs and start-ups. Some progress has been made but the pace of reform has been frustratingly slow. It is the Institute's considered view, that an overly defensive approach to the legislative design of these supports ultimately undermines their stated policy objective.

In our Pre-Budget 2025 Submission to the Minister for Finance, we outlined a selection of key legislative changes which we believe would encourage more investment in SMEs and make the current suite of measures more accessible to smaller companies.

The complexity and the administration involved in the SME tax measures deter business owners from pursuing their intended benefits. By way of example, Revenue guidance notes on the Employment Investment Incentive (EII) now run to over 100 pages. Few founders have either the time or the skills to navigate the application process and the cost of professional advice can put the scheme beyond the budget of a start-up.

Most of the measures impose severe penalties for any error in the convoluted qualifying or claiming processes. For example, the tax relieved can be clawed back in full for administrative errors in availing of EII. The risks involved in negotiating what can be a procedural minefield are prohibitive for most start-up businesses.

The eligibility criteria for some of the measures fail to recognise the reality of business structures in evolving start-up companies in which holding or dormant companies are formed for sound commercial reasons at certain stages of their development

Simplify the operation of share-based remuneration

Share-based remuneration can play an important role in rewarding key employees at all stages of development of a business. It can significantly reduce fixed labour costs and free up business cashflow. As recommended by Indecon[1], measures should be taken in the short term to enhance the attractiveness of the Key Employee Engagement Programme (KEEP) by providing greater clarity and guidance to SMEs particularly around share valuation. However, there are limitations inherent in the design of the KEEP which inevitably limit its uptake.

Consequently, it is important that the significant obstacles to the use of other types of share-based remuneration by SMEs and start-ups are dealt with such as addressing the upfront tax cost faced by employees on the receipt of a share award or on the exercise of a share option. For instance, Indecon recommended that the benefit-in-kind (BIK) rate on loans offered to employees for the purpose of funding costs associated with the purchase of shares in share-based remuneration plans should be reduced.

Reduce the regulatory burden

The EU's plan to boost competitiveness recognises the need to reduce reporting and other administrative burdens through simplification. The Government needs a similar plan that would require all arms of Government to business proof all legal, tax or administrative requirements.

The Institute fully supports the Programme for Government's commitment to establish a Cost of Business Advisory Forum which will include a review of all existing business taxes and costs and ensure that businesses are consulted before new legislation or policies are introduced that impact small businesses.

[1] Indecon Review of the Taxation of Share-Based Remuneration, 19 July 2024

Enhanced Reporting Requirements

Compliance processes of all kinds impose a burden on businesses. One recent example is Revenue's Enhanced Reporting Requirements (ERR), which came into effect on 1 January 2024, and requires employers to report details of certain non-taxable payments and benefits to their staff. We fully acknowledge the value of collecting data on non-taxable payments/ benefits and the need to ensure compliance with the tax rules for such payments. However, the stipulation that this information must be reported in real-time - which means on or before they are given to the employees - places a very significant administrative burden on businesses, particularly, smaller businesses.

Businesses are not opposed to providing this information but are concerned with the practical difficulty and associated additional costs of fulfilling these requirements in real-time and these concerns have been ignored. This has caused damage to Ireland's reputation as a good place to do business.

Changes made in Finance Act 2024 which raised the maximum value of the Small Benefit Exemption (SBE) by €500 and increased the number of permitted benefits from two to five were helpful, but uncertainty persists.

1. When is a working lunch an employee benefit? Revenue's view is that in certain circumstances it may be considered a benefit within the scope of the SBE. In which case, how is an employer to ascribe an accurate value to the benefit each employee has enjoyed from such a lunch – did the employee have a biscuit/cake as well as a sandwich etc? The practical difficulties are significant and the implications are not trivial: if an employer fails to report a non-taxable small benefit in real-time under ERR, a fixed penalty of €4,000 can apply.

2. The rules stipulate that only the first five benefits in any year can qualify for the exemption. Any additional benefit granted later in the year will be subject to income tax even if the cumulative value of all the benefits paid is less than €1,500.This means that a working lunch, which Revenue believes to be a benefit under the SBE could result in a voucher given to an employee at Christmas, for example as a reward for their work throughout the year, being taxable because the number of permissible benefits qualifying for the exemption has been exceeded.

We do not believe this is the policy intention.

Revenue paused the imposition of penalties for 2024 to give employers time to adjust to the new ERR rules. But the reality is that an employer who inadvertently omits to report any small benefit or payment made to an employee of the remote working daily allowance and business travel and subsistence expenses, all of which are non-taxable, faces a €4,000 penalty even though there may be no risk of an underpayment of tax. Furthermore, as the payments/ benefits must be reported in real-time, a penalty could apply even where an omission is discovered by an employer and subsequently reported to Revenue at the earliest opportunity.

In our view, this sanction is disproportionate and places an inordinate burden on smaller businesses that have limited resources. We strongly urge that the level of this penalty be reconsidered by Government and replaced with a more appropriate sanction.

Conclusion

Tax does not fall within the remit of the Department of Enterprise, Tourism and Employment but building competitiveness most assuredly does. Over the next three years and beyond, the tax system will be as powerful a lever as it has been over the last four decades in honing Ireland’s competitiveness and in incentivising investment to build innovative and resilient businesses.

Navigating the volatile and risk-laden period ahead will require all of Government to transcend the traditional boundaries and work together with agility and speed to ensure the Irish economy can adapt in a fast-moving and unpredictable environment and continue to provide quality employment for the country’s growing workforce.

We would welcome the opportunity to discuss the matters raised in this submission further with you or your officials as you develop and implement your Department’s strategy.

Yours sincerely

Aoife Lavan

Aoife Lavan
Institute President