

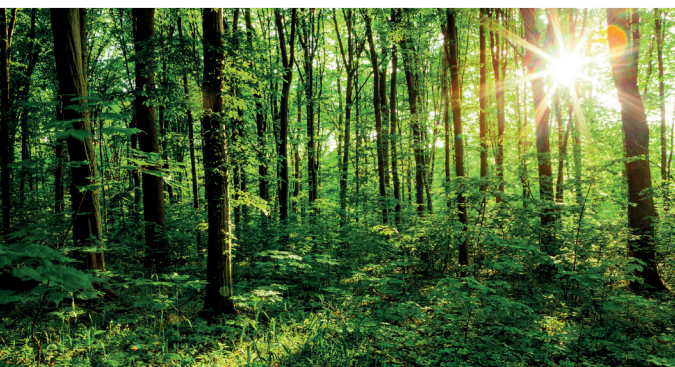


Irish Tax  
Institute

*Leaders in Tax*

# Public Consultation on the Role of the Tax System in Encouraging Entrepreneurship

IRISH TAX INSTITUTE SUBMISSION  
July 2015



## Table of Contents

|  |    |
|--|----|
| About the Institute.....   | 2  |
| Executive summary.....   | 3  |
| The main challenges facing entrepreneurs.....                    | 3  |
| Entrepreneurs - why they are important and deserve support ..... | 4  |
| Steps taken on tax so far, to promote entrepreneurs .....        | 5  |
| Key recommendations .....  | 8  |
| 1. Raising Capital.....  | 8  |
| 2. Building a team of talented staff .....                       | 8  |
| 3. Rewarding the initiative of job creators .....                | 9  |
| Detailed recommendations .....                                   | 10 |
| 1. Raising Finance / Capital .....                               | 10 |
| CGT rates.....   | 11 |
| Entrepreneur Relief.....   | 12 |
| Employment and Investment Incentive (EII).....                   | 13 |
| Start Up Relief for Entrepreneurs (SURE) .....                   | 17 |
| A new relief for loan investments.....                           | 18 |
| A Knowledge Development Box (KDB) for SMEs .....                 | 19 |
| 2. Building a team of talented staff .....                       | 20 |
| Share-based remuneration .....                                   | 21 |
| Impact of high marginal personal tax rates .....                 | 22 |
| Employer PRSI .....  | 23 |
| Mechanisms to attract mobile talent .....                        | 24 |
| 3. Rewarding the initiative of job creators .....                | 25 |
| Discrimination of the self-employed.....                         | 25 |
| Ease of paying tax .....   | 27 |

## **About the Institute**

The Irish Tax Institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

## Executive Summary

The Irish Tax Institute welcomes the opportunity to make a submission in response to the consultation on Role of the Tax System in Encouraging Entrepreneurship.

The Institute has made representations to government on the tax environment for entrepreneurs and SMEs (small and medium sized businesses) in our past four pre-Budget submissions. In that time, a number of government initiatives have been undertaken to improve the environment for entrepreneurs, within the fiscal parameters available:

- Action Plan for Jobs 2015
- The National Policy Statement on Entrepreneurship
- Budget 2014 - 10 Measures for small business

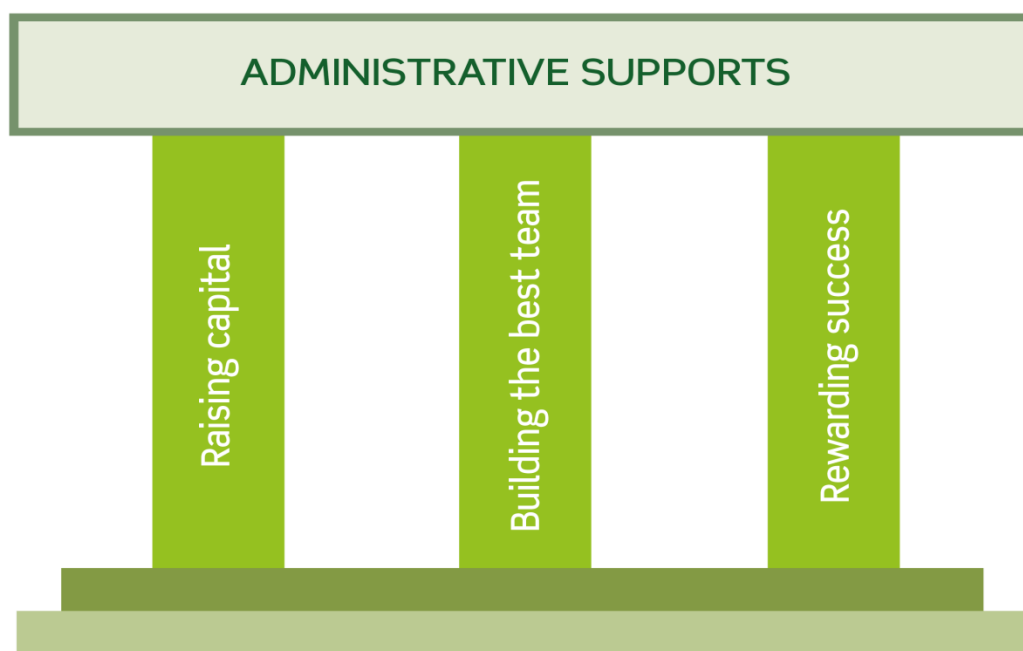
However, the environment remains challenging for start-up businesses and SMEs and if we want to encourage more individuals to embark on the entrepreneur's journey then further tax policy initiatives are required.

### The main challenges facing entrepreneurs

In carrying out our research for this submission, the Institute held detailed discussions with our members who work at the coal face of the tax system for the thousands of SMEs, business owners and entrepreneurs across Ireland. In addition, we met and spoke with a number of entrepreneurs and with other bodies representing them.

In the course of these discussions we learnt that the key challenges facing entrepreneurs in Ireland today fall under 3 main headings:

1. Raising capital to start and grow the business;
2. Building the best team to drive the business forward; and
3. Valuing and rewarding successful entrepreneurs.



The recommendations in this submission specifically address these three challenges which impact particularly on entrepreneurs. In addition, we make a number of recommendations to improve the tax administration environment generally, ease the tax compliance burden and address some of the administrative barriers that currently exist.

### **Entrepreneurs - why they are important and deserve support**

Entrepreneurs take risks, start businesses and create jobs. We know from the latest CSO figures available in 2012 that SMEs then accounted for 99.7% of active enterprises and 68% of persons in private sector employment<sup>1</sup>. Their contribution to Ireland's economy and employment must be recognised, encouraged and driven by ambitious overall government policy which includes a strong tax policy element. Entrepreneurs and start-ups need a business environment within which they can thrive and grow – if we can make this happen, it will benefit all aspects of Irish society.

Achieving a sustainable and ambitious policy framework requires entrepreneurs, professional advisers and government to work collaboratively in its design, implementation and ongoing review. We have some of the world's best entrepreneurs in Ireland and it is important that we keep them, value them and encourage others to join them by investing in Irish business.

There have been positive developments in entrepreneurship in Ireland over recent years but it is important that we set more ambitious goals for ourselves:

1. Ireland has consistently ranked 17<sup>th</sup> (2015), 18<sup>th</sup> (2014) and 17<sup>th</sup> (2013) in the Global Entrepreneurship Index over the last 3 years - by contrast the UK has risen from 14<sup>th</sup> in 2013 to 4<sup>th</sup> in 2015 (UK were 9<sup>th</sup> in 2014).
2. Ireland ranked 11<sup>th</sup> in the Global Innovation Index in 2014 (down from 10<sup>th</sup> in 2013). The UK ranked 2<sup>nd</sup> in 2014, up from 3<sup>rd</sup> in 2013.
3. Client companies of Enterprise Ireland created 18,000 net jobs in the three years between 2012 and 2014.

| Year | New Jobs | Net Increase in Jobs |
|------|----------|----------------------|
|      |          |                      |
| 2012 | 7,000 +  | 3,804                |
| 2013 | 18,033   | 5,442                |
| 2014 | 19,705   | 8,476                |

This is a strong contribution to the jobs target. However, in early 2015 An Taoiseach stated the Government's commitment to achieving full employment by 2018. This requires the creation of 160,000 new jobs in a similar three year period and if this ambitious job creation target is to be reached, the strategy must be competitive and focused.

4. The number of entrepreneurs starting new businesses is increasing again after a dip in 2014. But if we look to the UK, even taking account of their much larger population (64.1 million in the UK as compared with 4.5m in Ireland) and the different measurement bases below, there is opportunity for further growth if we prioritise our tax policies.

---

<sup>1</sup> CSO, Business in Ireland 2012 Report. Published in 2014.

| Year | Number of entrepreneurs starting a new business <sup>2</sup> in Ireland <sup>3</sup> | Number of new businesses started in the UK <sup>4</sup> |
|------|--|---|
| 2011 | 24,000   | 440,600   |
| 2012 | 19,000   | 484,224   |
| 2013 | 32,000   | 526,447   |
| 2014 | Not available  | 581,173   |

*"[t]axation has an important role to play in developing Ireland's entrepreneurship ecosystem to meet the highest international standards and facilitating the growth of start-ups into enduring companies offering sustainable long-term employment..."*

*"The tax environment for entrepreneurs and investors in Ireland has become more challenging, particularly when compared with the UK's tax rates. It is critical that Ireland should remain competitive as a location for both home-grown and internationally mobile entrepreneurs".<sup>5</sup>*

*"By driving implementation of the actions in the new National Entrepreneurship Policy Statement we will double the jobs impact of start-ups in Ireland over the next five years, from 93,000 currently. We will increase the number of start-ups, the survival rate and the capacity of startups to grow to scale, all by 25 per cent".<sup>6</sup>*

*"Certainly in any economy start-ups are the life's blood of the economy in terms of creating new opportunities and new jobs going forward and bringing new technologies in,"<sup>7</sup>*

*"Angel investing is increasingly encouraged and supported by policy makers in many countries, as a way to mobilize financial resources and entrepreneurial expertise towards dynamic new ventures"<sup>8</sup>*

### **Steps taken on tax so far, to promote entrepreneurs**

Since the government has come into office, welcome measures have been introduced to stimulate investment and improve the tax environment for SMEs:

- CGT Entrepreneur Relief was launched in 2013.
- An Employment and Investment Incentive (EII) was introduced to replace the Business Expansion Scheme, (albeit that this relief is more restrictive than its predecessor and the result has been a drop in SME investments made). After an initial period, the EII scheme was removed from the High Earners' Restriction and some elements of the relief were improved in Budget 2015.
- The Jobs Initiative in 2011 introduced a lower 9% VAT rate for certain tourism and personal services. The lower rate of Employer PRSI was also temporarily halved.
- The VAT cash receipts basis was extended.
- The income tax Foreign Earnings Deduction was introduced and subsequently extended.
- The Special Assignee Relief Programme was introduced and then improved in Budget 2015.
- The Start Up Relief for Entrepreneurs (SURE) scheme was launched to replace Seed Capital Relief.

<sup>2</sup> Some businesses have multiple co-founders and some founders may start more than one business in a year, so the actual number of businesses created in any one year will not equate exactly with these figures.

<sup>3</sup> As measured by the Global Entrepreneurship Monitor Ireland Reports.

<sup>4</sup> As measured by Start-up Britain

<sup>5</sup> The National Policy Statement on Entrepreneurship 2014

<sup>6</sup> The Action Plan for Jobs 2015

<sup>7</sup> Enterprise Ireland CEO Julie Sinnamon

<sup>8</sup> OECD New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments, 2015.

- Start Your Business Relief (SYOB) was launched, which is a tax relief for the long term unemployed who start a business.
- The R&D tax credit base year was removed.
- The Home Renovation Incentive was launched and subsequently extended.

These targeted steps have provided much needed support and contributed to job creation in certain sectors. However, they have enjoyed mixed success in practice (for reasons that we elaborate on below) and were introduced against the backdrop of a generally deteriorating tax environment in that same period, with rate increases and band reductions across the board.

The Minister has taken very welcome steps to set out a Roadmap and plan for our corporation tax policy, correctly addressing the challenges posed by global competitiveness in this area. However, the market for international entrepreneurial investment is equally mobile and competitive and the tax environment in Ireland for this type of business has become much less favourable in recent years.

- Marginal tax rates have increased from 46.5% up to 55% for entrepreneurs. These marginal income tax rates are now amongst the highest in the OECD
- The High Earner's Restriction was introduced and subsequently tightened and our effective tax rates are now at levels approaching those in Sweden.

The PRSI ceiling for proprietary directors and the self-employed was removed. The lower rate of employer PRSI of 4.25% on lower paid workers, which was introduced in the Jobs Initiative in 2011, expired bringing the rate back to 8.5% from 2014. Employers are obliged to account for PRSI at a rate of 10.75% of wages for all workers earning more than €356 a week.

The capital taxes position has also deteriorated significantly, leading to uncertainty for investors:

- The Capital Gains Tax (CGT) rate has increased by 65% from 20% to 33%.
- The Capital Acquisitions Tax (CAT) rate has increased from 20% to 33% and thresholds have approximately halved.

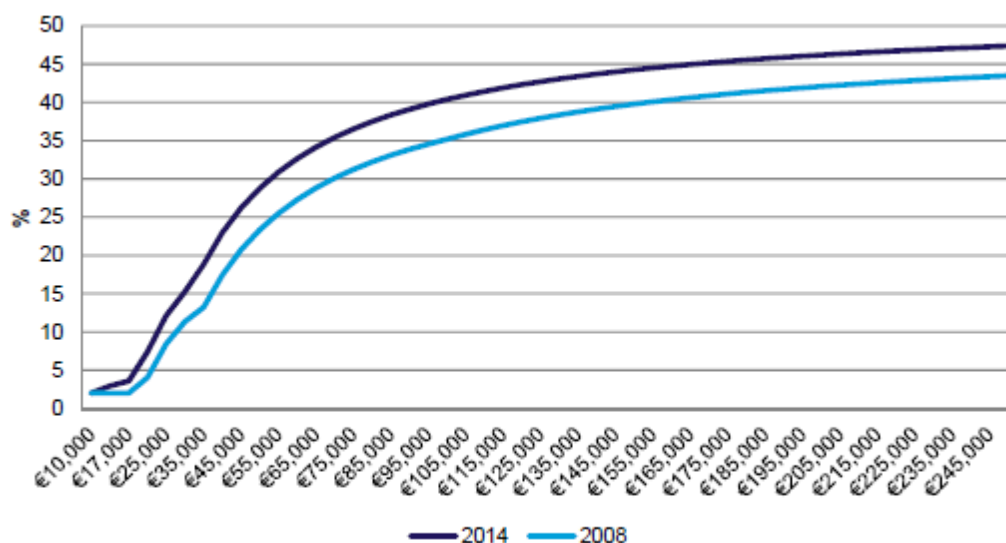
|   | 2008  | 2015   |
|---|---|--|
| <b>CGT rate</b>   | 20%   | 33%  |
| <b>CAT rate</b>   | 20%   | 33%  |
| <b>Value of transfer which can be made from parent to child free of CAT</b> | €521,208                                      | €225,000   |
| <b>CGT Retirement Relief</b>  | Relief available for any investor over age 55 | Age cap reduces the incentive to pass on business after age 66 |

At the same time as these tax increases which impact entrepreneurs and their employees, VAT rates have increased from 21% to 23%, which is the fourth highest rate in the EU.

During the difficult economic conditions of the past 7-8 years, entrepreneurs and the self-employed have contributed hugely to the consolidation of our fiscal position through our highly progressive tax system right across the board as evidenced at Figure 4.



Figure 4: Maximum effective tax rates for single income earners



Note: Inclusive of income tax, employees PRSI, the USC and other levies.

Source: Ibec calculations based on single person aged below 65.

Source: IBEC Report "Debunking Irish Income Tax Myths" September 2014

Now, as economic conditions improve, this vital group of people who drive jobs and innovation need to see some reward for their endeavours and a pathway to more sustainable levels of taxation before we lose them to competing jurisdictions such as the UK.

#### **Irish v UK Comparison for Investors**

- An Irish SME technology company seeks investment to fund its expansion.
- It sources funding from two equity investors, one Irish-based and one UK-based

The following table illustrates the tax analysis for each investor over a 5-year holding period:

|   | Irish resident investor | UK resident investor |
|---|-------------------------|----------------------|
| Marginal tax rate on interest/dividend income | 55%                     | 45%/30.56%*          |
| Tax rate on exit after 5 years                | 33%                     | 10%**                |

\* Currently the marginal rate on interest is 45%. The marginal rate on dividends is 30.56%.

\*\* Assuming the investor qualifies for Entrepreneurs' Relief. If investment is made through EIS Scheme then disposal will be exempt from CGT.



## Key recommendations

### 1. Raising Capital

- A roadmap is required in Budget 2016, similar to the Corporation Tax Roadmap, outlining a route for phased reductions in Capital Gains Tax (CGT) rates, to provide certainty and assurance for investors.
- A clear and targeted lower CGT rate of 10% on entrepreneurial gains is required. A 10% rate should apply to the disposals of investments in certain business assets and shares, once certain holding-requirements are met. A deferral mechanism should also be in place so that where the proceeds of a disposal are reinvested in another qualifying business, the 10% CGT would be “rolled over” and would not be due for payment until the subsequent acquisition is disposed of.
- Important changes are needed to make the Employment and Investment Incentive (EII) an effective tool for encouraging start-up investment:
  - The €150,000 annual investment limit for individuals is restricting investment that would otherwise be available and needs to be increased.
  - The removal of EII from the High Earner Restriction appears to have increased investment levels and this position should be confirmed as a permanent measure.
  - Full personal tax relief should be available in the year of investment because staggering the relief is significantly restricting its attractiveness when comparing these high risk investments with other safer options.
  - A review of the detailed technical restrictions (outlined below) is required.
  - A review of the tax treatment on inheritance is also required.
- Start Up Relief for Entrepreneurs (SURE)
  - The tax relief should be available upfront when the start-up business requires the cash to invest in the business, rather than after the investment has been made.
  - All tax payers should be entitled to avail of SURE – denying the relief to previously self-employed individuals is unfair and closes the start-up option to many individuals who would otherwise embark on this journey.
- A targeted tax relief is required for individuals making loan capital investments in SMEs, to provide important alternative sources of funding.
- SMEs require a Knowledge Development Box that imposes low compliance costs and provides certainty of treatment for them. As broad a definition as possible is needed for assets which are functionally equivalent to “patents”.

### 2. Building a team of talented staff

- A tax effective share incentive regime is urgently needed for both start-ups and growing SMEs to enable them attract the key staff they need to drive their business through the initial early years (when so many businesses can fail). This is particularly important given our environment of very high personal taxes for employees. We would like to see a new regime introduced similar to the UK Enterprise Management Incentive regime. In this regime no income tax is payable on the exercise of share options by employees of qualifying companies. The employee is only liable to CGT when they dispose of the underlying shares.
- A clearly articulated strategy is required outlining the phased reduction of the 52% marginal tax rate for all taxpayers and not limited only to those taxpayers earning less than €70,000. High performing individuals are core to the success of start-up business and we must ensure that their cash-in-hand remuneration is competitive in a very tight global market for their services.
- Employer PRSI is a major cash flow cost for employers and can delay and even prevent the hiring of those first staff for a new business. Other jurisdictions have introduced relief for employers who increase their net headcount and similar measures should be introduced in Ireland.
- There is a need to assess how attractive our regime is in attracting mobile talent and high-performing diaspora to indigenous businesses to help them grow and succeed. We would like to

see a relief mechanism, similar to the SARP, introduced aimed at attracting talent to indigenous Irish businesses. To be effective, this relief should be available to new hires as well as assignees.

- We would also like to see a form of SARP relief introduced which is aimed at attracting research leaders in areas of national strategic importance under the Science Foundation Ireland Research Professorship Programme.

### **3. Rewarding the initiative of job creators**

- Entrepreneurs are a small minority of taxpayers who generate new business and drive the jobs agenda. We should celebrate their contribution to our economic recovery and demonstrate our commitment to valuing this contribution by removing the tax discriminations that currently impact them:
  - The additional 3% USC is a penalty on entrepreneurship and should be abolished in Budget 2016. The marginal tax rate for the self-employed should be the same as the rate for employees.
  - Our aim should be to extend the PAYE tax credit to all income earners, even if this can only be achieved in clearly signalled stages.

## Detailed recommendations

### 1. Raising Finance / Capital

Finance is the lifeblood of SMEs and businesses of all sizes continue to struggle to access sufficient finance to develop and grow.

The Government has made welcome efforts in recent years to assist SMEs in raising finance including the package of measures introduced in Budget 2014. The Strategic Banking Corporation of Ireland (SBCI) was also established to

*“provide €800 million over 2 years of additional funding” for SMEs and “to intensify competition within the SME finance market, which has become over-concentrated”*

In spite of these efforts, SMEs in Ireland have faced, and continue to face, significant challenges when trying to raise finance. As the Action Plan for Jobs 2015 notes,

*“[b]oth pre- and post-crisis, Irish SMEs are among the most reliant on bank financing in Europe. Consequently Irish SMEs have been disproportionately exposed to the weaknesses in the banking sector”.*

Given the difficulties of obtaining bank finance in the current environment, the importance of equity finance for SMEs has also been recognised repeatedly by the Government. As the Action Plan for Jobs 2015 notes:

*“Notwithstanding recent improvements, the area of credit for enterprise requires ongoing attention given the stated ambition of developing a more diversified and competitive financial system capable of financing the growth potential of Irish SMEs”.*

*“As part of broadening the financing mix for SMEs, there is a need to encourage firms away from the current high level of reliance on debt financing towards a greater use of equity to fund investment..... the ESRI indicates that there are opportunities to expand the use of equity financing by the more domestically orientated cohort of Irish SMEs”*

While private sector financing may be provided to SMEs through institutional investors and venture capital funds, we believe that the private capital held by individuals who have the means to invest in Irish businesses, could provide another vital source of funding. The total amount held on deposit in Irish banks by households at the end of April 2015 was €91.9 billion. If even a small percentage of this capital was harnessed for productive investment in small, high-potential businesses, it would have significant benefits for the Exchequer.

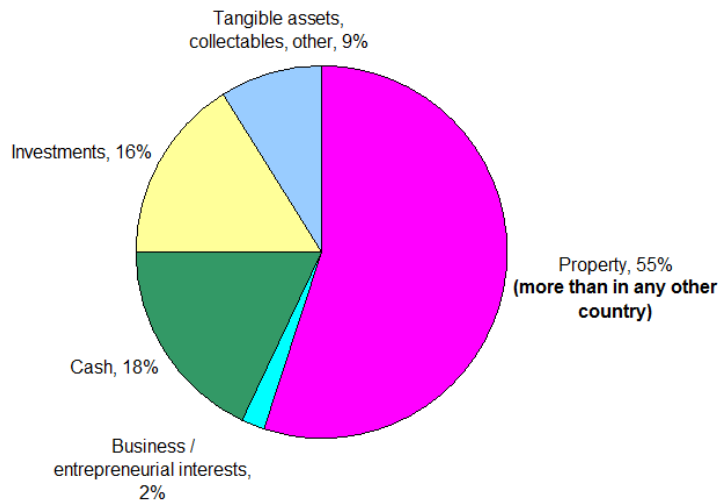
There is an internationally competitive market for investors’ funds. Irish investors are very mobile and they can make clear comparisons of the return on their investments across jurisdictions. In addition, Irish investors have a strong propensity for investing in property over other, riskier, investments.

*“Irish high net worth individuals are likely to hold the majority (55%) of their wealth in property, more than any other country globally”.<sup>9</sup>*

---

<sup>9</sup> Barclays Wealth Insights Report, 17 June 2013

## Where is Ireland's wealth invested?



Investors who choose to invest their funds in SMEs and start-ups generally take on much more significant risk than those who invest in property or “blue-chip” companies. In order to support those investors who are prepared to take these risks, it is important that tax policy encourages this type of active investment in circumstances where jobs are likely to be created.

So what changes to the tax policy environment is the Institute seeking, to help promote investment by entrepreneurs?

### CGT rates

#### Background

Starting a business or investing in a trading company is a high risk investment, particularly in comparison to investing in property or any asset backed investment. Irish people have typically chosen to invest in property rather than active businesses. Tax measures such as the recent 7 year CGT exemption have encouraged a focus on property investments in recent years.

The rate of CGT impacts the after-tax reward from a successful investment and therefore has a knock on impact on investment decisions. The potential increase in value of a business that is successful is often the key factor which attracts entrepreneurs and investors to risk their money in a trading business.

Ireland's CGT rate has increased from 20% in 2008 to 33% currently. In previous periods where Ireland had a high CGT rate, a roll-over relief for investments in active businesses was available and this relief was abolished as the CGT rate was lowered.

#### Issue

Ireland's high CGT rates are acting as a significant disincentive to making investments in active trading businesses which are inherently risky.

#### **Recommendation**

A Budget 2016 roadmap outlining phased reductions in CGT rates would provide certainty and assurance for investors.

## Entrepreneur Relief

### Background

Entrepreneur Relief was introduced in Budget 2014 with the objective of reducing the high CGT cost for successful entrepreneurs. However, the measure introduced has some significant limitations and was further restricted by changes introduced in Budget 2015. The relief is effectively only available where an entrepreneur makes two consecutive successful entrepreneurial investments.

### Issue

Ireland competes with other countries as a location for start-up investment. Investment capital is very mobile and other jurisdictions have increasingly competitive offerings. The current Entrepreneur Relief is very restrictive and complex. The benefits of the regime are often uncertain and crystallise too far into the future to influence decisions made today.

These restrictions are exacerbated by the availability of a simpler, clearer and more attractive relief in the UK (see spotlight on the UK relief below).

#### ***Spotlight on the UK CGT Entrepreneurs' Relief***

The UK Government's stated ambition is *"for the UK to be the best place in Europe to start, finance and grow a business"* and Entrepreneurs' Relief is a critical tool in pursuing this strategy.

Entrepreneurs' Relief was introduced in the UK from 2008 and it was aimed at encouraging individuals to start a business and invest in it. The relief operates by reducing the amount of CGT payable by an individual on a disposal of qualifying business assets, as long as certain conditions have been met throughout a one-year qualifying period either up to the date of disposal or the date the business ceased. Qualifying capital gains for each individual are subject to a lifetime limit of £10 million (for disposals on or after 6 April 2011). It is notable that this lifetime limit has been increased three times since the relief was introduced, increasing from an initial level of £1 million to the £10 million limit which applies now.

Qualifying gains are subject to **CGT at a rate of 10%**, instead of the normal UK rates of 18% and 28%. Relief can be claimed on a disposal of qualifying business assets or shares in a "personal company" (i.e. an individual holds at least 5% of the ordinary share capital and 5% of the voting rights).

#### ***Recommendation***

##### **A clear 10% CGT rate on entrepreneurial gains is required**

A significantly revised and simpler Entrepreneur Relief is required so that entrepreneurial gains are taxed at no more than 10%. A reform of this nature is essential if Ireland is to compete with countries such as the UK for investment business.

To ensure the relief meets its target objectives, it could:

- Be limited to certain types of business assets and shares, and
- Require a minimum investment period of 3 to 5 years.

A relief like this would be very similar in nature to the UK relief which should minimise any State Aid challenges arising. The attractiveness of this regime could be further enhanced by allowing payment of the tax to be deferred where the proceeds on disposal are reinvested in other qualifying business assets or shares within a certain timeframe. This would further encourage entrepreneurs to continue to invest in productive businesses in Ireland.

## Employment and Investment Incentive (EII)

### Background

The EII provides income tax relief for individuals who make equity investments in qualifying trading companies. Relief is granted in two tranches, 30% in the year of investment and a further 10% relief after 3 years if certain conditions are met (this additional tranche of relief was previously available at 11% prior to Budget 2015). There are a number of criteria that must be met by both the investor and the company, in order for EII relief to apply:

- The company receiving the funds must carry out a qualifying activity.
- The funds must be used by the company for that qualifying activity.
- The investor must not control more than 15% of the company.
- There are limits on how much a company can raise and how much an individual can invest.

The EII was introduced in Finance Act 2011 to replace the Business Expansion Scheme (BES). Budget 2011 outlined that the rationale for replacing BES with EII was to boost job creation by SMEs and it was anticipated that an extra €13 million of tax relief would be granted under the new scheme each year.

However, the introduction of the EII has actually resulted in a reduction in the level of tax relief being granted to investors in Irish businesses, with a significant knock-on effect on the level of funds invested.

| Year                | Relief | Cost €m            | Funds Invested<br>€m (approx) <sup>10</sup> | No. of investors |
|---------------------|--------|--------------------|---|------------------|
| 2011                | BES    | 41                 | 100   | 927              |
| 2012                | BES    | 31.5               | 76.8  | 984              |
| 2012 (part of year) | EII    | 4                  | 13  | 352              |
| 2013                | EII    | 12.3 <sup>11</sup> | 41  | 1,006            |
| 2014 (provisional)  | EII    | 15.1               | 50  | 1,132            |

The table above demonstrates that although the number of people investing has increased, the total level of EII funds invested in SMEs has significantly decreased (by 50% from 2011 levels).

One of the limitations with the EII as originally introduced was that the High Earners' Restriction effectively capped the amount of relief available to investors to such an extent that the relief was not attractive – particularly considering the high risk profile of the investments involved. Finance (No. 2) Act 2013 temporarily removed the EII from the scope of the high earner restriction and a further review was carried out in 2014. It appears from the provisional figures for 2014 available in the table above that this change has contributed to some increase in investment levels and it is essential that this position is made permanent.

Further changes were made in Finance Act 2014 (pending EU State Aid approval) to:

- Increase the amount of EII funds which a company can raise,
- increase the holding period by 1 year to 4 years, and
- include medium-sized companies in non-assisted areas and internationally traded financial services.

<sup>10</sup> Actual levels of funds invested through EII was not available at the time of writing and therefore these figures are estimated based on the published Cost amounts.

<sup>11</sup> The cost of the scheme that had been anticipated by Government was €54m – a clear demonstration that the terms of the scheme are delivering sub-optimal investment levels.

### *Increase in investment limits in Finance Act 2014*

| <b>EII Investment</b>       | <b>Pre- Finance Act 2014</b> | <b>Post- Finance Act 2014*</b> |
|-----------------------------|------------------------------|--------------------------------|
| Annual investment limit p.a | €2.5m                        | €4m                            |
| Lifetime investment limit   | €10m                         | €15m                           |

\*pending State Aid Approval

The table below compares the attractiveness of our current EII with both the previous BES regime and the two UK equivalents – the SEIS is a specific form of EII aimed at attracting investment into the smallest businesses. One of the biggest differences between the Irish and UK regimes is the eligible investor limit. Our €150,000 limit compared with the UK Stg £1m limit is one of the main restrictions on investment here. Coupled with this, there is a CGT exemption on the sale of the shares in the UK, which does not apply in Ireland. An effective 10% entrepreneurs' relief in Ireland would reduce the impact of this difference.

|                                   | <b>BES</b>   | <b>EII</b>                                | <b>UK EIS</b>   | <b>UK SEIS</b>                                       |
|-----------------------------------|--|---|---|--|
| <b>Rate of relief</b>             | 41% upfront  | 30% in year 1 + 10% after 3 years         | 30%   | 50%  |
| <b>Company investment limit</b>   | €2 million lifetime limit                              | €10 million lifetime limit                | £5 million per 12 months. No lifetime limit                   | Stg£150,000 lifetime limit                           |
| <b>Investor Limit</b>             | €150,000 p.a. (but subject to High Earner Restriction) | €150,000 p.a.                             | Stg£1,000,000   | Stg£100,000  |
| <b>Holding Period</b>             | 5 years  | 4 years                                   | 3 years   | 3 years  |
| <b>Eligible companies</b>         | Limited to qualifying trade and certain areas          | Most trading SMEs                         | Companies with gross assets < Stg£15 million & <250 employees | Small companies <25 employees + < £200,000 in assets |
| <b>Treatment of Capital Gains</b> | Gain on disposal of shares subject to CGT              | Gain on disposal of shares subject to CGT | Gain on disposal of shares <b>exempt</b> from CGT             | Gain on disposal of shares <b>exempt</b> from CGT    |

If an Irish investor has €1 million to invest in a qualifying business a comparison of the Irish and UK incentives makes for stark reading. If the investor chooses to invest in the Irish business their investment is limited to €150,000 while in the UK they could avail of relief on the entire €1m investment. Furthermore, if the investor opted for the UK investment there would be no CGT on a subsequent disposal compared to CGT of 33% had they opted to invest in the Irish business.

|                          | <b>Irish EIS</b>                                  | <b>UK EIS</b>                  |
|--------------------------|---|--------------------------------|
| Max investment           | €150,000  | €1,000,000                     |
| Tax Relief on investment | €45,000 in year of investment + €15,000 in year 4 | €300,000 in year of investment |
| CGT on gain on disposal  | 33%   | Zero                           |



Budget 2015 Estimates provided for no increase in the cost of the EII to the Exchequer which demonstrates the limited impact that these changes were expected to provide. As outlined in our submission on EII last year<sup>12</sup>, a number of additional changes are needed to ensure that the EII is “fit for purpose”.

#### **Issue 1 - Annual investment limit of €150,000**

An investor is limited to claiming EII on investments of €150,000 per annum. By contrast, the UK Enterprise Investment Scheme permits investments by an individual of up to Stg£1 million per annum.

Feedback from our members suggests that investors have funds available and would be interested in increasing their level of investment in SMEs. However, the relatively low investment limit is severely curtailing investment levels.

#### ***Recommendation 1 - Increase the €150,000 annual investment limit for individuals***

The aim of the relief is to encourage greater investment in active trading companies with the potential to create jobs. Placing relatively low restrictions on the amount an individual can invest reduces the potential pool of funds available to be invested and frustrates the intention of the relief.

#### **Issue 2 - Certainty over the High Earner Restriction**

The measure in Finance (No. 2) Act 2013 to temporarily remove the EII from the scope of the High Earners’ restriction is very welcome. However, uncertainty is created by the fact that it is a temporary relief that is due to expire at the end of 2016.

#### ***Recommendation 2 - Remove EII from High Earners’ Restriction permanently***

Feedback from our members indicates that the removal of EII from the High Earners’ Restriction has already enabled investors to increase the level of investment made in SMEs. This measure should be extended permanently beyond 2016.

#### **Issue 3 - The split in relief 30/10**

Income tax relief under EII is currently granted to an investor in two stages - 30% in the year of investment and an additional 10% after three years, if certain targets are met by the investee company. These targets require that employment levels must have increased at the company or that the investment has been used for R&D. This restriction did not apply to BES.

We appreciate the policy objective is to ensure a link with job creation. However, the deferral of full relief has become a real barrier to EII achieving significant investment funding.

As the investor will not have control of the investee company, they are not in a position to significantly influence whether the conditions are met. As a result, when evaluating whether to make an investment, a prudent investor cannot assume that the additional 10% relief will become available.

---

<sup>12</sup> Irish Tax Institute response to the Government Consultation on the Employment and Investment Incentive and the Seed Capital Scheme

***Recommendation 3 - Full relief should be provided in the year of investment***

If there is to be any prospect of returning to investment levels consistently achieved by the BES scheme then relief should be available to investors from the outset. In our view, this relief should include USC and PRSI relief and that would seriously enhance the attractiveness of the offering. However, at a minimum, full 40% income tax relief in year 1 is required (which would result in no overall cost to the Exchequer). This will make eligible investments more financially attractive to investors.

The Department of Finance report on the EII published with the Budget in October 2014 suggested that full relief in year 1 would:

*“undermine the aim of the scheme.... and lead to claims that the scheme is no longer focussed on job creation”.*

However, in our view the relief as currently structured is restricting investment in active businesses, which itself limits the scope for job creation.

**Issue 4 - Group companies**

EII relief is not available in situations where the investment is made in a holding company (which may own more than one trading company) even though the funds are used for qualifying purposes by a trading subsidiary.

This prevents a person from using EII to invest in a trading group which has more than one trading company.

***Recommendation 4 - Review of restrictions is required***

EII should be available for investments in a holding company subject to the condition that the funds are used by a qualifying company in the group, for qualifying purposes.

The Department of Finance Report in October 2014 considered this proposal only in the context of also removing the restriction on a “connected person” investor claiming EII.

This proposal is unrelated to the connected person restriction and should be separately evaluated.

**Issue 5 – Tax Treatment on Inheritance**

In the UK shares in their equivalent Enterprise Investment Scheme will qualify for Business Property Relief once they have been held for two years. This means that they are exempt from Inheritance Tax in the UK.

***Recommendation 5 – Exclude EII shares from the charge to CAT***

To further encourage investment in EII shares the shares should qualify for Business Property Relief in Ireland.

## **Start Up Relief for Entrepreneurs (SURE)**

### **Background**

The Start Up Relief for Entrepreneurs (SURE) has replaced the Seed Capital Scheme (SCS). It aims to incentivise individuals currently or recently in employment to start and invest in their own business. SURE enables such individuals to claim income tax relief on investments in their business of up to €100,000.

The relief is limited to the amount of income tax the individual has paid through PAYE over the previous 6 years. The individual must control at least 30% of the new trading company and must take up employment with that company.

While SURE has been rebranded and re-launched, no meaningful changes have been made which differentiates it from the SCS which preceded it. The SCS had a very low take up with only 57 investors availing of the relief in 2013.

### ***Issue 1 - Timing of the relief***

An individual can only claim the SURE refund after the investment has been made and therefore must find the cash upfront to invest in his/her new business.

As a result, the investor is not in a position to leverage the tax relief and must source additional finance to invest in the business.

#### ***Recommendation 1 - Tax relief should be available upfront***

A mechanism should be put in place, with appropriate safeguards, to provide up-front tax relief to the investor.

In response to this proposal, a Department of Finance Report on the Seed Capital Scheme that was published with the Budget in October 2014 commented that

*“there would be no guarantee that the refund would be invested in the business”.*

We believe that adequate safeguards could be put in place to ensure that refunds made are actually invested. For example, the taxpayer could be required to send proof of purchase of the shares to Revenue within a set period of time after receiving the refund (or suffer a claw back).

### ***Issue 2 - The relief is currently limited to PAYE employees***

To qualify for the relief, the individual needs to have paid sufficient income tax through the PAYE system. A self-employed person who has paid equivalent levels of income tax through self-assessment does not qualify.

Many new businesses are set up by people who were self-employed previously but want to embark on a new journey of entrepreneurship.

#### ***Recommendation 2 - All tax payers should be entitled to avail of SURE***

The requirement that the individual must have paid PAYE is limiting this relief for a whole group of potential entrepreneurs.

In response to this proposal the Department of Finance report in October 2014 stated that

*“there are other tax incentives already in place to support self-employed entrepreneurs”.*

However, there are no similar tax reliefs available to support previously self-employed individuals investing their own money into their own new business.

## **A new relief for loan investments**

### **Background**

Many entrepreneurs with small businesses may be reluctant to dilute share ownership but they still have a pressing need to access capital for start-ups and growth. Loan investment can meet this need for capital and can also provide more flexible options on exit, thereby offering a more attractive possibility for potential investors with cash. This loan capital can come from sources other than banks. The Action Plan for Jobs 2015 noted that *“evidence from Ireland and other OECD countries, in particular the UK and USA, highlights the potential to scale up the volume of alternative lending instruments targeted at SMEs”.*

There is currently no tax relief available for loan investments made by individuals in SMEs and tax is payable on any interest received by the lender.

### **Issue - No tax relief available for loan investments made in SMEs**

Non-bank loan finance is difficult for SMEs to source given the high risks for the investor and the high tax payable on any interest returns.

### **Recommendation - A targeted tax relief is required for individuals making loan capital investments in SMEs**

A relief should be introduced which provides a tax incentive for individuals to invest in active businesses and reduces the tax on any interest returns.

A tax relief for individuals making loan capital investments would encourage lending from the private sector into SME businesses. A cost/benefit exercise may be required before making any final decisions, but the proposed relief could have the following characteristics:

- The relief could be limited to investment in SMEs which are active trading companies and where the potential for job creation is demonstrated.
- There could be a minimum investment period of 3 to 5 years.
- To provide additional security for investors, the loan investment could be based on convertible loan stock, with conversion into share capital occurring only in the event of default.
- In order to diversify risk for individual investors, a facility for investing in pooled funds could be made available.
- The relief could be based on a tax deduction for individuals, which could be limited to the standard rate of income tax.
- To compete with other forms of investment, any interest return on these loan investments could be subject to income tax at the standard rate.
- The administrative burden must be kept to a minimum.

If we are to introduce a meaningful incentive for investment, then it must be excluded from the High Earners' Restriction.

## **A Knowledge Development Box (KDB) for SMEs**

### **Issue**

It is particularly important for smaller businesses that the KDB is designed in a manner which minimises compliance costs, provides certainty as to the level of relief available and applies to as broad a range of IP as possible.

SMEs have much more limited resources to deal with complex incentives and need a simple regime that will focus the key employees in the company on driving sales and growing the business to scale. A KDB for SMEs must be simple to understand and implement with low compliance cost – otherwise we could find that they do not participate fully.

SMEs will generally carry out the majority of their R&D activities in Ireland. They are less likely to fragment their R&D operations to other locations until they expand significantly into overseas markets. However, while this issue of related party outsourcing may not arise, SMEs often have to carry out a level of unrelated outsourcing work to universities and other 3rd party specialists. It is important that this commercial reality is accommodated within any KDB model.

Many SME's incur very significant R&D costs in their early years such that they are in an overall loss making position. We know from the experience which led to the R&D tax credit regime being amended to accommodate refundable credits, that this is a significant number of businesses. It is important to be aware that such companies will not be in a position to avail of an income based KDB at the outset. It is also important that restrictions on the use of losses are not a feature of the KDB design, as this could significantly limit its benefits for SMEs.

### **Recommendation**

The KDB priorities that SMEs have raised with us are:

1. Simplicity and certainty of treatment (they have limited resources to deal with a complex regime); and
2. A broader definition of IP that will encompass as much as possible within the definition of “functionally equivalent” to patents.

## 2. Building a team of talented staff

The tax system has a significant impact on the ability of a business to reward staff. Higher taxes on work can create a disincentive for staff to work the extra hours and contribute the extra effort that drives the business forward. Higher taxes also significantly impact on the ability of Irish businesses to attract key employees who are internationally mobile.

Our personal tax system has undergone a fundamental transformation in recent years. Ireland has the most progressive income tax system in the EU and it has become even more progressive since 2008.

Ireland has the 9th highest marginal tax rate of 34 OECD countries for employees. Marginal personal tax rates have increased significantly from 46.5% in 2008 to 52% for employees and 55% for the self-employed. The point at which Irish taxpayers become subject to high tax rates is also much lower than in other jurisdictions (a single person pays a 51% rate of tax on income above €33,800).

It is recognised internationally that high marginal personal tax rates inhibit business and economic growth<sup>13</sup>. This high rate is undermining our competitiveness as a location to work in or to do business in. It reduces the incentive for a business owner to grow a business and take on staff. It disincentivises individuals to work overtime, take on a promotion or a new position. It also influences investors as they decide where to invest their money.

The return to economic growth provides an opportunity to re-examine our income tax regime. The OECD and tax policy makers internationally have accepted that a broad base and lower income tax rate offers the best potential for economic growth. This is a model that we adopt for corporation tax but it applies equally to income tax. Significant steps have been taken already to broaden the personal tax base and it is important now to focus on the phased reduction of the rate for all taxpayers and not just those below €70,000.

We welcomed the Government's measures in Budget 2015 to reduce the income tax burden on incomes of less than €70,000. However, the introduction of a new 8% rate of USC has resulted in the marginal rate of tax payable by individuals earning over €70,000 remaining at a very high 52%.

We welcome the Taoiseach's comments that:

*"Following the income tax cuts introduced earlier this year, and consistent with the statement of Government priorities agreed last July, we will cut the 7% rate of USC on all of those earning less than €70,000 per year"*<sup>14</sup>

However, it is imperative that reductions in the tax rate are not limited to income below €70,000. Budget 2016 should take the opportunity to outline a timetable for the reduction (or removal) of the 8% rate of USC which applies to income over €70,000.

Reducing this high marginal rate would bring Ireland more in line with competitor countries in terms of attracting and retaining highly skilled employees and entrepreneurs. International tax changes at OECD and EU level are focusing on the importance of substance and a lower marginal tax rate for all workers would make Ireland a more attractive place to locate jobs and substance.

---

<sup>13</sup> 'Tax Policy Reform and Economic Growth, OECD Tax Policy Studies', No. 20, 2010

<sup>14</sup> An Taoiseach Enda Kenny, Dáil Debate on Spring Statement, 29 April 2015

## Share-based remuneration

### Background

Share-based remuneration can play an important role in rewarding key employees at all stages of a business' development. Share based employee remuneration can significantly reduce fixed labour costs and capital requirements, thereby providing significant cash-flow benefits to an enterprise, particularly a high potential start-up. It can also be a very attractive form of remuneration to employees in a growing business with the potential for the capital value of the business to significantly increase in value over time. High potential start-ups (in the tech sector and elsewhere) often have limited cash to pay competitive salaries to key employees with international experience. These individuals could really make a difference to the success and growth of the business and are an essential part of the core team.

The tax regime to support share based remuneration is currently very limited. Section 128D, Taxes Consolidation Act 1997 ("TCA 1997") provides tax relief for employees in receipt of restricted shares. The relief reduces the taxable amount depending on the length of the restriction. Relief of this nature can be worthwhile when applicable, but it has a number of drawbacks. Most notably, it does not apply to share options.

### Issue - A competitive offering is required for share-based remuneration

The tax treatment of share-based remuneration provides no support to SMEs in Ireland who need flexible means for rewarding staff. Typically an income tax liability arises for the employee when the shares vest e.g. when share options are exercised, resulting in a high income tax, PRSI and USC bill (typically of 52% of the value of the award) before the employee has sold the shares.

Additionally, any subsequent profits made on the shares are subject to CGT. The high CGT rate of 33% further reduces the attraction of share based remuneration for employees.

The National Policy Statement on Entrepreneurship in Ireland, published by the Department of Jobs in 2014, has recognised the need for a tax efficient method of using equity to reward employees.

It noted that

*"the current tax treatment of share options, however, is considered to be less competitive than that available in other countries and this is having a negative effect on the ability of Irish startups to attract world class talent".*

The UK has a an attractive regime designed to help small, higher risk companies recruit and retain employees who have the necessary skills to help them grow and succeed.

### **Spotlight on the UK Enterprise Management Incentive Scheme**

In the UK "Enterprise Management Incentive Scheme" share options with a market value of up to £250,000 can be granted tax-free to employees of certain trading companies which have less than 250 employees. In order to qualify for this relief an employee must meet certain "working time" requirements and cannot have a material interest in the company, i.e. broadly a 30% shareholding.

No income tax or NIC is payable by the employee on the grant of the option. In addition, no income tax or NIC is payable on exercise of the option, unless the exercise price is less than the market value at the date of grant of the option. The employee pays capital gains tax when they ultimately dispose of the shares.

Feedback from our members has indicated that this regime has been successful in facilitating the take-up of employee ownership in UK start-ups.



**Recommendation - Introduce a specific tax incentive for share based remuneration**

Small privately owned businesses need to be able to compete with larger business to attract and retain key talent. One of the biggest barriers to incentivising employees through share-based remuneration is the funding of the charge to income tax/USC/PRSI on exercise of share options.

We recommend that a new simple regime modelled on the UK Enterprise Management Incentive regime be introduced in Budget 2016. Employees should not be liable to tax on exercise of share options. Employees should only be liable to CGT when they realise value from the shares i.e. when they dispose of the shares.

**Impact of high marginal personal tax rates****Background**

Our personal tax system has undergone a fundamental transformation in recent years. Ireland has the most progressive income tax system in the EU and it has become even more progressive since 2008.

**1. Noonan PQs on Progressive Tax System – PQ 99, 23 June 2015**

*“As I have said on many occasions, a fair, efficient and competitive income tax system is essential for economic growth and job creation. I have long said that the burden of the income tax system in Ireland is too high and that I would seek to reduce it as soon as it was prudent to do so. Ireland already has one of the more progressive income tax systems in the developed world...”*

*...The changes announced in budget 2015 were steps in a process targeting low and middle income earners, which seeks to ensure that we continue to have a tax system that is progressive and which rewards employment. I intend to continue to reduce the tax burden on low and middle income earners in this manner, subject to having the required fiscal space”.*

Ireland has the 9th highest marginal tax rate of 34 OECD countries for employees. Marginal personal tax rates have increased significantly from 46.5% in 2008 to 52% for employees (and 55% for the self-employed). The point at which Irish taxpayers become subject to high tax rates is also much lower than in other jurisdictions (a single person pays a 51% rate of tax on income above €33,800).

**Issue - The high 52% marginal tax rate inhibits growth and damages Ireland’s attractiveness**

It is recognised internationally that high marginal personal tax rates inhibit business and economic growth<sup>15</sup>. Our very high personal tax rates are undermining our competitiveness as a location for business – for business owners, talented and mobile employees and ultimately investors.

We welcomed the Government’s measures in Budget 2015 to reduce the income tax burden on incomes of less than €70,000. However, the introduction of a new 8% rate of USC has resulted in the marginal rate of tax payable by individuals earning over €70,000 remaining at a very high 52%.

We also welcome the Taoiseach’s comments that the 7% USC rate will be reduced in Budget 2016. However, this change will again not reduce the 52% marginal rate for taxpayers earning over €70,000.

---

<sup>15</sup> See e.g. ‘Tax Policy Reform and Economic Growth, OECD Tax Policy Studies’, No. 20, 2010

***Recommendation - A clear roadmap is required outlining the phased reduction of the 52% marginal tax rate for all taxpayers to below 50%***

It is imperative that reductions in the tax rate are not limited to income below €70,000. Budget 2016 should take the opportunity to outline a timetable for the reduction (or removal) of the 8% rate of USC which applies to income over €70,000.

The OECD and tax policy makers internationally advise us that a broad base and lower income tax rate offers the best potential for economic growth. This is a model that we adopt for corporation tax but it applies equally to income tax. Significant steps have been taken already to broaden the personal tax base and it is important now to focus on the phased reduction of the rate for all taxpayers.

Reducing this high marginal rate to below 50% on a phased basis would bring Ireland more in line with competitor countries in terms of attracting and retaining highly skilled employees and entrepreneurs. International tax changes at OECD and EU level are focusing on the importance of substance and a lower marginal tax rate for all workers would make Ireland a more attractive place to locate jobs and substance.

## **Employer PRSI**

### **Background**

Employer PRSI is a significant cost for any business hiring staff.

Employers are obliged to account for PRSI at a rate of 10.75% of wages for all workers earning more than €356 a week. Where workers earn less than this amount, a rate of 8.5% applies.

The Jobs Initiative in 2011 introduced a lower rate of PRSI of 4.25% on lower paid workers. This rate reverted to 8.5% at the start of 2014.

The UK has made a number of reforms to their equivalent National Insurance Contributions (NIC), to incentivise businesses to hire staff. Recent policy changes in the UK provide an NIC exemption to most workers less than 21 years of age and also provide all businesses with a £2,000 Employment Allowance per year towards their employer NIC bill. This is being increased to £3,000 from April 2016.

### ***Issue 1 - High Employer PRSI is a significant cost barrier to hiring staff***

One of the most significant cash disincentives to hiring additional staff is the Employer PRSI liability. The lower rate introduced as part of the Jobs Initiative was considered to be very successful for businesses with lower paid employees.

The 10.75% monthly cost of taking on an additional staff member has a considerable impact on the cash flow of a small business. The impact of hiring an additional highly-skilled and therefore higher-paid employee is greater due to the fact that the liability applies without a ceiling.

***Recommendation - Employer PRSI relief for all employers who increase their net headcount.***

To encourage employers to continue to build their workforce, a relief for employers would be progressive in that it would increase incrementally for each additional hire. Rather than seeking to apply different PRSI rates during the year, it might be administratively simpler to grant the relief by way of refund at the end of the year, based on the increased headcount. The relief could apply for a limited period of time and the level of relief given could be capped. The relief would need to be reviewed to ensure it operates effectively.

## Mechanisms to attract mobile talent

### Issue

Welcome changes have been introduced to the Special Assignee Relief Programme (SARP) in recent Budgets to improve its general attractiveness to the business community. However, Ireland has a high marginal tax rate and the SARP has limitations that reduce its availability to indigenous Irish businesses who wish to attract international talent and high performing diaspora. We would like to see a renewed focus on helping indigenous businesses attract this talent to assist Irish businesses grow and succeed. In line with international practices, we would like to see a relief mechanism introduced which would provide a similar relief to the SARP but which is broad enough to include new hires as SMEs will often not be in a position to avail of an assignee only programme.

This could also play an important role in building Ireland as an Innovation Hub by attracting top international research Professors through Science Foundation Ireland. Attracting top international talent is a crucial part of the Government's strategy to build research capacity in key areas of economic importance.

#### ***Recommendations – attracting talent to Ireland***

1. There is a need to assess how attractive our regime is in attracting mobile talent and high-performing diaspora to indigenous businesses to help them grow and succeed. We would like to see a relief mechanism introduced, similar to the SARP, but aimed at attracting talent to indigenous Irish businesses. In particular, this relief should be available to new hires as well as assignees in order to be effective.
2. We would also like to see a form of SARP relief introduced aimed at attracting research leaders in areas of national strategic importance under the Science Foundation Ireland Research Professorship Programme.

### 3. Rewarding the initiative of job creators

Entrepreneurs are needed in Ireland to create the 160,000 new jobs that are required by 2018 if we are to return to full employment – the Government’s stated objective.

In relative terms, a small number of self-employed people are personally paying income tax which represents 6% of the total tax yield in the economy. In addition, the regional spread of employment created by SMEs is particularly important for sustainable job growth – as highlighted in the Action Plan for Jobs 2015:

*“The aim of the Action Plan for Jobs is to support enterprise growth and job creation in every region of the country. The pace of progress in the regions – and especially those with the highest unemployment levels - needs to be accelerated through targeted supports for enterprise and job creation. Vibrant and competitive regions are important, not just from an economic perspective, but also from a societal point of view. Growing the economic base of regions supports social cohesion and provides opportunities for young people in particular to continue to live and work in their local communities”*

As well as in the National Policy Statement on Entrepreneurship in Ireland, whose aim is to:

*“Build world class entrepreneurial hubs and achieve greater regional spread of such hubs, facilitating entrepreneurial leadership”.*

Our tax regime should be supportive of these individuals who are creating jobs.

#### **Discrimination of the self-employed**

##### **Background**

The Government has recognised that the income tax regime currently treats the self-employed less favourably than those in employment. An Taoiseach, Enda Kenny, pledged to address this issue in March 2015 when he said:

*“We will also begin the process of equalising the income tax treatment of the employed and the self-employed. I want Irish entrepreneurs and small businesses to play a significant role in delivering full employment. The discriminatory tax treatment of self-employed people inherited by this Government can no longer be justified”<sup>16</sup>.*

#### **Issue 1 - PAYE tax credit of €1,650 for the self-employed/proprietary directors.**

Over 300,000<sup>17</sup> income earners are currently denied this credit which is available to all employees.

The PAYE tax credit was initially introduced in recognition of the fact that, at the time, the self-employed generally had the advantage of paying tax on a prior year basis. However, this logic is no longer relevant because the rules on payment dates have changed significantly since the credit was introduced. Now preliminary tax (which is typically 90% of the final tax liability) is paid in the **current year**. This eliminates the timing advantage and indeed requires some tax to be paid on part of profits before they have even been earned.

---

<sup>16</sup> An Taoiseach, Enda Kenny, at Ibec CEO conference, 4 March 2015

<sup>17</sup> Minister Noonan, Dáil PQ 67, 26 Feb 2015

***Recommendation 1 - Outline a timetable for extending the PAYE tax credit to all income earners***

We welcome the Government's commitment to end the unfair treatment of the self-employed. As it would cost €470 million to extend the full credit to all income earners, it may not be feasible in one Budget. However, first steps should be made in October and a clear timetable on equalisation should be outlined in Budget 2016.

***Issue 2 - Extra 3% rate USC on non-PAYE income over €100,000***

The top USC rate for self-employed individuals is 3% higher than that for employees on equivalent incomes, resulting in a 55% marginal rate for the self-employed.

This differential was first introduced for a 3 year period in 2011 at the same time as the PRSI ceiling for employees was removed. The extra USC had been due to expire at the end of 2014 but was extended indefinitely in Budget 2015.

The decision not to remove this disparity in Budget 2015 was justified on the basis that Government wished to ensure that the maximum benefit of Budget 2015 measures was capped for all tax payers.

However, no justification has been put forward to explain why the self-employed should actually pay more tax than employees on equivalent income.

***Recommendation 2 - The additional 3% USC is a penalty on entrepreneurship and should be abolished***

The extra 3% USC should be removed as part of the Government's plan of equalising the tax treatment of the employed and the self-employed. It would cost €125 million to remove this disparity, which impacts over 11,000 taxpayers.

If there is not sufficient fiscal space to fully equalise the treatment of the self-employed in Budget 2016, then a roadmap for how this full equalisation will be achieved should be outlined.

## Ease of paying tax

In our Executive Summary we emphasised the three key pillars for supporting entrepreneurs:

1. Raising capital to start and grow the business;
2. Building the best team to drive the business forward; and
3. Valuing and rewarding successful entrepreneurs.

In addition to these specific issues, it is important to maintain efforts to keep the tax compliance burden to a minimum. An efficient tax administration system is vital to reduce the barriers that impact entrepreneurs.

An efficient system is one which is simple, which provides certainty to taxpayers and which is fair and transparent. All taxpayers need to understand their basic rights and obligations. The system should provide ready access to the information which either they or their advisers need to comply, at a reasonable cost.

In the UK's recent Summer Budget the government outlined plans to publish a roadmap by the end of the year showing how it will transform tax administration for individuals and small businesses over the term of this Parliament. We would like to see a similar approach in Ireland.

Areas highlighted by our members where improvements could be made that would assist entrepreneurs, are listed below:

- **Developing Revenue Centres of Excellence:** Dedicated units within Revenue aimed at providing support to businesses on crucial areas would be welcome. In particular, a R&D Centre of Excellence which engaged with taxpayers on R&D tax credit claims would greatly enhance the R&D tax credit regime. Additionally, a dedicated mobile talent unit in Revenue would provide welcome assistance to businesses looking at bringing crucial mobile executives to Ireland. HMRC have taken this approach in the UK and created an Expatriate Team to specifically handle the tax affairs of expatriate employees in the UK.
- **Delays in VAT registration:** Feedback from a recent survey conducted by the Institute indicated that over a fifth of VAT registrations are taking more than four weeks to be processed. In many cases, the turnaround time on these registrations is in excess of 2 to 3 months. These delays are impacting businesses and preventing economic activity and the creation of jobs from taking place. It is vital that sufficient resources are provided to resolve the VAT registration process.
- **VAT Return of Trading Details:** Increased emphasis has been placed by Revenue recently on the VAT Return of Trading Details (VAT RTD). Feedback from members of the Institute has indicated that a significant number of VAT refunds are being withheld until VAT RTDs are filed. This imposes a significant cash-flow cost on businesses. The rigid approach being adopted by Revenue is not consistent with the work plan of the European Commission that is proposing the abolishment of such statistical returns as part of its work on the Standard EU VAT Return.
- **iXBRL filing:** The requirement to file accounts in iXBRL format imposes an additional regulatory burden and cost on business. While the smallest businesses are currently exempt from the requirement to file in iXBRL, the plan is for this to be rolled out to all corporate taxpayers over the coming years. Despite the additional burden and cost this will impose, the Action Plan for Jobs 2015 lists the extension of iXBRL as a job creation measure. iXBRL is an administrative cost for business and Revenue should ensure that supports are provided to smaller businesses to comply with the obligation. HMRC offer a free software tool to assist businesses in converting their accounts and a similar tool should be offered by Revenue.

- **Interest levels:** Where a taxpayer inadvertently underpays tax or pays a tax bill late they face an interest bill of 0.0219% per day for non-fiduciary taxes (8% annualised) and 0.0274% per day for fiduciary taxes (10% annualised). These rates are significantly higher than commercial interest rates. This interest burden acts as a de facto penalty (and is often charged in addition to penalties) rather than compensating the State for the delay in payment. This high interest cost is a significant cost to businesses and results in a disproportionate penalty applying.
- **Payment of tax:** As part of their simplified filing arrangements, Revenue allows small companies to pay their VAT and PAYE/PRSI liabilities on a less frequent basis. We would like to see a similar arrangement extended to small businesses for corporation tax and income tax so that they do not pay a large tax bill in one lump sum. We also think it would be useful to allow businesses to pay tax “on account” during the year. This would be of particular use to for example, businesses in the service sector with seasonal cash-flow.





**Irish Tax  
Institute**

*Leaders in Tax*

Irish Tax Institute  
Longboat Quay  
Grand Canal Harbour  
Dublin 2  
Tel.: +353 1 663 1700  
Email: [info@taxinstitute.ie](mailto:info@taxinstitute.ie)  
Website: [www.taxinstitute.ie](http://www.taxinstitute.ie)