Irish Tax Institute

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A future tax strategy to grow Irish indigenous exports

Opportunities and challenges in the new global landscape

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About Us

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

The Chartered Tax Advisers (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. With over 5,000 members in Ireland, along with the Chartered Institute of Taxation UK and The Tax Institute of Australia, we are part of the 28,000-strong international CTA network and a member of the Confédération Fiscale Européene (CFE), the European umbrella body for tax professionals.

Our members provide tax education and expertise to thousands of businesses, multinationals and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue, state bodies and the European Commission.

After 50 years, the Institute remains deeply committed to the role it can play in education, tax administration and tax policy in Ireland and in building and efficient and innovative tax system that contributes to a successful economy and society. We are also committed to the future of the tax profession, our members and our role in serving Ireland's taxpayers and best interests in a new international world order. Our *Irish Tax Series* publications and online database *TaxFind* are respected and recognised as Ireland's most extensive tax information sources.

Irish Tax Institute – Leading through tax education.

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Executive Summary

The combined threat of Brexit, US trade/tax reforms and proposed EU tax base changes has led to a series of warnings in 2017 about the high risks for Ireland's economy. The IMF has raised the flag in relation to the external risks that could impact Ireland, while the European Commission has said that Ireland could be subject to external shocks linked to Brexit and the international tax environment, through their impact on multinational location decisions. The Department of Finance has also expressed concerns, stating that "a shadow" could be cast on the economy. Key trade and tax statistics tell the story.

The UK accounts for almost 20% of Ireland's services exports and 13% of our goods exports and remains the biggest export market for Irish food, with 42% of food exports going there in 2016. Enterprise Ireland has said that the impact of Brexit on Irish companies has already started, and the ESRI has warned that a hard Brexit could cost Ireland €200m a year and 49,000 jobs over a decade. The country's economic output would be reduced, with export companies worst hit.

The significance of US and EU tax reforms is also clear, when you consider that IDA Ireland-assisted multinationals account for 89% of total exports among agency-assisted companies. Multinationals account for 80% of Ireland's corporate tax base, and US multinationals account for 70% of employment in IDA Ireland-supported companies. The foreign-dominated pharmaceutical sector, on its own, accounts for almost 40% of the value of manufacturing production in Ireland.

While the outcome of these global trade and tax issues may be unknown, the threats that have arisen have flashed amber lights for Ireland. They give us good reason to look with urgency at the vulnerabilities in our economic model. They are also forcing us to focus ambitiously on a new and diverse exporting strategy that includes the pursuit of new market opportunities in the Eurozone area and beyond. The prospects are good if we can take full advantage. The Eurozone grew by 0.5% in the first quarter of 2017, an annualised rate of around 2%. It is picking up speed and is now growing at a faster rate than the US economy. However, growth opportunities are not just about new markets – there is plenty of scope for us to increase exports in all markets through product innovation and diversification.

In addition, global changes such as the digitisation of the world economy and the rapid growth in services as a share of world trade represent opportunities for Ireland, with its small, open economy. Trade in services has been the fastest-growing component of international trade, and annual growth rates in recent years have averaged close to 10%. Ireland has a strong starting point in harnessing this opportunity, with our successful export record over many years and a deep understanding of the value of international trade in our economic journey.

However, in planning for the future we must not just reflect on our past success. We must acknowledge and address the weaknesses in our indigenous export model before we can proceed. It is a skewed model in many respects, with high concentrations of exports in certain sectors and markets. Ireland has a strong reliance on a small number of high-volume export sectors such as food. It leans on a small number of export markets and a limited range of products. Although there are "superstar" Irish performers that are globally focused, most Irish exporting manufacturers need to broaden their sights when it comes to their product range and export markets. 20% of Irish manufacturing companies export just one product, and close to half of them export fewer than five. Nine out of the top ten products exported by Irish-owned firms are food products. The Irish indigenous sector is also focused on a narrow range of export markets. 27% of Irish firms export to just one market.

Less is known about services firms because research to date has been narrowly targeted at patterns of trade participation and the differences between exporters and non-exporters. However, based on ESRI reports, we know that there are also weaknesses in the Irish services model. For example, the information service activities sector represents almost 14% of total exports by services firms in Ireland, but Irish firms in this sector are mainly domestically oriented, exporting less than 2% of their sales and accounting for just 0.5% of total exports.

All of this points to the highly concentrated, high-risk profile of Ireland's indigenous export sector.

Irish Tax Institute/B&A research among Irish companies in exporting sectors reflects the challenges that Ireland faces. It found that 61% of companies export to some destination, yet growing business closer to home is their priority and this takes precedence over growing new customers in export markets.

Just over half of companies export a product or service to the UK, yet most of those that do not export to the UK do not see themselves exporting there in the next 18 months. The challenges of Brexit also seem to be reflected in the fact that exporters to the UK see little growth in UK export activity in the future.

56% of companies export a product or service beyond the UK, and the growth expectations are more upbeat here, with two-thirds of them expecting their exporting business to be higher in 18 months' time. Of real concern, however, is the fact that almost all companies that do not export beyond the UK do not see themselves exporting beyond the UK in the next 18 months or so.

The IMF has been instructive in terms of what Ireland must set out to do. It "must create a resilient, dynamic, innovative economy that is broader based in its structure and less vulnerable". In parallel with our high-performing FDI sector, Ireland needs an innovative, export-led Irish indigenous sector. Enterprise Ireland put it well when it said: "while diversifying from the UK might have been a desirable objective for Irish companies in the past, Brexit means that it is now an urgent imperative".

A seismic shift in behaviour is needed if Irish-owned companies are to become diversified. The right "tools", supported by the right policies and actions, are essential. Highly skilled talent, expertise, innovation and R&D, as well as capital investment and finance, are critical to the plan. However, in many important respects, Ireland's tax policies are not matching the needs of the indigenous sector and will not drive the shift in behaviour that is required. While our 12.5% corporation tax rate is valued by many Irish businesses, we have a pattern of sustained high rates across a range of other taxes that are critical for growth and we have tax reliefs that are either not available or not accessible to Irish SMEs. This is creating challenges.

This urgent need to change tax policy is reflected in the Irish Tax Institute/B&A survey. 84% of companies believe that tax policies relating to the future of the Irish indigenous sector now need to be addressed in October's Budget. This Budget must take a strategically focused approach to Irish business and address barriers in the tax environment. While recent economic reports signal a reduction in the fiscal space in the first three years of a hard Brexit, the cost of not addressing key tax policies for the Irish indigenous sector risks storing up export and economic challenges for Ireland.

Capital gains tax and investment

Ireland's high capital gains tax rates are a barrier to investment. They are hindering the structural changes needed for a new and more resilient export model, including the national ambition to "increase the number of our Irish-owned companies of scale by 30%".

The 33% CGT rate is the fourth highest in the OECD and 10 percentage points above the median OECD CGT rate. It is dampening business activity in Ireland and causing stagnation in terms of the necessary scaling, capital investment, and the buying and selling of businesses that are core to the dynamism that the IMF says is necessary, given the global threats we face.

Related to this, Ireland's special "entrepreneur relief" reduces the high CGT burden on business sales to a limited degree. However, it locks out third-party investors, including the important "angel investors", who are willing to invest money, experience and industry expertise in ambitious young companies, without being involved in their day-to-day running. Business angel investment in Ireland is low compared to other countries such as the UK, Spain, France, Germany and Sweden. In an economy that faces risks and vulnerabilities, the existence or indeed continuation of such a restrictive policy does not speak to the ambition of Irish businesses seeking to scale and expand.

We know that Irish SMEs are more reliant on bank finance than those in other EU Member States and that they need to diversify into other equity sources of finance. The Government has recognised the need to develop appropriate alternative funding mechanisms to support companies over the coming years. This makes the capital gains tax environment critical.

High CGT rates in Ireland are a matter of real concern because investment in innovation, talent and equipment is essential if Irish businesses are to increase their level of exports. German *Mittelstand* companies are renowned for their levels of long-term investment, ensuring that German companies are among the highest-performing globally.

Those countries with targeted tax strategies for investors have seen direct results: venture capital investments in Israel were 14 times the level of those in Ireland in 2014, while the UK had the highest level of venture capital investment in Europe in 2015.

The personal tax regime

High tax rates are also evident in the personal tax landscape, despite the backdrop of skills shortages and a very real and intense competition among countries for talent. Employees in Ireland have some of the highest effective tax bills in the world as salary levels rise above the average wage. The global shortage of talent is making its impact felt in Ireland and elsewhere, with 81% of Irish CEOs now believing that the lack of availability of key skills is a top business threat to growth.

For example, over 2,800 ICT-related vacancies are listed on TechLifeIreland.com, a national website to attract technology talent into the country. Indeed, across the EU, 40% of companies recruiting ICT specialists are reporting problems finding candidates with the required skills, which is an indicator of the challenges facing high-growth sectors in our economy. The availability of skills is also a challenge for the knowledge-intensive advanced manufacturing sector, with reported skill shortages across a wide range of roles including chemical engineers, biochemists, biotechnology technicians and scientists.

Irish SMEs need the best human capital and talent to build strategic management expertise, innovation and R&D capability and to drive export-led expansion. But challenges abound here. In addition to having high personal tax rates, Ireland does not have a workable share option regime that allows SMEs to attract and reward highly skilled and hard-found talented employees. SMEs must compete with larger companies for talent, and 38% of them do not believe they can compete with larger companies when trying to recruit the best candidates. A new share option scheme that would help them attract the talent to drive and expand their businesses is vital.

Another policy tool for attracting talent from abroad is Ireland's Special Assignee Relief Programme (SARP), but it effectively locks out Irish SMEs because it is available only to assignees working within a multinational group. A new regime focused on SMEs should be considered.

R&D and innovation

Innovation and new product development must underpin export growth. The importance placed on innovation is evident in its listing as one of four essential pillars in a new national exporting strategy, '*Enterprise Ireland Strategy 2017–2020*'. It is key to deepening "resilience" in our enterprise base. International research reinforces this, showing that consumer companies have "become dependent on innovation for growth" and that new products alone account for 15–20% of annual sales in leading consumer companies. The reality in Ireland is that innovation and new product development are nowhere near where they need to be among SMEs if we are to achieve the important goal of product diversification.

Only 1% of small firms and 16% of medium firms consider themselves to be R&D active, low percentages in the context of our national ambitions. Older companies are driving the recent increases in R&D activity, but innovation in younger companies has flatlined since 2009. The 1% figure is a concern in the context of IMF findings which show that SMEs are the drivers of change in innovation and National Competitiveness Council findings which indicate that new start-ups are more inclined to engage in more radical innovations.

Overall, R&D expenditure in Ireland still falls some way short of the EU average and well short of countries such as Sweden, Germany and France. It is largely carried out by foreign multinationals. Without the innovation expenditure of the foreign-owned sector, Ireland would be the lowest overall performer in the EU in terms of share of GDP.

Ireland has an attractive R&D tax credit regime, but administration barriers are weighing heavily on its success in terms of the low take-up among SMEs. Irish Tax Institute research shows that 75% of Irish companies are aware of the R&D tax credit and 20% have availed of it. However, of those that availed of it, 47% said that the process was difficult to prepare for and administer. Only 35% of companies surveyed said that they intend to use it in the next 18 months, although this would rise to 62% if there was more clarity around the criteria for qualification.

Of real concern is the fact that the R&D tax credit regime restricts outsourcing and collaboration, a condition that is at odds with the best-practice models internationally. These models actively promote outsourcing and collaboration with the university sector. We know that such collaboration is critically important to the export-focused modern manufacturing sector, as well as many other businesses in Ireland.

An ambitious strategy for Ireland

Export-focused reports and strategies published in recent months are ambitious in their targets for Irish-owned exporters. Given our strong export record over the years, Ireland is right to be ambitious for its future. Enterprise Ireland client companies recorded export sales of €21.6bn in 2016, a 6% increase on 2015. This follows several years of export growth. Ireland has a healthy start-up culture, and our clustering of expertise, innovation and knowledge across different sectors has been successful. The tech sector in the east, the medical devices sector in the west, and the pharmaceutical and chemical sector in the south-west have driven exports, while we also have a vast array of young ambitious companies throughout the country with a proud record of growth and innovation.

Knowledge-intensive exports in services and modern manufacturing have surged, albeit from a low base when set against the volume of exports from the food and traditional manufacturing sectors. “Software, public procurement and internationally traded services” grew by 16% in 2016, and “lifesciences, engineering, paper print & packaging, electronics, and cleantech” grew by 10%. They signal where many of the future export opportunities lie for Ireland, provided we have the right policies in place to grasp them.

International reports, too, have highlighted opportunities for Ireland in the digitised economy. A new global report, “Digitizing Europe”, has named Ireland as one of nine European front-runner countries that could see the largest benefits from a more digitised European economy because we are geographically small, with limited domestic markets, but are well digitised. The nine front-runners, including Ireland, are even more sensitive than other EU countries to a lost digital opportunity, because a larger share of our economy is digitised and most of our future growth is digitally enabled.

The “Digitizing Europe” report focuses on a range of tax policies that it sees as key to the successful digitisation of the nine economies, including Ireland. It highlights share options regimes, tax measures for angel investors, an attractive capital tax environment and measures that promote entrepreneurial activity. Ireland must take heed.

Ambition has been the central theme of many of the strategic plans published in 2016 and 2017. Ambition is a shared effort that involves everyone: policy-makers, legislators, taxpayers, entrepreneurs, representative bodies and business organisations, State agencies and Revenue authorities. This report has specifically focused on the important tax policies and tax administration changes that we believe will contribute to achieving this ambition.

While Ireland cannot control the external threats to its future, what it can control, it should. The Government’s report on Irish trade, *Ireland Connected*, stresses that the key to sustaining jobs and incomes is Ireland’s ability to succeed in international markets. No stone can be left unturned in our efforts to do so.

Chapter 2

DID YOU KNOW?

Economic threats

- IMF – the external risks to Ireland's economy are high. The factors are Brexit, US tax reform and EU tax proposals, and global protectionism.[1]
- European Commission – Ireland could be subject to external shocks linked to Brexit and the international tax environment, through its impact on multinational location decisions.[2]
- Department of Finance – Brexit's "potential to adversely affect the Irish economy" and "the uncertainty of the policy stance in the US" are among the factors "casting a shadow over future growth prospects".[3]
- Enterprise Ireland – the fact that the growth of exports to the UK has slowed suggests that the impact of Brexit on Irish companies has already started.
- ESRI – a hard Brexit could cost Ireland €200m a year and deprive us of 49,000 jobs over a decade. The country's economic output would be reduced, with exporting companies worst hit.[4]

Dependencies in our economic model

Dependency on multinationals

- Exports by foreign-owned agency-assisted companies account for 89% of total exports in agency-assisted companies.[5]
- US multinationals account for over 70% of employment in IDA Ireland-supported companies.[6]
- 80% of Ireland's corporate tax is paid by multinationals.[7]
- The pharmaceutical sector, which is dominated by multinationals, accounts for 37% of the total value of all industrial production in Ireland.[8]
- Profits in the manufacturing sector account for almost 40% of all trading profits recorded by Revenue – the largest subsectors in corporation tax terms are the manufacture of basic pharmaceutical products, the manufacture of pharmaceutical preparations, and the manufacture of medical and dental instruments/supplies.[9]
- A quarter of all employment in foreign-owned companies is in manufacturing.[10]
- Foreign-owned companies contribute over 50% of gross added value to the overall non-financial business economy in Ireland.[11]
- Ireland's businesses have the highest profitability rate in the EU28, at 15.5%. When foreign-owned enterprises are excluded from the data, Ireland drops 15 places in the rankings, to 8.9%.[12]

Dependency on the UK export market

- In 2015 the UK was our biggest services export market, at 19% of the total.[13]
- In 2016 13% of Ireland's goods exports went to the UK.[14]
- The food sector is particularly dependent on the UK market. The UK remains the biggest export market for Irish food, with 42% of food exports going there in 2016.[15]
- Exports from Enterprise Ireland client companies to the UK totalled €7.5 billion in 2016. However, export growth rates to the UK has slowed from 12% in 2015 to 2% in 2016. The slowdown was largely due to a decline in food exports.
- Such is the dependency on, and impact of, the UK market that global exports growth for Irish-owned food sector companies was only 1% in 2016[16].
- The UK accounts for 35% of net Irish Indigenous exports (€7.5 billion)[17].

Weaknesses in Ireland's indigenous export model

Weak product diversification in manufacturing

- Most Irish owned manufacturing firms who are exporting are quite small, exporting few products to a small number of destinations[18].
- Exporting is highly skewed, according to research undertaken by the ESRI.
- 20% of Ireland's smaller firms export just a single product, and close to half export fewer than five products.[19]
- The median number of products exported by Irish firms in 2015 was four, this is one less than the median of five in 2000.[20]
- 9 out of 10 products exported by Irish-owned companies in 2015 were food[21].
- The Number 1 exported product was 'Meat of Bovine Animals, Fresh or Chilled' and it accounted for 23% of all exported products by Irish firms in 2015.
- 11% of Irish-owned firms export more than 20 products to over 20 markets and account for over 46% of the total export value.[22]

Weak market diversification in manufacturing

- Almost 27% of Irish firms export to just one market.[23]
- In 2015, the median number of export markets for Irish exporting firms was just three. This was the same number of median export markets that Irish manufacturers were focused on 15 years previously.
- 29% of Irish SMEs consider "finding new markets" their most pressing problem.[24]
- The IMD ranks Ireland's "export concentration by partner and product" as 52nd and 47th in the world respectively.[25]

Services

- Research on services firms is more narrowly focused on patterns of trade participation and the differences between exporters and non-exporters.
- However, based on research reports on services[26] we know that there are weaknesses in the Irish services model. E.g. The information service activities sector represents almost 14% of total exports by services firms in Ireland but Irish firms in this sector are mainly domestically orientated, exporting less than 2% of their sales and accounting for just 0.5% of total exports.
- Reports also show that large differences in export activity and intensity between Irish-owned and foreign-owned firms suggests that greater international engagement by indigenous firms might be possible[27].

Challenges with the key enablers to grow our exports

Talent

- High effective personal tax rates are a barrier to attracting talent.
- 81% of Irish CEOs say the lack of available talent is a key threat to business growth.[28]
- The services sector is key to exports, yet there are over 2,800 ICT-related vacancies on TechLifeIreland.com,[29] a national website to attract technology talent.

- The big growth in jobs is in the services area. 40% of EU companies recruiting ICT specialists reported problems finding candidates with the required skills[30]. Advanced ICT specialists are the fastest-growing large jobs category in the EU and are also among the best-paid 20% of jobs[31].
- Knowledge-intensive modern manufacturing is key for exports, yet skills shortages exist across a wide range of roles, e.g. chemical engineers, biochemists, biotechnology technicians and scientists.[32] Highly skilled employees are critical in key growth areas such as medical devices.
- A global talent shortage is impacting all EU countries.
- Young Irish SMEs competing for global talent need to offer share awards to attract employees, but Ireland has no workable share option regime for Irish businesses.
- The UK share regime specifically targets SMEs and is employee-friendly from a tax perspective.
- Ireland's employee tax regime to attract overseas talent is the Special Assignee Relief Programme (SARP).[33]
- SARP cannot be used by most Irish businesses as the relief applies only to staff assigned to Ireland from another group company outside the country.
- 67% of Irish HR management say that there are delays or cancellations of strategic activity because of a skills shortage.[34]

R&D and innovation

- Only 1% of all small companies consider themselves to be R&D active and 16% of medium companies consider themselves to be R&D active.[35]
- The largest 100 enterprises in terms of R&D spend account for 70% of the total R&D expenditure.[36]
- R&D expenditure in Ireland (1.51% of GDP) falls short of the EU average of 2.03%.[37]
- It also falls well short of some of the leading performers in the EU, such as Sweden, Germany and France.[38]
- R&D is largely carried out by foreign multinational companies.[39] Without the innovation spend of this sector, Ireland would have been one of the lowest performers in the EU.[40]
- R&D in Ireland leans heavily on companies that are foreign owned, large and long established (over 16 years of age). Innovation in younger companies (less than 3 years of age) has flatlined.[41]
- Outsourcing and collaboration are restricted in the R&D tax credit, at odds with international standards and especially worrying as an R&D environment that supports further collaboration with the university sector is regarded as the best-practice model internationally.
- A critical factor for Ireland's modern manufacturing companies is the importance of R&D and collaboration with third-level institutes.
- The R&D tax credit claims process and the uncertainty surrounding the qualifying criteria are daunting, and some SMEs do not venture to use the R&D tax credit as a result.
- The UK has an extensive range of measures that encourage all companies to make full use of the R&D tax regime.

Irish Tax Institute/B&A Research[42]

- 75% of companies surveyed were aware of the R&D tax credit and 20% had claimed it.
- Of those who availed of the R&D tax credit, almost half found it difficult to prepare for and administer.
- Only 35% of companies surveyed intend to avail of the R&D tax credit in the next 18 months.
- Over 60% would consider using the R&D tax credit if there was more clarity around the criteria for qualification.

The real-life importance of R&D and innovation in Irish enterprise

- Innovation is key to ensuring the long-term growth and increased competitiveness of medical device companies and many others in the modern manufacturing sector.
- There is growing pressure on manufacturing companies to conserve energy and reduce their carbon footprint, and innovation will be key to this.
- The pace of change in the fintech sector necessitates high levels of innovation – Enterprise Ireland's fintech portfolio employs more than 8,000 people, of which 40% are located outside Dublin.
- Enterprise Ireland – "the need for greater levels of innovation among Irish companies as part of their response to Brexit is crucial".

Financing

- More businesses in Ireland rated access to finance as their number one problem than in most other EU countries.[43]
- By European standards, Irish SMEs are considered among the most reliant on banks.[44]
- Almost 42% of Irish SMEs that were unsuccessful in a bank financing application did not seek alternative sources of funding.[45]
- Business angels provide equity investment and industry know-how to early-stage companies. Business angels invested €13.6m in 50 Irish start-ups in 2016.[46]
- Business angel investment in Ireland is low compared with other countries, such as the UK, Spain, France, Germany and Sweden.
- Ireland is also behind economies of a similar size such as Denmark and Finland.[47]
- Revised entrepreneur relief is restricted to owner-managers and locks out much-needed external investors.
- Ireland's 33% CGT rate is the fourth-highest rate in the OECD and is having a negative impact on investment in Irish business. The median rate in the OECD is 23%.
- High CGT rates are not generating high receipts for the Exchequer – CGT represented only 1.7% of the total tax yield in 2016.[48]
- Countries with targeted tax strategies for investors have seen results:
    - Venture capital investments in Israel were 14 times the level of those in Ireland in 2014.[49]
    - The UK had the highest level of venture capital investment in Europe in 2015.[50]

Low level of take-up of tax incentives

- The Foreign Earnings Deduction (FED) encourages businesses to send employees into emerging markets – only 144 FED claims were made in 2014.[51]
- The Employment and Investment Incentive (EII) is an income tax relief to encourage early-stage investment in scaling companies. In 2016, 1768 claimed it[52] – just over half the number are using it compared to the BES when it was at its most successful.
- Start-Up Refunds for Entrepreneurs (SURE) is a measure to encourage employees to start a business – only 59 people claimed it in 2014.[53]
- Income tax relief is available for key employees engaged in R&D[54] – only 25 people claimed it in 2014.[55]

Future opportunities and potential

The services economy

- Globally, trade in services has been the fastest-growing component of international trade.[56]
- Annual growth rates in recent years have been 10%.[57]
- Ireland has gained relative comparative advantage in high-tech knowledge-intensive services, one of the most dynamic export sectors worldwide.
- Irish-owned services agency-assisted companies recorded 97% exports growth in the seven-year period between 2008 and 2015.[58]
- Exports in ICT alone grew 114% in that period, but this was from a low base, and they accounted for just 9% of exports among Irish-owned companies in 2015.[59]
- Last year the trend continued. The strongest export growth sector among Irish companies in 2016 was software and internationally traded services. It grew by 16%.[60]
- Services account for 35% of total employment in Irish-owned companies, compared to 20% in 2000.[61]
- The presence of leading global IT and computer companies in Ireland is creating a dynamism that encourages Irish-owned start-ups, innovators and creatives in the services sector.
- Growth in areas such as fintech highlights the fast-paced nature of the services sector and the potential that exists for Irish companies. In Enterprise Ireland's fintech portfolio, 220 companies represent a wide range of subsectors from financial software to supply chain finance. Fintech employs more than 8,000 people, of which 40% are located outside Dublin.[62]
- Ireland is a hub for Fintech innovation and a key focus on Enterprise Ireland is to encourage and support more entrepreneurs through the Fintech Competitive Start Fund (CSF).

Modern manufacturing

- Modern manufacturing sectors that have significant growth potential include chemical products; computer, electronic and optical products, and medical devices.[63]
- Irish-owned modern manufacturing is intensely export driven, with an export intensity of 72%.[64]

- Irish-owned modern manufacturing exports grew by 85% in the seven years between 2008 and 2015 – and grew faster than traditional manufacturing exports in that period.[65]
- Last year Enterprise Ireland clients in "lifesciences, engineering, paper print & packaging, electronics, and cleantech" grew their exports by 10%, a reflection of the future importance of growth in modern manufacturing.[66]
- Modern manufacturing is experiencing high levels of growth but accounts for just 5% of exports by Irish-owned companies in value terms.[67]

The digitised economy

- A new global report, *Digitizing Europe*,[68] has named Ireland as one of nine European frontrunner countries that could see the largest benefits from a more digitised European economy.
- This is because we are geographically small and have limited domestic markets but are well digitised.
- The nine frontrunners are even more sensitive than other EU countries to a lost digital opportunity, because a larger share of their economies is digitized and the majority of their future growth is digitally enabled.[69]
- In Ireland e-commerce sales account for 46% of total sales of enterprises that have an online platform (52%).[70] This includes the influence of multinational companies.
- However, over 66% of SMEs in Ireland are not capable of processing e-commerce, and almost 25% have no website at all.[71]
- The digital economy offers plenty of opportunities for SMEs, traditional industries and for disadvantaged regions.[72]
- Digitisation is no longer a choice businesses can ignore – it is a necessity: any business missing out on the opportunities of digital will not be able to sustain the competitive pressure from more digitised rivals[73].
- Digitisation creates opportunities for small companies to innovate and grow faster by making it easier to distribute products, market services and reach a global audience.[74]
- The World Economic Forum ranks Ireland 25th out of 139 countries in its Networked Readiness Index. This measures how well countries are using information and communication technologies to boost competitiveness and well-being.[75]
- The potential export market that the digitised economy provides is huge, but if we fail to grasp it fully, the opportunity lost would be equally great.[76]
- 90% of existing jobs in the EU require some level of digital skills.[77]
- 37% of the European labour force does not have basic digital skills[78]

Eurozone Growth

- Growth in the Eurozone grew by 0.5% in the first quarter of 2017, an annualised rate of around 2%[79].
- The Eurozone is picking up speed and is growing at a faster rate than the US economy.

- The European Commission's economic-sentiment index rose to its highest level for a decade in April.
- The index is based on surveys of services industries, manufacturers, builders and consumers in the eurozone.
- Growth across the economies is becoming more broad-based[80].
- The Eurozone is now Ireland's second largest market for Irish indigenous exporters and accounts for €4.2 billion of sales[81]. Enterprise Ireland launched a new Eurozone Market Strategy in May. Innovation and diversification are two of the pillars in the strategy.

SMEs using FDI knowledge and collaboration as a springboard for global growth

- The IMF Ireland Report says that continued efforts to support SME collaboration with multinational companies and research centres can help to overcome knowledge barriers and increase linkages to foreign markets.[82]
- An important factor in developing globally focused SMEs in Ireland is the presence and influence of multinationals in Ireland's ecosystem. Innovators and creatives are attracted to FDI companies, with spill-over effects for Irish SMEs that are collaborating with or learning from the global companies.[83]
- The IDA Ireland/Enterprise Ireland Global Outsourcing Initiative is bringing Irish companies in contact with multinationals, with the aim of developing supplier contracts that allow Irish companies to gain global experience and global standards.[84]
- Foreign multinationals have played an important and valued role in Ireland's export growth and made a vast contribution to our tax base, employment growth, the development of talent and innovation, and the encouragement of Irish SMEs that are working closely with them.[85]
- Clusterings of Irish indigenous tech companies in the east, medical device companies in the west and pharma-related companies in the south-west have been the result of collaboration, partnerships and interaction, across a range of levels, with FDI companies.

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Chapter 3

Irish Tax Institute/Behaviour & Attitudes Survey

Irish Tax Institute/Behaviour & Attitudes Survey

These are the key findings from a survey amongst a representative sample of indigenous Irish companies with 10 or more employees, operating across a range of export potential sectors including manufacturing, IT/telecommunications, professional services, architectural/engineering, financial services etc.

Tax Policy & Budget 2018 – *Urgency*

- 84% of companies believe that the current tax policies as they relate to Irish indigenous businesses need to be improved upon in the next Budget.

Exporting Behaviour – *Focus on home market takes precedence*

- 61% of companies export some products or services to some destinations.
- Over half (56%) of companies export some products and services to the UK, while just under half (45%) export some products or services beyond the UK.
- Yet, growing business closer to home is the priority focus for companies and takes precedence over growing new customers in export markets.

Export Ambitions – *those not already exporting do not seem likely to do so in the near future*

- Just over half of companies export to the UK – most of those who <u>don't</u> export to the UK <u>do not</u> see themselves exporting any products or services there in the next 18 months.
- The challenges of Brexit seem to be reflected in the fact that exporters to the UK see little growth in the export activity in the future.
- 56% of companies export beyond the UK and two-thirds of them expect their exporting business to be higher in 18 months' time. Of concern, is the fact that almost all companies who <u>don't</u> export beyond the UK at the moment <u>do not</u> see themselves doing so in the next 18 months or so.

R&D Tax Credit and Innovation* – *half found it difficult to prepare and administer*

- 75% of companies surveyed were aware of the R&D tax credit and 20% had claimed it.
- Of those who availed of the R&D tax credit, almost half found it difficult to prepare and administer.
- Only 35% of all companies surveyed intend to avail of the R&D tax credit in the next 18 months.
- Over 60% of companies surveyed would consider using the R&D tax credit if there was more clarity around the criteria for qualification.

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* One of the four pillars in Ireland's new Eurozone export strategy.

Chapter 4

The Business Landscape in Ireland

This chapter gives a general overview of the structure of the Irish business landscape. It looks at:

1. Size, numbers and employment levels of enterprises in Ireland
2. A profile of foreign-owned enterprises in the economy
3. Irish-owned services and manufacturing companies – a sectoral analysis

1. Size, numbers and employment levels of enterprises in Ireland

There were over 238,000 active enterprises in the private business economy in 2014, employing 1.3m[1] people. They comprise large, medium and small companies and are made up of both foreign- and Irish-owned companies.

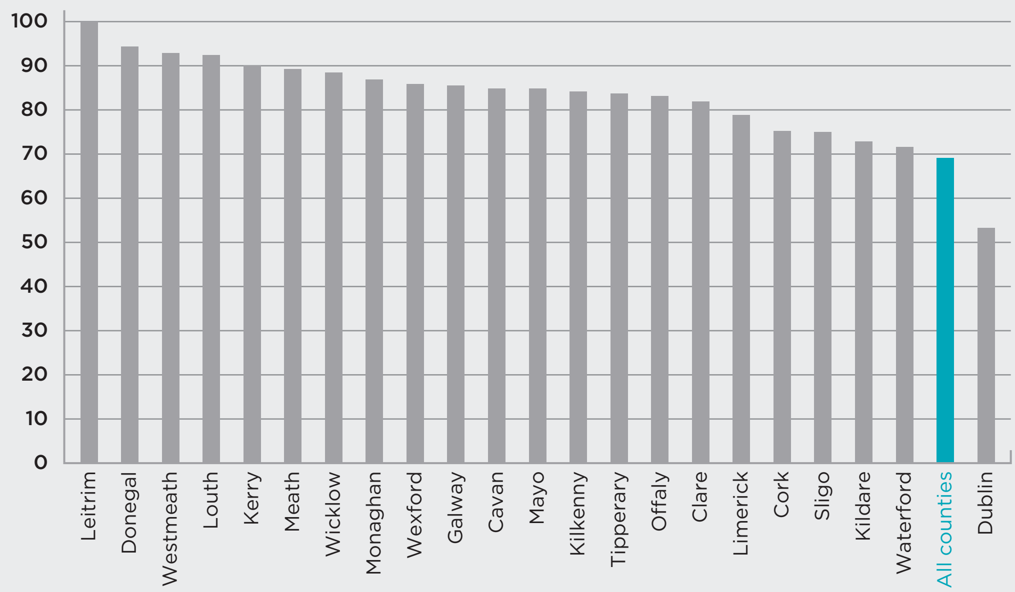
Large enterprises account for just 0.2% of enterprises but 31% of the people engaged,[2] an indicator of their heavyweight status in the economy. SMEs account for 99.8% of enterprises and almost 69% of the employment.

Company type	% of persons engaged	Number of persons engaged	% of enterprises
SMEs	68.9	919,984	99.8
Large enterprises	31.5	414,307	0.2

Source: CSO, Table BRA08

The role of SMEs cannot be overstated, especially in the context of regional employment, as we see in the below table. They account for more than 70% of employment in all counties except Dublin, and they are the majority employer in the capital, at 53%.[3]

Percentage of persons engaged by SMEs per county* 2014



Source: CSO

* Excludes counties Carlow, Laois, Longford and Roscommon because the observation is missing or falls under the limit of discretion/uncertainty.

1 CSO Statistical Release, Business Demography 2014 (6 July 2016).
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3 CSO Statistical Release, Business Demography 2014 (6 July 2016).

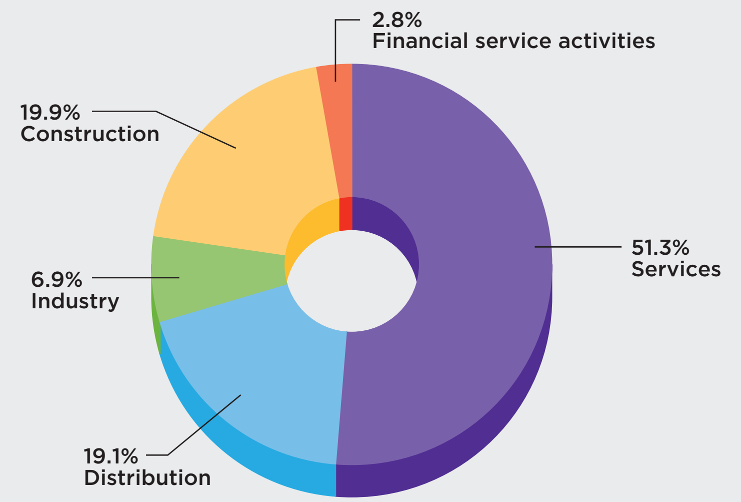
Contribution of Irish-owned and foreign-owned firms to employment

The Department of Finance's report *Economic Impact of the Foreign-Owned Sector in Ireland*[4] highlights the impact of Irish companies on employment by looking at the multiplier effect concerning jobs. The Irish indigenous sector has an employment multiplier effect of 10, in comparison to one of 3 for the FDI sector. Having an employment multiplier effect of 10 means that for each additional €1m in final demand, 10 full-time equivalent jobs are created in the economy.

Sectoral – Number of enterprises

Services dominate the number of enterprises, at 51.3%, with Construction (19.9%) and Distribution (19.1%) following.[5]

Distribution of enterprises by sector, 2014

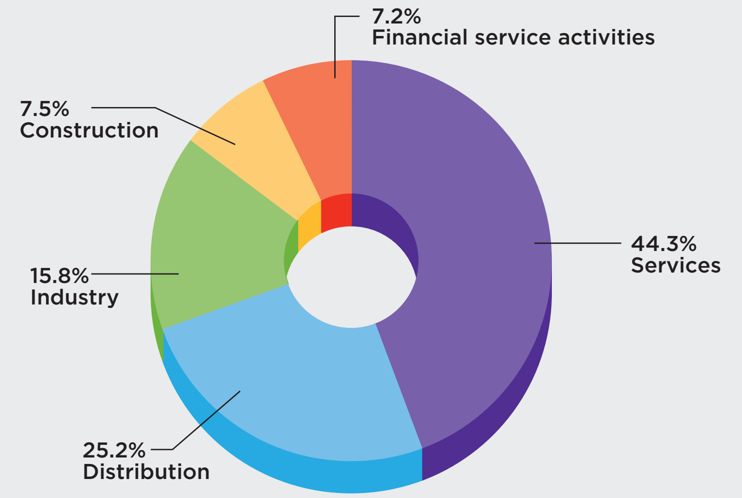


Source: CSO

Sectoral – Employment

The big employment numbers in Ireland are in Services and Distribution,[6] with almost 70% of the people employed in private enterprise working in these two sectors.

Distribution of persons engaged by sector, 2014



Source: CSO

4 Department of Finance, *Economic Impact of the Foreign-Owned Sector in Ireland* (October 2014).
5 CSO, Business Demography 2014 (6 July 2016).
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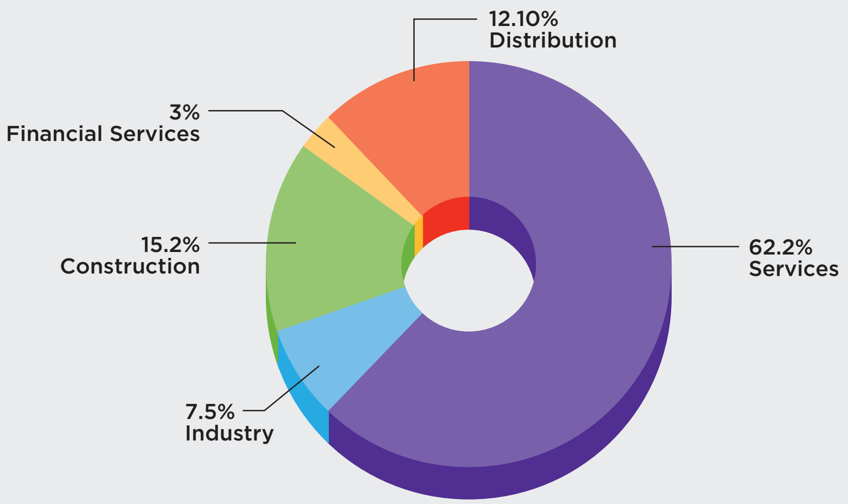
To get a complete picture of everyone employed in Irish business activity, we will look at those working in self-employment. Services is also by far the largest sector for the self-employed in Ireland. In 2014 this was the distribution of self-employed persons engaged by sector.[7]

Distribution of self-employed persons engaged by sector, 2014



Source: CSO

2. A profile of foreign-owned enterprises in the economy

Given the influential role that foreign multinationals play in the Irish business landscape, no analysis would be complete without a look at their profiles and contribution to Irish business.

We are mindful that within the foreign multinational sector, US multinationals play a dominant role, accounting for 56% of IDA Ireland-supported companies and 73% of the employment in those companies.[8] This serves as an important reminder of their contribution in the context of US tax reform proposals and their potential impact on US companies here.

The CSO's Business Demography report (2008–2014) and Revenue's report on corporation tax returns for 2015[9] provide further analysis of foreign companies. In Ireland, foreign-owned companies make up 1.5% of enterprises and account for 24% of employment. The Revenue report also brings home the scale of the contribution of multinational companies to Ireland's macro economy in terms of our corporate tax base. Foreign multinationals accounted for around 80% of corporation tax receipts in 2016, with Irish companies accounting for the remaining 20%.

A comparison of Irish- and foreign-owned firms by variables

	Irish-owned	Foreign-owned
Enterprises	98.5%	1.5%
Employment	76%	24%
Corporate tax take[10]	20%	80%

Source: CSO (Statbank)[11] and Revenue

7 CSO, Business Demography 2014 (6 July 2016).
8 IDA Ireland, Annual Report and Accounts 2015 (2016).
9 Revenue, *An Analysis of 2015 Corporate Tax Returns and 2016 Payments* (April 2017).
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11 Structural business statistics by nationality of ownership, NACE Rev 2 Sector, statistical indicator and year

Other interesting insights into the role of foreign companies are provided by the *Annual Business Survey of Economic Impact – 2015 (ABSEI 2015)*.[12]

Important information about the *ABSEI*

Throughout this report, we refer to the *Annual Business Survey of Economic Impact – 2015 (ABSEI 2015),* which analyses **only** the client companies of State agencies (Enterprise Ireland, IDA Ireland and Údarás na Gaeltachta). It is a study of Irish and foreign-owned agency assisted exporting companies with over 10 employees, operating in services and manufacturing. The report does **not** include retail companies in the services sector and so provides a pure picture of export-focused services companies engaged in internationally tradeable services.

The survey tells us much about the dominance of foreign multinationals in Ireland. They account for 82% of sales and 89% of exports of State agency-assisted companies in 2015.

Summary of key business indicators of client companies of State agencies (current prices), 2015

	Value, €bn	Percentage share of total		
	All	Foreign-owned	Irish-owned	All
Sales	195.6	82%	18%	100%
Exports	171.3	89%	11%	100%
Direct expenditure	42.6	49%	51%	100%

Source: *ABSEI 2015*

The contribution to added value and profitability in Ireland's business economy driven by foreign-owned companies (CSO data)

CSO data looks at all companies in Ireland and extends beyond agency assisted companies in the *ABSEI* and provides us with more detail on foreign companies.

The gross added value (GVA) contributions from foreign-owned enterprises to the overall non-financial business economy in Ireland was high in 2014, at 52.1% of total GVA. This is in comparison to an EU average of 23.9% in 2013.[13]

Other high-ranking countries for the impact of foreign-owned enterprises included Hungary (52.7%) and Luxembourg (47%). Larger economies such as Germany (21.9%) and France (16%) had lower shares.[14]

The CSO's International Comparisons report,[15] which looks at the profitability of companies across the EU (2013), also puts a sharp focus on the contrast between multinationals and Irish-owned companies in the economy. Ireland's businesses, measured across a broad range of sectors, have the highest profitability rate in the EU28, at 15.5%. However, when foreign-owned enterprises are excluded from the data, Ireland's figure falls to 8.9% and it drops 15 places in the EU rankings.

12 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015* (2017).
13 CSO, Business in Ireland Report 2014, Multinationals – An Irish Perspective. 2013 is the most recent year for which EU comparative data is available.
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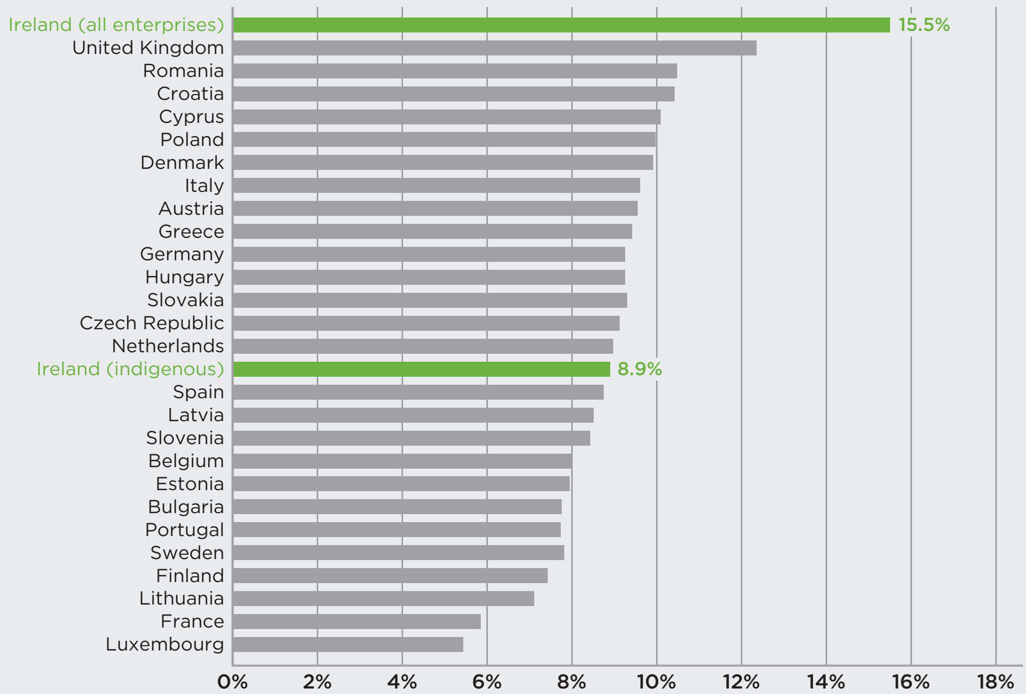
Gross operating surplus as a percentage of turnover by EU country, 2013



Source: CSO (Eurostat)[16]

3. Irish-owned services and manufacturing companies

We return to the *ABSEI* survey as it gives a close up look at exporting clients of Enterprise Ireland.

Important information about the *ABSEI*

Throughout this report, we refer to the *Annual Business Survey of Economic Impact – 2015 (ABSEI 2015),* which analyses **only** the client companies of State agencies (Enterprise Ireland, IDA Ireland and Údarás na Gaeltachta). It is a study of Irish and foreign-owned agency assisted companies exporting companies with over 10 employees, operating in services and manufacturing. The report does **not** include retail companies in the services sector and so provides a pure picture of export-focused services companies engaged in internationally tradeable services.

a) The services sector – a growth story

We are focusing here only on services companies exporting internationally tradeable services.

16 CSO, Business in Ireland Report 2014, Multinationals – An Irish Perspective.

When looking at services, *ABSEI* 2015 focuses only on companies in services that are providing and selling exportable services, sometimes referred to also as internationally tradeable services.

We appreciate that there are thousands of services companies in Ireland that do not export but whose main function is to serve the domestic market. They make an important contribution to employment, the tax base, payroll taxes and the overall economy. However, as they are not creating or designing exportable services and are not part of the exporting economy, they will not be analysed in detail in this report.

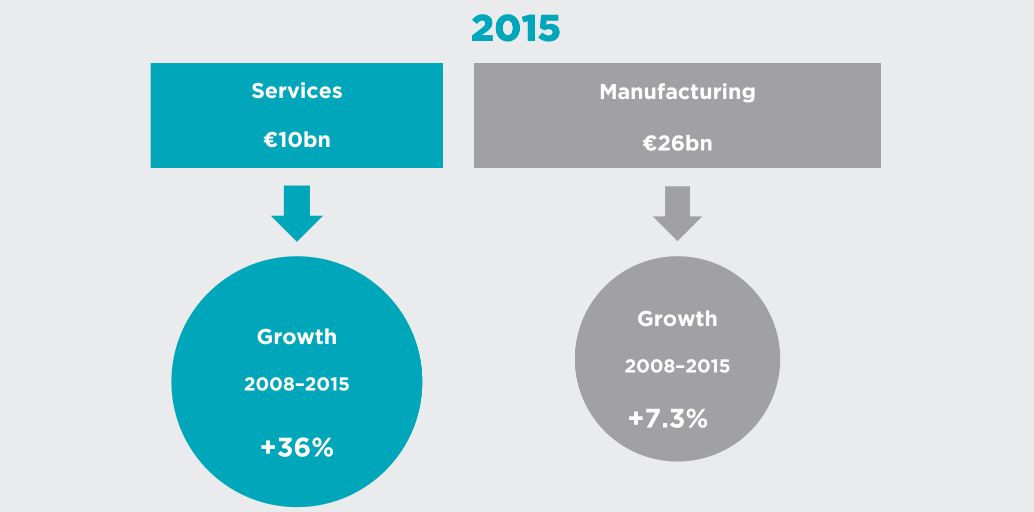
1. Sales growth among the Irish-owned client companies of State agencies

Sales by the Irish-owned services companies account for one-third of the total €36bn in sales by Irish companies in 2015, in contrast to two-thirds of sales for the manufacturing sector.

However, it is the rate of sales growth that impresses here, with services experiencing a much higher rate. That sector had a 36% increase between 2008 and 2015 in contrast to 7.3% for the manufacturing sector.

Services is an area of strategic significance to Ireland and a real area of export growth potential in future years.

Total value of sales and sales growth in Irish-owned agency-assisted companies, 2008–2015

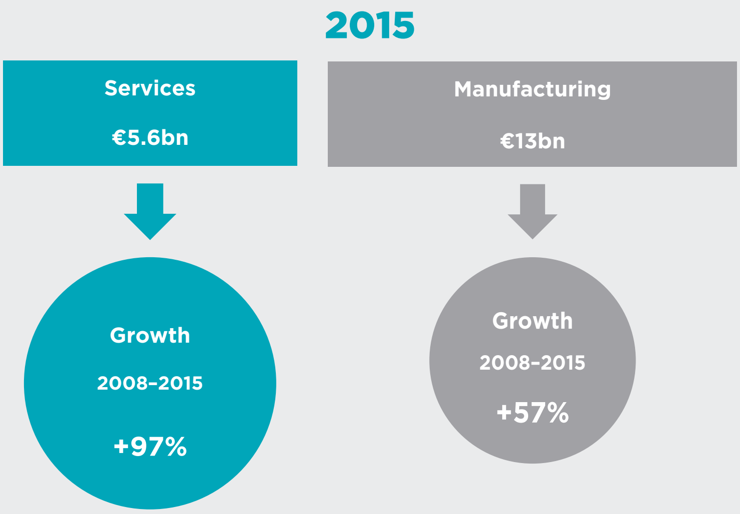


Source: *ABSEI 2015*

2. Exports growth among Irish-owned client companies of State agencies

When it comes to exports, services may account for only 30% of total exports among Irish-owned agency-assisted companies, but again it is the rapid progress in exports growth over the six-year period that impresses. The sector increased exports by 97% between 2008 and 2015, outpacing manufacturing export growth, at 57%.

Total exports and exports growth in Irish-owned agency-assisted companies, 2008–2015



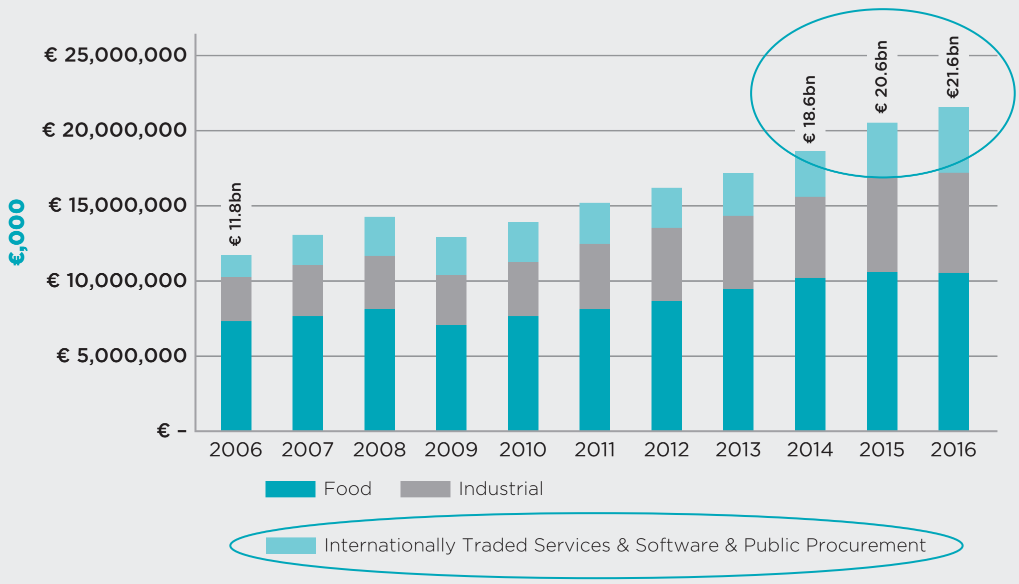
Source: ABSEI

Knowledge intensive services – the key to growth

Such high levels of growth in services as we have seen among Irish-owned companies in the *ABSEI 2015* are perhaps reflected in comments by the ESRI recently[17] when it highlighted that "Ireland has gained relative comparative advantage in high-tech knowledge intensive services, one of the most dynamic export sectors worldwide".

A further indicator of the growing role of those all-important "high-tech knowledge intensive services" was seen in export growth figures for 2016 released by Enterprise Ireland[18] in May 2017. We will focus further on the positive export trends and patterns in detail in Chapter 6 on Exports.

Enterprise Ireland client companies — export performance 2006-2016



Source: Enterprise Ireland

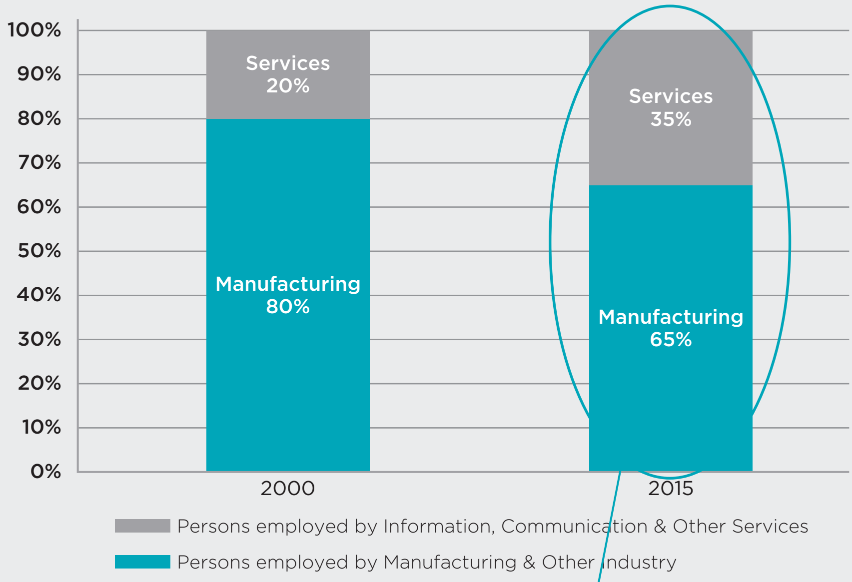
17 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises* (April 2017).
18 Enterprise Ireland, Export Performance in Global Markets: EI Client Company Export Results 2016 (May 2017).

3. The employment "big switch" – the increasing role of services in employment amongst agency-assisted companies

The changing trends in employment levels in services versus manufacturing are another part of the growing services story. The following bar chart shows the increasing role of services in employment.

> In 2000 the ratio was 20% services versus 80% manufacturing. In 2015 services has grown its share of employment to 35% while manufacturing has dropped its share to 65%.

Percentage of persons employed in Irish-owned agency-assisted companies: Manufacturing Vs Services sectors 2000 and 2015



Source: *ABSEI 2015*

Here is the 2015 breakdown of the share of total employment in Irish-owned agency-assisted companies in 2015.

Share of total employment in Irish agency-assisted companies in 2015	
Manufacturing & Other Industry	**65%**
Food & Drink	26%
Traditional Manufacturing	27%
Modern Manufacturing	5%
Energy, Water, Waste, Construction	7%
Information, Communication & Other Services	**35%**
Information, Communication & Computer	14%
Business, Financial & Other Services	21%
Source: *ABSEI 2015*	

It is worth noting that the shift towards greater employment in services applies across companies of all nationalities, not just Irish ones. Services employment used to account for just 28% of total employment in foreign-owned agency assisted companies in 2000 but has expanded significantly to account for 47% of employment in those companies in 2015.

CSO Annual Services Inquiry

To glean additional information on employment trends in services, we will also take a quick look at the CSO's Annual Services Inquiry (ASI), which looks at all companies in Ireland and goes beyond just the agency-assisted companies we looked at in the *ABSEI* 2015. It deals with the "Services & Distribution" sector in Ireland across Irish-owned **and** foreign companies combined.[19] The breadth of the "Services and Distribution" sector makes it difficult to make one sweeping statement on overall employment. However, looking at specific categories in the ASI provides us with insight into key growth areas in employment terms.

For example, we see significant employment growth in "Information and Communication" from 2008 to 2014. Areas in "Information and Communication" that increased include:

- Information services activities (+58%)
- Computer programming, consultancy and related activities (+35%)
- Motion picture, video, television programmes, sound recording and music publishing (+6.5%)

We also see significant increases in employment in:

- Activities of head offices, management consultancy activities (+37.5%)
- Wholesale of information and communication equipment (+21%)
- Restaurants and mobile food service activities (+10.9%)
- Employment activities (+14.4%)[20]

b) The Irish-owned manufacturing sector – a story of "traditional" and "modern" manufacturing amongst agency-assisted companies

To consider the strategic approach and the exporting strategy that are necessary for the Irish economy in the years ahead, it is useful to look at agency-assisted companies in the manufacturing sector in terms of the different dynamics of "traditional" and "modern" manufacturing.

The *ABSEI 2015* addresses the changing nature of modern and traditional manufacturing firms across several variables such as sales, exports growth and employment. It tells us in some detail what is happening within the sector and where future potential lies.

1. Sales – changing trends in manufacturing

Taking the sales data in this survey, we can see that although traditional manufacturing sales have grown, they are experiencing a very small growth rate compared to modern manufacturing. The contrast in sales growth in Irish-owned companies is stark: 1.7% versus 41%.

19 The ASI does **not** include the financial services sector.

20 Also of interest is the fact employment from the Irish enterprises alone make up the big numbers in this sector, accounting for 76% of the employment. Foreign-owned account for 24% of employment, according to the CSO Statbank. As we mentioned earlier, this is not surprising given that Irish SMEs make up most of the "Services & Distribution" sector.

Sales by Irish-owned companies, €m	% change from 2008 to 2015	Sales in 2015, €m
Traditional Manufacturing	1.7%	7,633
Modern Manufacturing	41%	1,417
Source: *ABSEI 2015*		

Sales by foreign-owned companies, €m	% change from 2008 to 2015	Sales in 2015, €m
Modern Manufacturing	7%	61,242
Chemicals	25%	39,966
Computer/Electronic/Optical	-34%	12,387
Medical Devices	40%	8,889
Traditional Manufacturing	10%	6,423
Source: *ABSEI 2015*		

2. Exports – changing trends in modern and traditional manufacturing

Again, we see that for Irish-owned agency-assisted companies modern manufacturing is experiencing higher export growth than traditional manufacturing over the seven-year period 2008–2015. This is also happening among the foreign-owned companies – see table. We will study exports in more detail in Chapter 6.

Exports by Irish- and foreign-owned traditional and modern manufacturing agency-assisted companies		
	Change from 2008 to 2015	**Exports in 2015, €m**
Irish-owned companies		
Modern Manufacturing	85%	1,024
Traditional Manufacturing	74%	3,803
Foreign-owned companies		
Modern Manufacturing	7%	60,407
Chemicals	26%	39,478
Computer/Electronic/Optical	-34%	12,162
Medical Devices	42%	8,767
Traditional Manufacturing	18%	5,769
Source: *ABSEI 2015*		

3. Employment – changing trends in modern and traditional manufacturing

Breakdown of employment in Irish-owned and foreign-owned agency-assisted companies, 2000 and 2015

	% of employment, Irish-owned companies		% of employment, foreign-owned companies	
	2000	**2015**	**2000**	**2015**
Manufacturing & Other Industry	80%	65%	71%	53%
Food & Drink	29%	26%	6%	4%
Modern Manufacturing	5%	5%		
• Chemicals			13%	14%
• Computer, Electronic & Optical Products			19%	8.5%
• Medical Devices			9%	15%
Energy, Water, Waste, Construction	3%	6.5%		
Traditional Manufacturing	42.5%	27%	24%	11%

Source: *ABSEI 2015*. Note, the percentages are rounded up.

We see substantial declines in the percentage of people employed in traditional manufacturing. It dropped from 42.5% to 27% of those employed by Irish companies and from 24% to 11% of those employed by foreign-owned agency assisted companies. In contrast, there was a large jump in the percentage of people employed by foreign-owned agency assisted medical devices companies – from 9% to 15%.

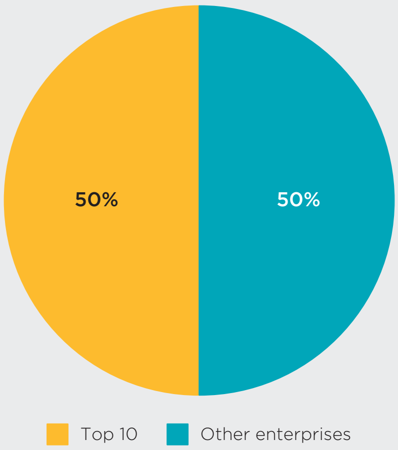
The dominance of a handful of companies in manufacturing – the "vulnerability" issue

The CSO report titled Irish Industrial Production by Sector[21] looks at all companies in Ireland, foreign-owned and Irish-owned. It goes beyond the *ABSEI* report which only looks at agency-assisted companies.

The report shows that the "value" produced in the manufacturing sector in Ireland is heavily reliant on a very small number of enterprises.

In 2015 50% of the value of all production in Ireland was accounted for by the "Top 10" industrial enterprises by value. These 10 enterprises had production with a net selling value (NSV) of €57.8bn. The remaining 3,278 enterprises combined generated the other 50% of NSV.

Net selling value 2015, Top 10 and Other Enterprises



Source: CSO

The big player – the Pharmaceutical sector

1. The Pharmaceutical sector accounted for €42.6bn of NSV in 2015 – 37% of total NSV.
2. The dominance of the Chemical and Pharmaceutical sectors has increased steadily since 2013, with the two sectors accounting for 51.5% of total NSV in 2015.
3. The Chemical and Pharmaceutical sectors saw the largest NSV increases from 2013 to 2015. The Chemical sector experienced 51.8% growth in that period, and the Pharmaceutical sector 46.9%.

Definition of NSV in Irish industrial production

NSV = net selling value of products manufactured and sold by Irish-based enterprises.

21 CSO, Irish Industrial Production by Sector 2015 (28 July 2016).

Modern manufacturing – a major performer in trading profits

Profits in the manufacturing sector account for almost 40% of all trading profits, according to Revenue's recent report *An Analysis of 2015 Corporate Tax Returns and 2016 Payments*.[22] The largest of subsectors in corporation tax terms are the manufacture of basic pharmaceutical products, the manufacture of pharmaceutical preparations, and the manufacture of medical and dental instruments/supplies.

Of total trading profits for 2015, 90% are attributed to just five sectors – the first five in the table below.

Sector	Adjusted profits*		Variance	
	2014, €m	**2015, €m**	**€m**	**%**
Manufacturing	26,307.01	55,207.66	28,900.65	109.9%
Financial and Insurance Activities	23,051.54	26,257.56	3,206.02	13.9%
Information and Communication	16,649.96	18,448.05	1,798.09	10.8%
Wholesale and Retail Trade, Repair of Motor Vehicles and Motorcycles	10,356.87	16,584.44	6,227.57	60.1%
Administrative and Support Service Activities	9,072.66	12,983.09	3,910.43	43.1%
Professional, Scientific and Technical Activities	2,526.25	4,119.63	1,593.38	63.1%
Transportation and Storage	2,477.60	2,713.95	236.35	9.5%
Mining and Utilities	1,727.20	1,657.31	-69.89	-4.0%
Construction	1,042.63	1,252.60	209.97	20.1%
Accommodation and Food Service Activities	555.93	761.01	205.08	36.9%
Other Activities and Sectors	412.05	524.95	112.90	27.4%
Real Estate Activities	404.97	393.20	-11.78	-2.9%
Human Health and Social Work Activities	336.54	352.40	15.86	4.7%
Agriculture, Forestry and Fishing	345.15	368.90	23.75	6.9%
Education	54.62	64.06	9.45	17.3%
Public Administration and Defence	52.55	31.68	-20.87	-39.7%
Total	**95,374**	**141,720**	**46,347**	**48.6%**

Source: Revenue analysis

* Adjusted profits are the trading profits of a company after being adjusted to reflect any differing treatment of certain items for accounting purposes compared to tax purposes

As well as representing a significant percentage of trading profits, manufacturing accounts for approximately 25% of the employment in foreign-owned companies. Over 75,000 people are employed in manufacturing in these companies.[23] This indicates the scale of the enterprises operating in the sector.

IBEC has highlighted in its report *Manufacturing a Renaissance* that some 82% of manufacturing firms are based outside the Dublin region.[24]

22 Revenue, *An Analysis of Corporation Tax Returns 2015 and Tax Returns 2016* (April 2017)
23 CSO, FDI Report 2015.
24 IBEC, *Manufacturing a Renaissance* (2016).

Chapter 5

A Changing Global Environment – Challenges for Ireland

The threat of Brexit along with possible changes arising from an EU common tax base and US Trade/Tax Reform has led to serious warnings on the possible impact on the Irish economy, and to Ireland's export model. Political, economic and trade changes beyond our control are bringing uncertainty to Ireland's economy and the outcome remains unknown.

In this chapter, we highlight the tax challenges for Ireland posed by Brexit, potential US business tax reform measures and the EU's proposal for a Common Consolidated Corporate Tax Base. Due to the immediacy of Brexit we have taken a closer look at the economic and political challenges posed by the UK's exit from the EU.

An Overview of Brexit

Background

Following the UK vote to leave the EU in 2016 and the triggering of Article 50 earlier this year, the impact of Brexit is of real concern to people in Ireland. Although Brexit is a British policy, the consequences could be very serious for Ireland, given the close relationship between Ireland and Britain. The Irish economy is closely linked to the UK economy, especially through a strong trading relationship, which sees Ireland and the UK trade more than €1bn worth of goods and services every week and over €60bn per annum.

Post-recession, Ireland's economic stability is underpinned by its healthy and mutually beneficial trading relationship with the UK. In 2016 Ireland exported €14.9bn worth of goods to Britain.[1] In 2015 14% of Irish exported goods were destined for the UK and 26% of Irish imports were sourced from the UK. In 2014 the value of Irish goods and services exported to the UK amounted to 17% of our GDP, while most other EU countries' exports to the UK are in low single digits.[2]

Britain's departure from the EU is going to alter Ireland's trading relationships. The UK is Ireland's largest single trading partner in Europe and ranks second to the US in terms of global export markets.[3] Brexit will also mean that Ireland's two largest trading partners will be outside the EU.

Ireland's main political parties advocate our remaining committed to the EU and believe that our future prosperity and well-being lie with continued membership of the EU. The Government is making concerted efforts to ensure that Ireland is well prepared for the challenges that lie ahead in the Brexit negotiations and beyond.

The Government has sought to articulate the position that it is in the interests of all EU Member States that the UK maintain the closest possible links to the EU. The Government can claim some success to date. The Chief EU negotiator, Michel Barnier, has named only four initial priorities – Northern Ireland is one of them.

The economy

The impact of Brexit on Ireland's economy is potentially damaging, with specific sectors such as agri-food and tourism particularly challenged. The European Commission has said that Ireland's GDP is forecast to expand robustly over this year and the next but that the pace of growth will then moderate. In its spring economic forecast, the Commission predicted Irish GDP growth of 4% for 2017 and 3.6% for 2018. The Commission said that

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1 CSO statistical release, Goods Exports and Imports December 2016 (15 February 2017), http://www.cso.ie/en/releasesandpublications/er/gei/goodsexportsandimportsdecember2016/.
2 Remarks by Dan O'Brien to the Oireachtas symposium on Brexit, *Irish Independent*, 25 September 2016.
3 IBEC, *The UK Referendum on EU Membership: The Impact of a Possible Brexit on Irish Business* (2016), p. 6.

improving labour market conditions are expected to support domestic demand over the next two years. It predicted that the unemployment rate will fall to 5.9% in 2018, while employment trends will remain positive. The Commission, however, also warned that considerable uncertainty surrounds the final outcome of the Brexit talks between the UK and the EU, as well as potential changes to US tax and trade policies, to which Ireland is highly exposed.[4]

Brexit's likely negative impact on business and trade is a huge concern for Ireland. As a small, open economy, Ireland's national prosperity is hugely dependent on our ability to trade. As the Institute of International and European Affairs[5] argues: "Big countries with big home markets can get rich without doing much international trade. Small countries can't. Ireland proves that rule. Since the 1990s, and in parallel with accelerated globalisation and Europeanisation, exporting has been central to driving Ireland's prosperity levels closer to those of our peers in northern Europe."[6]

The precise economic implications of Brexit will depend on the trade and other arrangements ultimately negotiated between the EU and the UK. However, the reality that Brexit is going to place obstacles in the route of Ireland's trading relationship with the UK should be enough to start economic alarm bells ringing for a country that must trade to thrive. Today, the UK is Ireland's most important European market, and Ireland is the UK's fifth-largest trading partner. As we mentioned previously, total exports of Irish goods to the UK in 2016 were worth €14.9bn, or 13% of total goods exports.[7]

Economic analysis from global leaders in the field of trade-related credit insurance, suggests that Brexit will mean increased economic uncertainty for Ireland, resulting in delayed investments and a slowdown in GDP growth.[8] Furthermore, this analysis suggests that Brexit will increase export and import prices in Ireland's trading relationship with the UK, leading to higher inflation and lower volumes of trade, all of which will impinge on economic growth.[9]

The impact of Brexit on the British economy is projected to mean that UK GDP in 2020 could be between 3% and 5.5% lower. Analysis undertaken by the ESRI suggests that this could equate to an estimated reduction of between 0.9% and 1.6% in Irish GDP in the medium term.[10] Open Europe has estimated that "in a worst case scenario" Ireland could see a permanent loss of 3.1% from GDP by 2030. Even in the best-case scenario the loss would still be 1.1% of GDP.[11]

Note: The ESRI Quarterly Economic Report Summer 2017 was published since this Brexit analysis was written. The new QER says Brexit continues to pose a substantial risk for the Irish economy. New calculations presented in the QEC suggests that a hard Brexit could have significant implications for the fiscal space available in the budgetary process. The need for caution on the public finances is reinforced by the results of analysis presented in the Commentary using the new structural model of the Irish economy (COSMO). The analysis uses the model to examine the impact on Irish potential output of different Brexit possibilities. The results indicate that a 'hard' Brexit would reduce Irish potential output by more than 3% over the medium term.

4 "EU Predicts Irish GDP Growth of 4% for 2017", RTE.ie, 11 May 2017.
5 Dan O'Brien, Chief Economist at the Institute of International and European Affairs.
6 *Irish Independent*, 30 April 2017.
7 CSO statistical release, Goods Exports and Imports December 2016 (15 February 2017), http://www.cso.ie/en/releasesandpublications/er/gei/goodsexportsandimportsdecember2016/.
8 R. Lissek and B. Murphy, *Ireland, Germany and the EU: Meeting the Brexit Challenge*, Report by the German-Irish Chamber of Commerce (May 2017), p. 15.
9 Euler Hermes (Ana Boata, Economist for Europe), "Brexit: What Are the Pressure Points on Ireland?" (June 2015).
10 ESRI, *Scoping the Possible Economic Implications of Brexit on Ireland*, Research Series No. 48 (November 2015), p. 6.
11 National Treasury Management Agency, *Brexit and Its Impact on the Irish Economy* (2015), p. 5.

Trade

Since 1973, Ireland's strong trading relationship with the UK has been regulated by the Single Market framework, but Brexit will change this completely. When Britain formally leaves the EU, this will place obstacles in the way of the flow of goods and services and will lead to a reduction in Ireland's GDP.[12] A so-called hard Brexit, would see the UK leave the Single Market entirely and then have a relationship with it based, at least initially, on World Trade Organisation (WTO) rules. This would place significant restrictions on the current favourable regime, which allows for the free movement of goods, services, capital and people between the UK and the other EU Member States, including Ireland.

The Irish Department of Finance has warned that the separation of the UK from the EU could lead to an increase in tariff and non-tariff barriers, which would have a very damaging impact on sectors in Ireland that export to the UK. In addition to the exporter impact, trade barriers could cause disruption to the global production networks that characterise many modern industries, making it more costly for sectors to source inputs.[13]

The Chartered Institute of Logistics and Transport points out that over 80% of Ireland's trade with mainland Europe transits as road freight through the UK. This is principally perishable or other time-sensitive trade. The dominant mode is RoRo (Roll-on/Roll-off), and there is unlikely to be any realistic alternative for this trade other than the UK landbridge. After Brexit, Irish landbridge trade will have to exit and re-enter the EU, with potential Customs and border inspection implications that it does not face at present. To illustrate this point, the WTO estimates that, on average, Customs clearance accounts for around 8% of the cost of importing goods by sea and adds about a day to the import process for a single freight container. The impact would potentially be more serious for Irish landbridge trade, which involves two sea crossings.

In a submission to an Oireachtas Committee, the Irish Exporters Association highlighted that a significant share of Irish exports is shipped through the UK landbridge as this is the quickest route to continental Europe. Depending on the terms of the future trade agreement between the EU and the UK, Brexit has the capacity to significantly threaten the reliability of this transit route.[14]

It is estimated that if the UK withdraws from the Single Market, through a hard Brexit, Irish annual exports could decrease by approximately 3.6% in GDP terms, or €6.6bn.[15] Even in a soft Brexit scenario, the additional expense of complying with two different regulatory regimes (EU and non-EU) and associated costs will substantially hit Irish exports, with negative knock-on effects for employment and for economic growth.

The first international sector-by-sector impact study of Brexit suggests that Ireland is particularly exposed to a hard Brexit. The ESRI examined 5,200 products that face some sort of tariffs when crossing EU borders and concluded that, irrespective of the nature of Brexit, Estonia, Finland, Latvia and Slovenia would experience only a very small decrease in their total trade, with "reductions of less than half of one per cent".[16] In contrast, "Ireland is the most severely affected [country] when total trade is used, followed by Belgium and Slovakia".[17] The ESRI report projects that Ireland could lose 4% of its total exports, representing an annual loss of €4.5bn in cash terms, and states that "Ireland now stands out as the most reliant on the UK market, followed by Cyprus, whereas Germany with its more global export reach is less vulnerable than the EU shares columns suggested".[18] The scale of Irish losses is compounded by the fact that much of Ireland's trade with the UK is in agricultural products, to which high tariff levels may apply when Britain actually leaves

12 P. McGrath, *Brexit and Likely Implications for Ireland* (2015), p. 3.
13 Department of Finance, *UK EU Exit – An Exposure Analysis of Sectors of the Irish Economy* (October 2016), p. 1.
14 Irish Exporters Association, submission to the Joint Committee on Foreign Affairs and Trade and Defence (9 March 2017).
15 Houses of the Oireachtas Joint Committee on European Union Affairs, "UK/EU Future Relationship: Implications for Ireland" (June 2015), p. 22.
16 ESRI, *The Product and Sector Level Impact of a Hard Brexit Across the EU* (November 2016), p. 24.
17 ESRI, *The Product and Sector Level Impact of a Hard Brexit Across the EU*, p. 24.
18 *The Irish Times*, 24 November 2016; ESRI, *The Product and Sector Level Impact of a Hard Brexit Across the EU*, p. 8.

the EU. The report suggests that "trade in some specific sectors, such as food and textiles would be close to wiped out while others would be almost unaffected".[19]

Instead of turning inward as a result of Brexit, the Government says that it is committed to redoubling our efforts to help Irish business trade more into Europe and across the world. For example, in March the Government launched a new trade, tourism and investment strategy, *Ireland Connected*, which sets out a vision and a plan to rebuild a strong economy and make Ireland the best place to do business in, to visit, to work in and to live in. Its goal is to increase Irish indigenous exports by 26% by 2020.

The huge uncertainty around Brexit is particularly severe when it comes to services trade. In 2015, the most recent year for which figures are available by individual market, Irish services exports to the UK were worth €24bn and this far exceeds the value of merchandise goods, at €14bn that the British buy from Ireland-based firms.[20] That latter figures, incidentally, includes all food products sold into the UK market. Services are a large part of our exports to the UK and are especially vulnerable to Brexit. It has been suggested that the new arrangements post-Brexit will mean barriers for such business and "a deterioration in access to the UK by EU-based firms."[21]

Employment

Almost 200,000 people in Ireland are employed as a direct result of Irish exports to the UK. This represents 10.4% of those currently employed.[22]

The damage that Brexit will inflict on Irish exports, as a result of increased transaction and compliance costs for business, has the potential to increase unemployment significantly.

According to the ESRI, as a result of Brexit, there will be a risk of wage reductions as high as 5% in exposed industries.[23] Brexit also creates a threat to employment through a loss of business and higher costs.

A Status Report on Brexit published by the Institute of International and European Affairs in 2017 noted that: "Brexit will cause companies to change their investment decisions. This is likely to result in both Irish jobs moving to the UK and British jobs moving to Ireland. Among the most traditional motivations for foreign direct investment is to jump over trade barriers that exist between countries. The higher the new barriers to trade between Britain and Ireland are after Brexit, the more likely it is that companies based in Ireland, which service the UK market, will have reason to relocate at least part of their operations into the UK. Such barrier jumping is likely to lead to job losses in Ireland."[24]

The same report also noted, however, that "jumping trade barriers works both ways. While Ireland stands to lose some jobs, it also stands to gain jobs from Britain as a result of Brexit. This is the only significant upside for Ireland from the UK departing the EU."

The CSO Business Demography results from 2014 show that 919,985 people are employed by SMEs in Ireland.[25] This major employment sector in Ireland is particularly vulnerable to Brexit.

FDI

The threat of the UK competing more aggressively for FDI upon formally leaving the EU has been identified by the National Treasury Management Agency (NTMA), a State entity that provides a range of asset and liability management services to the Irish Government.

19 ESRI, *The Product and Sector Level Impact of a Hard Brexit Across the EU*, p. 4.
20 Dan O'Brien, *Irish Independent*, 14 May 2017.
21 Dan O'Brien, *Irish Independent*, 14 May 2017.
22 Houses of the Oireachtas Joint Committee on European Union Affairs, "UK/EU Future Relationship: Implications for Ireland", p. 24.
23 British–Irish Chamber of Commerce, *UK – EU Membership Referendum* (June 2016), p. 4.
24 Institute of International and European Affairs, "Brexit: A Status Report" (2017), p. 35.
25 Irish Small and Medium Enterprises Association, "SME Facts and FAQs" (factsheet) (July 2016), https://www.isme.ie/advice/sme-facts-faq#employed.

The NTMA has stated that "the UK could lure FDI away from Ireland with lower taxes, higher subsidies and other incentives. The EU state aid rules may no longer apply to the UK and could give the UK a competitive advantage over the remaining EU nations."[26]

The British Prime Minister, Theresa May, has suggested that the UK will cut corporation tax to the lowest rate among the world's 20 largest economies. In a speech to the Confederation of British Industry, Mrs May said that her aim was "not solely for the UK to have the lowest corporate tax rate in the G-20 but also a tax system that is profoundly pro-innovation".[27] Experts have suggested that Britain could reduce corporation tax to less than 15% and that this would pose a serious challenge to Ireland.[28]

In Ireland, 40% of the population is under 29; we have the youngest population in the EU. Ireland's education system ranks in the top ten in the world, and over 50% of Irish 30–34-year-olds have a third-level degree – higher than any other country in the EU. Ireland offers a pro-business environment, together with a stable and competitive corporation tax regime.[29]

Brexit has the potential to make the Irish financial services sector more attractive. "Passporting", which allows London-based lenders and insurance companies to sell their services anywhere in the EU Single Market, is unlikely to continue after the UK leaves the EU.

Energy

Brexit has huge implications for the Irish energy market. It is estimated that Ireland imported in excess of €6bn worth of energy products through the UK in 2014.[30]

The UK and Ireland's gas grids are linked by sub-sea gas pipelines between the two countries. 100% of Ireland's natural gas came via transmission through the UK in 2015, and the introduction of tariffs or other barriers to trade on British gas could make Ireland's attempts to decarbonise more expensive. Alternatively, UK tariffs could incentivise Irish investment in indigenous renewable resources or finding new countries from which to import gas.[31] A report by the Oxford Institute for Energy Studies suggests that Ireland will "be effectively cut off from the main European Continent" gas market when the UK leaves the EU.[32]

Ireland and the UK's electricity grids are also linked. In turn, the British energy market is connected to both mainland Europe and Norway, but the UK is less dependent on energy imports than Ireland because the UK has North Sea reserves.[33] Electricity prices in Ireland are high but actually currently benefit from the UK cheaper access (with a 20% mark-up).[34] There is a distinct possibility that Brexit will substantially increase the price of electricity for Irish consumers and businesses.

Agri-food

The agri-food sector is Ireland's largest indigenous industry, directly and indirectly employing over 230,000 people. The sector is continuing to perform extremely well, increasing exports by 51% since 2009 to reach a record value of €10.8bn in 2015. The strongest categories in terms of export growth were beverages (+10%), beef (+6%) and

26 National Treasury Management Agency, *Brexit and Its Impact on the Irish Economy*, p. 8.
27 *The Irish Times*, 21 November 2016.
28 *The Irish Times*, 21 November 2016.
29 Briefing document coordinated by the Trade Division, Department of Foreign Affairs and Trade (St Patrick's Day 2017).
30 LK Shields, "Brexit: What Will It Mean for Ireland's Energy Market?" (October 2016).
31 P. Higgins and R. Costello, *What Does Brexit Mean for the Energy Sector in Ireland* (2016), p. 9.
32 Oxford Institute for Energy Studies, *Brexit's Impact on Gas Markets* (January 2017), p. 1.
33 National Treasury Management Agency, *Brexit and Its Impact on the Irish Economy*, p. 10.
34 Euler Hermes (Ana Boata, Economist for Europe), "Brexit: What Are the Pressure Points on Ireland?".

seafood (+4%).[35] The UK was the main destination for Irish agri-food and drink exports in 2016, accounting for 47% of such exports.[36]

The Irish agri-food sector is much more closely linked to the UK than to the rest of the EU.[37] Even without post-Brexit tariffs, additional costs associated with the reintroduction of Customs controls (rules-of-origin checks, import licence requirements, documentation, physical border checks), as well as the expense of complying with two different regulatory regimes, are likely to make Irish agri-food exports less competitive in the UK.

Teagasc (the Irish Agriculture and Food Development Authority) projects annual losses of between €150m and €800m in agri-food export value as a result of Brexit.[38] The UK is by far Ireland's largest trading partner in the agri-food sector. According to official figures, last year Ireland exported almost €5.1bn worth of agricultural products to the UK. This included more than €1.1bn of beef products (almost 50% of our total beef exports) and almost €970m of dairy products (almost one-third of our total dairy exports). Ireland is also the UK's largest destination for its food exports – worth €3.8bn last year.[39]

A recent report by ESRI economists underlines that Britain remains by far the most important market for Irish-owned companies and that over the course of the current decade (2011–15) the UK market absorbed just under half of the food exports of such companies.[40] The same report highlights the importance of the agri-food industry to Ireland's exports regime, with only one of the top 10 indigenous exports coming from the non-food sector.[41]

Adding to the challenge that Ireland's food and drink exporters face is the difficulty that Brexit poses regarding the UK landbridge. Ireland's agri-food and fisheries sector depends on fast access to its markets. Post-Brexit, Ireland will need alternative physical routes to markets to avoid the use of the UK landbridge. These alternative routes to continental Europe will need to be researched and funded, including the upgrading of Irish ports.[42]

Bord Bia is responding to the concerns of food and drink exporters to the UK that wish to consolidate their position in the marketplace while planning for a changing environment post Brexit. It is providing exporters with information on the changing landscape and tailored assistance to manage short-term volatility and will work with them to devise options for medium- and long-term challenges.[43]

Tourism

Tourism contributes 4% of our GNP and is one of Ireland's largest indigenous industries.[44] The sector employs over 220,000 people across the country, more than 10% of all employment. Overseas visitor numbers have grown every year since 2010, and 2016 was another record year: we welcomed 9m overseas visitors to Ireland, an increase of 11% on 2015. More importantly, overseas tourism revenue grew by 10% in 2016, delivering in the region of €4.7bn to the economy. In addition, Irish air and sea carriers earned an estimated €1.5bn in fares from overseas visitors in 2016.[45]

Britain is Ireland's most important tourism market. Over 4.9m UK citizens visited Ireland in 2016, which was worth over €1.5bn to the Irish economy.[46] Although Britain remains

35 Briefing document coordinated by the Trade Division, Department of Foreign Affairs and Trade (St Patrick's Day 2017).
36 Bord Bia, "Factsheet on the Irish Agriculture and Food & Drink Sector" (2017), http://www.bordbia.ie/industry/buyers/industryinfo/agri/pages/default.aspx.
37 Trinity Economics Paper (Professor Alan Matthews, former President of the European Association of Agricultural Economists), *Implications of the British Exit from the EU for the Irish Agri-food Sector* (April 2015), p. 3.
38 House of Lords European Union Committee, *Brexit: UK–Irish Relations* (December 2016), pp 9–10.
39 Briefing document coordinated by the Trade Division, Department of Foreign Affairs and Trade (St Patrick's Day 2017).
40 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises* (April 2017).
41 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.
42 Irish Exporters Association, submission to the Joint Committee on Foreign Affairs and Trade and Defence (9 March 2017).
43 Briefing document coordinated by the Trade Division, Department of Foreign Affairs and Trade (St Patrick's Day 2017).
44 Tourism Ireland, "New Tourism Ireland Red C Research Shows Brexit Implications for Tourism" (January 2017), https://www.tourismireland.com/Press-Releases/2017/January/New-Tourism-Ireland-RedC-research-shows-Brexit-imp.
45 Briefing document coordinated by the Trade Division, Department of Foreign Affairs and Trade (St Patrick's Day 2017).
46 Tourism Ireland, "New Tourism Ireland Red C Research Shows Brexit Implications for Tourism".

Ireland's biggest source market for overseas tourists, representing 41.6% of all such visits,[47] Brexit has the potential to undermine this huge source of revenue and employment for the Irish economy.

The depreciation of sterling since the UK voted to leave the EU is making Ireland more expensive for British visitors to travel to.[48] In addition, economic uncertainty may make British people more cautious about discretionary spending, and this may impact on Irish visitor numbers. The Irish Tourist Industry Confederation also sees Brexit as posing an "immediate-term challenge" for the tourism sector in Ireland because "the UK has become a better value location for international holiday-makers due to the fall of sterling".[49] The depreciation of the UK pound against the euro may also see more British tourists opt for Northern Ireland rather than the Republic of Ireland.

Oxford Economics projects that, as a result of the weaker pound, UK outbound visits will decline by 2.4% in 2017.[50] As the British market accounts for almost 42% of Ireland's overseas visitors, this decline could cost Ireland significant earnings and could lead to considerable job losses.[51]

Northern Ireland

Ireland is the only EU Member State to share a land border with the UK. There is free movement of people and goods across this border. 30,000 people cross the border between Ireland and Northern Ireland every day to work or visit family and friends.[52] The elimination of a hard border in modern times has been critical in the context of the Northern Ireland peace process and in building cooperation between the two jurisdictions on the island.[53] The Government has stressed that, irrespective of Brexit, the border between Ireland and Northern Ireland must remain "invisible" and that the Irish Government will be emphasising the importance of this approach in negotiations with EU colleagues.[54]

Brexit – the tax challenges

1. Customs duty and tariffs

The Brexit issue is shrouded in uncertainty and it is unclear at this stage what the final outcome of the negotiations will be between the EU and the UK.

In the worst case scenario, where the UK fails to secure a trade agreement with the EU on exit and no transitional arrangements can be agreed, the fall-back position for access to the EU market could be the standard World Trade Organisation (WTO) rules. This means the UK would be treated like any other non-EU (third) country without a free trade agreement with the EU, such as the US.

Even if a free trade agreement is ultimately achieved, all goods moving cross-border between Ireland (EU) and the UK would have to be cleared through customs. This process would create costs, additional administration and possibly time delays.

After exit, the UK could introduce its own regulations and non-tariff measures for products that are sold in the UK market. This could add to the complexity as businesses may have to deal with two different regimes.

47 Fáilte Ireland, "Tourism Facts" (September 2016).
48 Department of Finance, *Getting Ireland Brexit Ready* (October 2016), p. 6.
49 R. McHugh, "Irish Tourism Industry Facing Challenges as a Result of Brexit", *Business World* (8 August 2016).
50 Tourism Ireland, "Post-Brexit Briefing and Update on the British Market" (July 2016), https://www.tourismireland.com/Press-Releases/2016/July/Tourism-Ireland-post-Brexit-briefing-and-update-on.
51 R. Lissek and B. Murphy, *Ireland, Germany and the EU: Meeting the Brexit Challenge*, p. 33.
52 Comments by the Minister for Foreign Affairs, Charles Flanagan TD, *Drivetime*, RTÉ Radio 1, 26 July 2016.
53 Houses of the Oireachtas Joint Committee on European Union Affairs, *UK/EU Future Relationship: Implications for Ireland*, p. 11.
54 Comments by the Minister for Foreign Affairs, Charles Flanagan TD, *Drivetime*, RTÉ Radio 1, 26 July 2016.

2. Corporate tax policy

Immediately after the Brexit vote, the then Chancellor of the Exchequer, George Osborne, announced that the UK would seek to reduce its corporate tax rate to 15% or less. The British Prime Minister, Theresa May, said that her aim was "not solely for the UK to have the lowest corporate tax rate in the G20 but also a tax system that is profoundly pro-innovation" in a speech to the Confederation of British Industry.[55]

Undoubtedly, changes in the UK's corporate tax policy, including a falling corporate tax rate, could pose a challenge to Ireland.

Assuming the UK leaves the EU, it will no longer be subject to EU State Aid rules and the tax reform measures in the EU Anti-Tax Avoidance Directives (ATAD 1 and 2).[56]

However, the UK will continue to be an active member of the OECD and is committed to the reform measures set out in the OECD's Base Erosion and Profit Shifting (BEPS) Project. Indeed, the UK is already further along the road than many of its European neighbours. It has legislated for anti-hybrid rules and interest deductibility rules akin to those outlined in the ATAD. The UK also has a general anti-abuse rule, an exit tax and what it regards as EU-compliant controlled foreign company (CFC) rules.

What might concern the UK more is its potential departure from EU Directives that allow for dividends, interest, royalty payments and certain asset transfers to be made free of withholding taxes between EU Member States.[57] This would mean the UK relying on existing tax treaties, which are not always as favourable as the EU Directives.

Even though the UK can be somewhat more flexible with its corporate tax policy post-Brexit, its options are not without limits.

3. New UK VAT system

After Brexit the European Directives and Regulations on which the EU VAT system is based would no longer apply to the UK and the UK could determine its own VAT system.

As with customs, the UK would become a third country from a VAT perspective which would create an import/export border between Ireland and the UK. All supply chains to, from and via the UK could be affected by the changing VAT treatment and new reporting obligations. This could happen even where goods do not physically move through the UK but are supplied to or by a UK entity or under a UK VAT number. This could create cash-flow and administrative issues relating to VAT recovery in the UK and difficulties around registration and related filings.

55 *The Irish Times*, 21 November 2016.

56 See http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1454056979779&uri=COM:2016:26:FIN.; http://data.consilium.europa.eu/doc/document/ST-6333-2017-INIT/en/pdf

57 Parent–Subsidiary Directive (2003/123/EC), Interest and Royalty Payments Directive (2003/49/EC), Mergers Directive (2005/19/EC).

US business tax reform measures

The Trump Administration announced a two-page tax reform plan[58] on 26 April 2017.

Extract of the Trump Administration's Tax Reform Plan

THE WHITE HOUSE
WASHINGTON

2017 Tax Reform for Economic Growth and American Jobs

The Biggest Individual And Business Tax Cut In American History

Top Line:

- The U.S. tax code is overcomplicated and fails to create enough jobs, or provide relief to middle class families.
    - Since 2001, the U.S. tax code has faced nearly 6,000 changes, more than one per day.
    - Taxpayers spend nearly 7 billion hours and over $250 billion annually on compliance costs.
    - The U.S. has the highest statutory tax rate in the developed world, discouraging business investment and job creation.
- President Trump is proposing the largest tax cut for individuals and businesses in U.S. history.
    - It will simplify the tax code, incentivize investment and growth and create jobs.
    - It will provide historic tax relief for middle income families and small business owners.

The Need For Comprehensive Tax Reform

- An overly complex tax code is confusing and burdensome on American taxpayers.
    - The last major effort to successfully reform the U.S. tax code was over 30 years ago under President Reagan.
    - Today, according to the IRS' National Taxpayer Advocate, the federal tax code is nearly four million words long.
    - Congress has made more than 5,900 changes to the federal tax code since 2001 alone, averaging more than one change a day.
    - The National Taxpayers Union estimates that Americans spend 6.989 billion hours at a cost of more than $262 billion on compliance and record keeping costs.
    - Instead of a single tax form, the IRS now 199 individual income tax forms and 235 business tax return forms.
    - Approximately 90% of taxpayers need help doing their taxes.
- Today, with a corporate tax rate of 35%, U.S. businesses face the highest statutory tax rate in the developed world, and fourth highest effective tax rate, which discourages job creation or investment.
    - The U.S. is out of step with its competitors, having the highest corporate income tax rate among the 35 OECD nations and being the only nation that has increased its rate since 1988.
    - A lower business tax rate will discourage corporate inversions and companies from moving jobs overseas.
    - The high corporate tax rate keeps trillions of business assets overseas rather than being reinvested back home.
    - Even President Obama proposed lowering the business tax rate to 28 percent to help spur economic activity.

There are three main business tax measures included in the Administration's proposal:

1. A reduction in the corporate federal tax rate from 35% to 15%.
2. A one-time tax on the repatriation of foreign earnings of US companies (no rate is mentioned in the plan).
3. The replacement of the current worldwide tax system with a territorial regime.

The tax reform plan does not address the border adjustment measures proposed in the Blueprint[59] released by the House Republicans' Task Force on Tax Reform in June 2016.

58 See http://taxprof.typepad.com/files/trump-tax-plan.pdf
59 See https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

House Republicans' Task Force on Tax Reform Blueprint

Under the border adjustment proposed in the Republican Blueprint, exports would be excluded from the tax base and imports would not be tax-deductible.

At its heart, US tax reform is trying to change the behaviour of US companies by encouraging them to invest at home and penalising them for importing from abroad. A recent UN report examining greenfield investments around the world has indicated that tax reform in the US could potentially "affect FDI flows significantly."[60] The report suggests that if the US introduces a change in corporate tax rules that would reduce tax liabilities of US multinationals on overseas earnings, "it is likely that these multinationals would repatriate the accumulated overseas earnings and create negative FDI outflows."[61]

Following the tax reform announcement by the Trump Administration, the Speaker of the House of Representatives, Paul Ryan, the Senate Majority Leader, Mitch McConnell, the Chairman of the House Ways and Means Committee, Kevin Brady, and the Senate Finance Committee Chairman, Orrin Hatch, issued a joint statement saying: "The principles outlined by the Trump Administration today will serve as critical guideposts for Congress and the Administration as we work together to overhaul the American tax system."[62]

Considerable work is now required to convert the core principles of the Trump tax reform plan into a detailed legislative proposal to be agreed by both Houses of Congress. Intense consultation on the proposals has begun. The House Ways and Means Committee held public hearings[63] in May with stakeholders and interested parties to discuss the tax reform proposals, including the border adjustment measure.

> "Speaking on Monday 19 June, Paul Ryan said "I am here to tell you: we are going to get this done in 2017."

60 United Nations Conference on Trade and Development, *World Investment Report 2017*, p. 3, http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf.
61 United Nations Conference on Trade and Development, *World Investment Report 2017*, http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf, p. 78.
62 See http://www.speaker.gov/press-release/mcconnell-ryan-hatch-brady-statement-administration-s-tax-plan.
63 See https://waysandmeans.house.gov/event/hearing-increasing-u-s-competitiveness-preventing-american-jobs-moving-overseas/.

European Commission's proposed CCCTB – the tax challenges

The European Commission is proposing a fundamental change to the corporate tax regime for companies with taxable operations in the EU. This new system is referred to as the Common Consolidated Corporate Tax Base,[64] or CCCTB. The Commission claims that CCCTB will reduce complexity and compliance costs for cross-border companies and will help to tackle profit shifting and corporate tax abuse in the EU.

About the proposal

Under the CCCTB proposal, the total profits of a multinational group operating within the EU would be added together, using the same tax base in each EU country, and then allocated to the individual countries based on a pre-determined formula.

The CCCTB was first tabled by the Commission in 2011 but Member States were unable to reach agreement on the proposal then. The consolidated element was particularly problematic.

The Commission relaunched CCCTB[65] in October 2016, proposing that if introduced, it would be done through a two-step process:

1. Member States would agree a Common Corporate Tax Base, or CCTB, and (if that was agreed)
2. Member States would move ahead to agree a method of consolidation, CCCTB.

The CCCTB would be mandatory for multinationals with annual consolidated turnover above €750m that have taxable operations in any of the EU Member States. Smaller companies could opt in to the regime.

About the common base, CCTB

The common base would provide a single set of EU rules to determine how a group's profits would be taxed. This means that multinationals would have to refer to only one set of rules when computing their taxable profits and the calculation would be uniform throughout the EU. For example, this would include common rules for the tax treatment of depreciation, entertainment expenses, interest, R&D expenditure, dividend income and tax losses.

About consolidation, CCCTB

Once the EU tax base of the group has been established, these profits would then be shared out between Member States in which the company is active using an agreed allocation formula. Each Member State would tax its share of the group's profits at its own national rate.

The formula currently being proposed is based on three equally weighted factors:

1. The assets the company has in a Member State (e.g. buildings, machinery).
2. The labour the company has in a Member State (i.e. the number of employees and employment costs).
3. The sales the company makes in a Member State. The sales factor will be calculated based on destination (i.e. where the goods are sold/dispatched to or where the service is carried out).

Intangible and financial assets are specifically excluded from the allocation formula in the proposal.

64 See https://ec.europa.eu/taxation_customs/sites/taxation/files/ctr_factsheet2016.pdf.
65 See https://ec.europa.eu/taxation_customs/sites/taxation/files/ctr_factsheet2016.pdf.

The implications for Ireland

1. Loss of sovereignty

Ireland would retain the right to set a corporation tax rate but only a single rate. The rest of the corporation tax system for CCCTB companies would be determined entirely by the EU. Irish courts would likely have no role in determining legal disputes, which would be heard by the Court of Justice of the European Union in Luxembourg.

2. Loss of control over tax policy matters

A country's tax policy should be matched to the social and economic needs of its citizens. For each country, these needs will be different, and Ireland has a unique set of circumstances as a very small, open economy on the periphery of the continent. What is good tax policy for Ireland will not be good tax policy for France (for example) and vice versa.

Countries need the flexibility to adapt their tax policy if problems arise or individual circumstances change. One of Ireland's unique strengths is that it can adapt quickly to change when the need arises; this has served the country well and is not something to surrender lightly.

3. Impact on the Irish Exchequer

As outlined, the proposed allocation formula has three equally weighted factors of sales, assets and labour. This has been described as "a formula based on Victorian manufacturing."[66]

The allocation formula ignores the existence of intangible assets, which are a major part of modern global business. Ignoring the existence of intangible assets is simply not a realistic way of allocating profits to locations where economic value is created. It runs contrary to the EU growth agenda based on digital advancement, at a time when the Commission has estimated that there will be 500,000 unfilled vacancies for ICT professionals by 2020.[67]

According to the allocation formula proposed, one-third of a CCCTB group's profits would be allocated across the EU based purely on the location of its customers. EU Member States already collect huge amounts of tax as a direct result of their consumer market size, in the form of VAT.

A sales element in an allocation formula will always reduce the profits attributable to small economies such as Ireland that are export focused and have fewer domestic consumers. The Irish population of consumers is 4.7m, compared to 66m in France and 81m in Germany. In any exercise where one-third of a group's profits are spread across the EU on the basis of sales, Ireland will get only a minimal allocation.

IBEC's chief economist, Gerard Brady, has stated, that "Ireland would lose over 50 per cent of its taxable profits under this formula, with larger low-exporting countries such as France gaining over 73 per cent to its corporate tax base."[68]

Profits from trade outside the EU that are currently taxed in Ireland would also be reallocated to other Member States, based on an EU-wide assets-and-labour formula. To stimulate growth and diversify risk (particularly in light of Brexit developments), businesses are trying to develop more non-EU markets. Profits from this non-EU business could also be affected by a CCCTB formula and reallocated to other Member States.

All income would be treated the same way under the CCCTB proposal, which puts into question whether Ireland could continue to apply higher 25% and 33% rates to

66 Bill Dodwell, "Adjusting the Masterplan", *Tax Adviser*, 1 November 2016.
67 European Commission, "Digital Skills Market: Digital Skills and Jobs" (May 2017).
68 *The Irish Times*, 24 April 2017.

passive income and capital gains. The Irish Exchequer yield would almost certainly be impacted on by the loss of two key higher tax rates.

As well as the Exchequer impact from the loss of our two higher rates, it is also likely that Ireland's corporate tax base (which is wide by international standards) would be narrowed; how much it would be narrowed and the extent of the impact on the Exchequer will not be clear without further economic analysis. However, any corporate taxes forgone would have to be replaced.

Research carried out by the ESRI in 2014[69] found that an increase in Ireland's corporation tax rate would negatively impact foreign direct investment. Thus, there is little scope to increase the 12.5% rate to compensate for the narrower tax base that would arise under a CCCTB.

4. Impact on business

The way that the allocation formula has been designed in the proposal means that groups operating in Ireland are very likely to see profits currently earned here and taxed at 12.5% being reallocated to countries with higher tax rates. This could have a direct impact on competitiveness not only for Ireland but also for the whole EU.

There is a lack of certainty about the new rules. We have almost two hundred years' experience in Ireland of dealing with company tax. Much of the legislation and case law that has evolved over that time could become redundant, with a new regime, new rules and new definitions creating huge uncertainty for business and Revenue.

Although there could be some administrative benefits for business from having a common set of rules, independent research[70] commissioned by stakeholders including the Irish Tax Institute on the 2011 CCCTB proposal concluded that it would result in net higher administrative costs for companies. Time saved in preparing local tax returns would be outweighed by the additional work required to manage the consolidation process and deal with queries and disputes with tax authorities EU wide.

Because this is an EU tax proposal, it requires unanimous agreement from Member States before it can be introduced on an EU wide basis. However, in the absence of unanimity, EU law allows for a procedure called "Enhanced Cooperation", whereby a minimum of nine EU Member States could cooperate on CCCTB without the other Member States being involved. This would clearly create much uncertainty for multinational companies operating in EU countries that adopt CCCTB and in countries that do not. Undoubtedly, the CCCTB proposals represent a potential challenge for Ireland and for businesses operating across the EU.

In December 2016, the Joint Committee on Finance, Public Expenditure and Reform and Taoiseach issued a Reasoned Opinion[71] that the proposals for a CCTB/CCCTB breach the principle of subsidiarity - that the EU shall act "only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States." The Committee was concerned about the disproportionate impact of the proposals on a small open economy like Ireland, their potential to narrow Ireland's tax base, the complexity of operating two tax systems in parallel, the role of Ireland's national courts and the fact that the proposals impinge on our national competency.

The national parliaments of five other EU Members States have also raised formal objections to the Commission's CCCTB proposal (i.e. Sweden, Denmark, Malta, Luxembourg and the Netherlands).[72]

In the meantime, the Irish Government continues to engage with the European Commission's technical working groups pending a final outcome.

69 Department of Finance, "Economic Assessment of Ireland's Corporate Tax Policy" (October 2014).
70 Ernst & Young, "Common Consolidated Corporate Tax Base: A Study on the Impact of the Common Consolidated Corporate Tax Base Proposals on European Business Taxpayers" (January 2011).
71 https://www.oireachtas.ie/parliament/media/committees/finance/2016/RO-on-CCCTB---COM(2016)683-and-685.pdf
72 *RTE News* (9 January 2017) https://www.rte.ie/news/business/2017/0109/843579-7-countries-object-to/

Chapter 6

Exports – A Story of Growth and Potential

Tax recommendations to expand export markets

A new tax strategy for the Irish indigenous sector

1. It is recognised that a seismic shift in Ireland's exporting strategy is required to grasp new global opportunities and meet global uncertainties and challenges.

The urgency of this issue requires:

a. A tax policy strategy that helps Irish businesses to be ambitious and removes any blockers that prevent this ambition; and

b. That tax policies are implemented and administered in a seamless way that is easy to understand and apply and is barrier-free for SMEs.

Supported by an extensive Government information campaign

2. An early and extensive information campaign should be rolled out for Irish businesses, explaining both the tax policies in the strategy and how they will be administered.

3. The Foreign Earnings Deduction (FED) reduces the income tax bill of employees travelling to develop export markets in 30 countries, including the BRICS, some Middle Eastern, South American, Asian and African countries. With Irish companies needing new export markets more than ever, the range of qualifying countries should be reviewed and broadened.

4. There are also some significant gaps in Ireland's double taxation agreement (DTA) network across Latin America, Africa and southern Asia. These DTAs are critical for cross-border trade as they prevent double taxation. Negotiating a DTA requires commitment and cooperation from both countries; nonetheless, all efforts possible should be applied to addressing these gaps.

An overview

There is a deep appreciation of the role that exports have played in Ireland's economic growth and expansion for many decades now. The scale and value of exports from foreign multinationals and the success of the Irish-owned traditional manufacturing and food and drink sector have played a central part in the Irish exporting story. However, this has been complemented by ambitious Irish-owned companies exporting knowledge-intensive services and modern manufacturing products. A clustering of export-focused tech companies in the east, medical device companies in Galway and pharma-related companies in the south-west, along with many other successful companies throughout the country, has bolstered our export performance in recent years and given deeper foundations to our overall exports model.

However, the uncertainty and change in the political and economic landscape of our two biggest trading partners, the UK and the US, have put the issues of dependency and vulnerability in Ireland's export model under the spotlight.

No matter what is the outcome of the Brexit arrangements between the EU and the UK, or the shape of US tax reforms, the threat of uncertainty alone has flashed major warning signs for Ireland and given us good reason to look with urgency at the potential consequences for our export model, tax base, employment base and overall economic performance.

With or without external threats, exports are a priority issue for Ireland. Given our small population of 4.76m,[1] "the route to stable and sustainable economic expansion depends on the country's ability to grow knowledge-intensive, sophisticated goods and tradeable services for export". The ESRI has also warned that "the extent to which Ireland's exports can continue to grow depends on whether Ireland is exporting products whose export demand is increasing and to growing geographic markets" and that, for the Irish-owned sector in particular, "the challenge is to secure greater investment growth in dynamic products, to promote enterprise innovation and to support export expansion into expanding markets."[2]

To understand the scale of the challenges, the potential vulnerabilities and opportunities, and the tax policy that is now required to meet those challenges, we will consider how Ireland's exporting story has unfolded in recent years and where it needs to go in the years ahead. We will look at:

1. Overall trends in exports in recent years
   - services and manufacturing
   - multinational and Irish-owned companies
2. The key issues of dependency and vulnerability
   - Ireland's trading relationship with the UK
   - the significant contribution of multinationals, both domestic and US
3. Weaknesses in Ireland's indigenous exporting model
4. Potential opportunities and growth areas
5. The tax policies that will help to drive export growth and that must be addressed

1. Overall exporting trends in Ireland

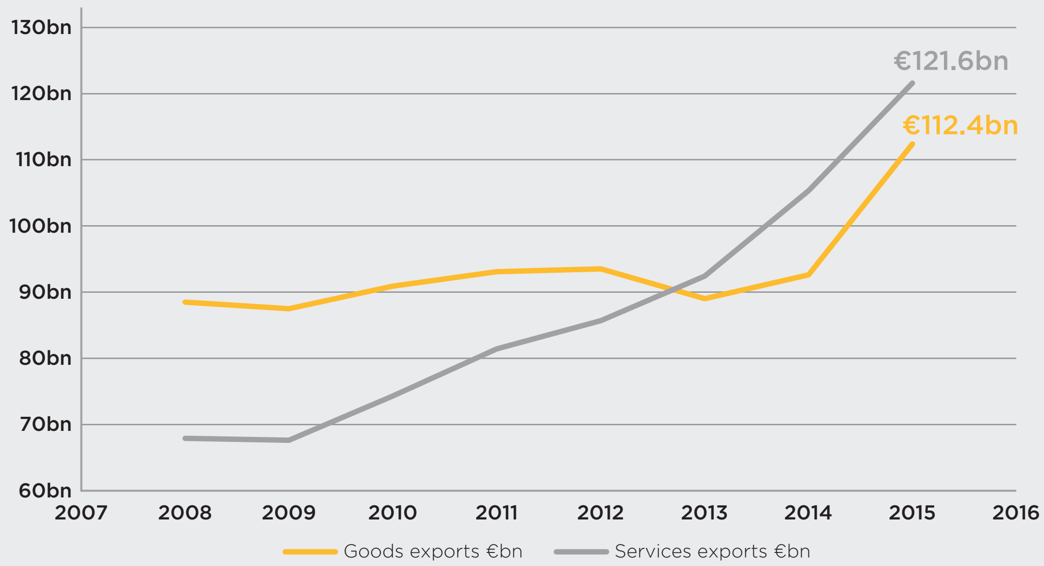
Looking first at the CSO's record of combined Irish-owned and foreign-owned exports, we see substantial growth in goods and services. Although exports were once driven by goods, it is notable that exports of services and goods are now quite evenly matched. In 2015 exports of services reached €121.6bn while exports of goods were €112.4bn – a record total of €234bn.[3]

The fast pace of growth in the services sector is reflected in the fact that exports of services[4] surpassed those of goods for the first time in 2013, and this has continued to be the case since then.

> Between 2008 and 2015 goods exports grew by 26% while services exports grew by almost 80%.

1 CSO, Census 2016.
2 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises* (April 2017); http://www.esri.ie/pubs/BKMNEXT335.pdf.
3 To compare the performance of goods and services exports, we chose the CSO's 2015 reports, as they contain the most recently available data for both categories when it comes to services.
4 CSO, International Trade in Services 2015 (November 2016), http://www.cso.ie/en/releasesandpublications/er/its/internationaltradeinservices2015/.

Goods exports versus services exports, 2008–2015



Source: CSO

Globally, trade in services has been the fastest-growing component of international trade, with average annual growth rates of around 10% over recent years. In 2014 trade in services represented 21% of world trade in goods and services.[5]

Trends in goods exports

More up-to-date figures on Ireland's goods exports show that they continued their upward trend in 2016, totalling €116.9bn, the highest figure on record.[6] We see below that "modern manufacturing" was a key driver of growth.

Top three goods exports as measured by % growth, 2015–2016

Goods	Increase 2015–2016	Share of total goods exports in 2016
Electrical Machinery, Apparatus and Appliances and Parts	150%↑	6.2%
Miscellaneous Edible Products and Preparations	11.7%↑	1.9%
Organic Chemicals	10%↑	20.2%

Source: CSO, Goods Exports and Imports December 2016

5 World Trade Organisation, *'The most dynamic segment of international trade: Trade in services'*, 2015
6 CSO, Goods Exports and Imports December 2016 (February 2017), http://www.cso.ie/en/releasesandpublications/er/gei/goodsexportsandimportsdecember2016/.

Trends in services exports

On the services side, it is interesting to observe huge clustering, with three categories accounting for almost 66% of total services exports in 2015. The biggest exporting sector by far is Computer Services,[7] followed by Operational Leasing and Financial Services. Again, the influence of foreign multinational companies is included in this table.

Exports of services by largest share of total exports for all companies based in Ireland, 2015

Services	Share of total exports in 2015	Value of exports in 2015, €m
Computer Services	47.0%	57,409
Operational Leasing	9.6%	11,751
Financial Services	9.0%	11,042

Source: CSO, International Trade in Services 2015

A look at Irish exporting agency-assisted companies

Given the strategic economic importance of a successful indigenous exporting sector, we are going to look closely at exports from Irish-owned companies on their own. The trend here is also one of growth.

A report by Enterprise Ireland, the State agency responsible for helping Irish companies export to international markets, showed its clients recording export sales of €21.6bn in 2016, representing a 6% increase on 2015.[8]

The leader of the growth performers was "software, public procurement and internationally traded services", with growth of 16%. These are knowledge-intensive, internationally tradeable services, signalling where many of the future export opportunities lie for Ireland. This high-performing "pack" of companies includes those involved in digital technologies, education services, business and consumer services, business process outsourcing and fintech.

Growth in "modern manufacturing" is also to be seen among Irish-owned agency-assisted companies, reflecting the trend we have seen in the combined foreign and Irish goods exports figures in the previous pages. "Lifesciences, engineering, paper print & packaging, electronics, and cleantech" grew by 10%, a reflection of the future importance of growth in modern manufacturing.

It should be pointed out that growth in Irish-owned exporting companies has been positive for many years, as shown in the *Annual Business Survey of Economic Impact – 2015* (*ABSEI*),[9] which looks solely at exporting agency-assisted companies.

Important information about the *ABSEI*

Throughout this report, we refer to the *Annual Business Survey of Economic Impact – 2015* (*ABSEI 2015*), which analyses **only** the client companies of State agencies (Enterprise Ireland, IDA Ireland and Údarás na Gaeltachta). It is a study of export-focused companies with over 10 employees in both the manufacturing and the services sector.

When it comes to services, this report does **not** include retail companies and so provides a pure analysis of export-focused services companies engaged in internationally tradeable services.

7 CSO, Services Exports and Imports Background Notes (December 2009), http://www.cso.ie/en/methods/balanceofpayments/methodologydocuments/servicesexportsandimportsbackgroundnotes/.
8 Enterprise Ireland, "Export Performance in Global Markets 2016" (May 2017); https://www.enterprise-ireland.com/en/Publications/Reports-Published-Strategies/ABR-2017.PDF.
9 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015* (January 2017); https://www.djei.ie/en/Publications/Publication-files/Annual-Business-Survey-of-Economic-Impact-2015.pdf.

The *ABSEI 2015* gives us insights into:

- The "big players" in the Irish-owned exporting sector by percentage share of total exports
- The export growth rates of each sector
- Export intensity (percentage of total sales that were exports)

Growth of exports in Irish-owned agency-assisted companies

	Exports in 2015, €m	Share of total Irish companies' exports in 2015	Exports growth from 2008 to 2015
Manufacturing & Other Industry	**13,061**	**70%**	**57% ↑**
Food & Drink	7,372	39%	35% ↑
Traditional Manufacturing	3,803	20%	74% ↑
Modern Manufacturing*	1,024	6%	85% ↑
Energy, Water, Waste, Construction	862	5%	584% ↑
Information, Communication & Other Services	**5,670**	**30%**	**97% ↑**
Information, Communication & Computer	1,741	9%	114% ↑
Business, Financial & Other Services	3,929	21%	90% ↑
Total for all sectors	**18,731**	—	**68% ↑**

Source: *ABSEI 2015.* Note the percentages have been rounded up.

The big players in terms of exports value

- The overall breakdown in 2015 exports is 70% manufacturing versus 30% services.
- This is driven by the big player in manufacturing, the Food & Drink sector, which accounts for over 39% of all Irish-owned agency assisted exports on its own.
- The sheer scale of the Food & Drink sector and its dependency on the UK market are obviously reasons for the high levels of concern about the impact of Brexit.
- Business, Financial & Other Services is the second-largest exporting sector, at 21%.
- Traditional Manufacturing is the third-largest, at 20%.

a) Export growth rates

Irish-owned agency-assisted companies have recorded very positive exports growth rates, increasing 68% in the seven years between 2008 and 2015.

Services: Services in its totality has grown significantly, by 97% from 2008 to 2015. Within the services sector the Information, Communication and Computer category grew by 114%, but this was from a low base, and it accounted for just 9% of 2015 exports. The Business, Financial Services and Other Services category also showed stellar growth, with a 90% increase in the same period.

Manufacturing: Manufacturing in its totality grew by over 57% between 2008 and 2015.

> Modern manufacturing grew by 85%, faster than traditional manufacturing. However, growth was from a low base, and accounted for just 6% of 2015 exports.

These high-performing sectors may be small in comparison to the Food & Drink sector; however, their growth rates show much more promise.

b) Export intensity

Export intensity, tells us the degree to which companies/sectors are export driven. Some industries are more geared towards exporting than others and indicate potential for further market expansion.

Definition of export intensity

Export intensity = the percentage of total sales that are exports.

Overall export intensity

Export intensity among Irish-owned agency-assisted companies rose from 35% in 2008 to an impressive 52% across all sectors in 2015.[10] This contrasts with the 96% export intensity among foreign-owned agency-assisted companies, but that is to be expected given the sheer scale and global breadth of their businesses. The Government's ambition is to have Irish-owned companies reach 60% export intensity by 2020, as outlined in the *Enterprise 2025* policy document.[11]

Manufacturing: Modern manufacturing (chemicals, medical devices, and computer, electronic and optical products) has the highest export intensity, at 72%, and is intensely export driven.

Services: Export intensity is also very high among services companies, ranging from the mid- to high 50s in percentage terms.

10 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015* (January 2017)
11 Department of Jobs, Enterprise and Innovation, *Enterprise 2025: Ireland's National Enterprise Policy 2015–2025, Summary Report* (November 2015); https://www.djei.ie/en/Publications/Publication-files/Enterprise-2025-Summary-Report.pdf.

2. The key issues of dependency and vulnerability in Ireland's export model

The major and immediate concerns for Ireland are that it has:

a) A high-intensity and high-dependency trade relationship with the UK and

b) A high dependency on export-led foreign multinationals, the majority of which are US companies and could be impacted in some manner by possible US tax reforms.

Despite the growth in our exports, the threats from political and economic developments globally, mainly Brexit and US tax reform are casting shadows on aspects of the Irish exporting model, as outlined in Chapter 5 on global challenges. The IMF has recently identified "serious global risks to Ireland's economy"[12] arising from Brexit, US tax reform and EU common tax base proposals.[13]

> The European Commission's Ireland Country Report[14] said: "Ireland could be subject to external shocks linked to the referendum on the UK's membership of the EU and the international tax environment, through its impact on multinational location decision".

Domestically, many others, including the ESRI and the Central Bank, have warned about various aspects of the challenges facing Ireland. The Department of Finance's Stability Programme Update[15] notes Brexit's "potential to adversely affect the Irish economy" and "the uncertainty of the policy stance in the US" as among the most prominent factors casting a shadow over our future growth prospects.

> "If Ireland is to protect its economy from major political and trade developments outside its control, it must support and build the indigenous exporting sector, helping to bring about significant structural changes in the operations and strategic approach of Irish companies – from product development, innovation and market diversification through to expansion, scaling, strategic management and the development of talent and knowledge across all divisions of the business." – Department of Finance's Stability Programme Update

Enterprise Ireland, which has launched a new Eurozone-focused exporting strategy, has highlighted the need for such change. It stressed the urgency of the matter in May 2017, stating that "the fact that the growth of exports to the UK, has slowed suggests that the impact of Brexit on Irish companies has already started". The agency has stressed that companies cannot afford to wait until the Brexit negotiations conclude but must act now. Enterprise Ireland makes clear that "while diversifying from the UK might have been a

12 IMF, "Ireland: Staff Concluding Statement of the 2017 Article IV Consultation" (May 2017), http://www.imf.org/en/News/Articles/2017/05/12/ms051217-ireland-staff-concluding-statement-of-the-2017-article-iv-consultation.

13 European Commission, Proposal for a Council Directive on a Common Corporate Tax Base (October 2016); https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_685_en.pdf.

14 European Commission, 2017 European Semester: Country Report – Ireland (February 2017); https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-ireland-en.pdf.

15 Department of Finance, "Ireland's Stability Programme, April 2017 Update" (April 2017); http://www.finance.gov.ie/sites/default/files/170502%20Final%20SPU%202017.pdf.

desirable objective for Irish companies in the past, Brexit means that it is now an urgent imperative”.[16]

The State body, which works with Irish-owned exporting firms, is undertaking a new Eurozone strategy aimed at inspiring and supporting “ambitious business leaders to increase the reach of their businesses into the Eurozone and build the scale of their business within Eurozone markets”.[17] Working with the Department of Jobs, Enterprise and Innovation and partners across Government, the agency is substantially increasing the level of resources in the Eurozone, as well as the supports available to client companies, including market access grants, business innovation funding, market opportunity reviews, management development programmes and access to trade missions/market study visits. Enterprise Ireland’s aim is to grow Irish exports by 6–8% per annum by 2020 to €24–26bn.[18]

And there are positive signals that the economic health of the Eurozone is improving. According to Eurostat, the Eurozone experienced growth of 0.6% in the first quarter of 2017, compared to the same period in 2016.[19] This is twice as much as the US, which saw growth of 0.3% in the same timeframe.

a) The high-dependency trade relationship with the UK

Ireland’s export-dependent relationship with the UK is evident in the following graphs, showing goods exports, services exports and exports by the food sector.

- The UK was our second-largest exports market for goods in 2016: 13% of our goods exports went to the UK, with a total value of €14.6bn.
- The UK is our biggest export market for services, at 19% of the total. (The latest CSO figures for services exports[20] are from 2015.)
- The UK remains the biggest export market for Irish food, with 42% of our food exports going there in 2016.[21] This is six times the share of our next-largest exports markets – China and France (7%).

16 Remarks by Enterprise Ireland CEO, Julie Sinnamon, at media launch, quoted in Ellie Donnelly, “‘Impact of Brexit on Irish Companies Already Started’ as Export Growth to UK Slows Considerably”, *Irish Independent*, 15 May 2017.

17 Enterprise Ireland, “Eurozone Market Strategy 2017–2020” (May 2017); https://www.enterprise-ireland.com/en/Publications/Reports-Published-Strategies/Eurozone-Strategy.pdf.

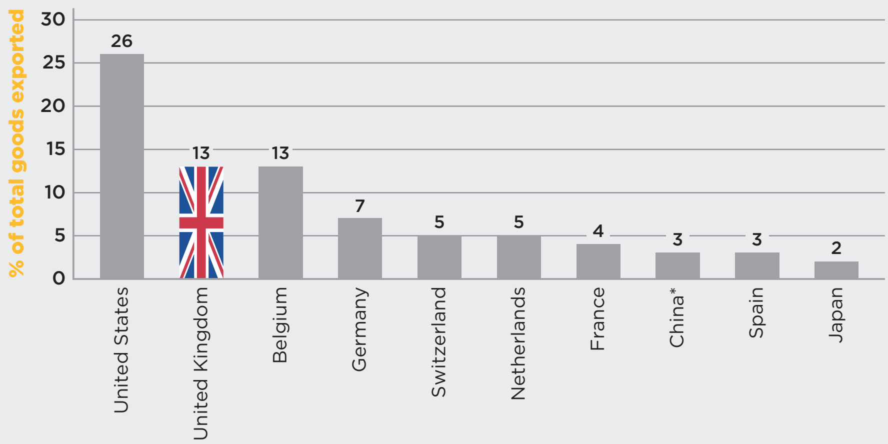
18 Department of Jobs, Enterprise and Innovation, *Enterprise 2025: Ireland’s National Enterprise Policy 2015–2025*.

19 Eurostat, News Release, 8 June 2017, http://ec.europa.eu/eurostat/documents/2995521/8057546/2-08062017-AP-EN.pdf/8321df8a-ba1b-433e-9cdc-bfd81e3f4a45.

20 CSO, International Trade in Services 2015 (November 2016), http://www.cso.ie/en/releasesandpublications/er/its/internationaltradeinservices2015/.

21 CSO, Goods Exports and Imports December 2016 (February 2017), http://www.cso.ie/en/releasesandpublications/er/gei/goodsexportsandimportsdecember2016/.

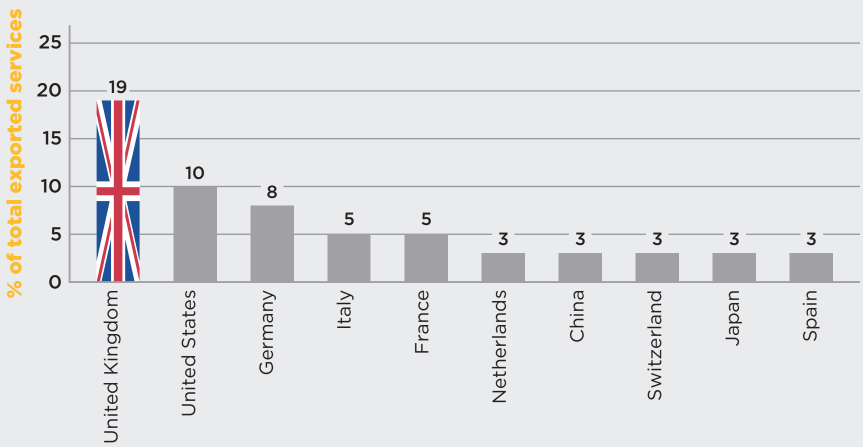
Top 10 destinations for all Irish goods exports (including food) 2016[23]



*This includes Hong Kong and Macau.
The rest of the world accounts for the remaining 19%.

Source: CSO

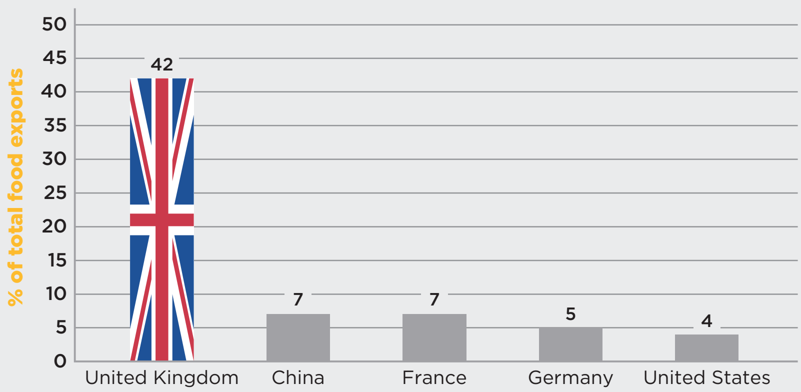
Top 10 destinations for Irish services exports, 2015



The rest of the world accounts for the remaining 38%.

Source: CSO statistical release, International trade in services 2015 (24 November 2016)

Top 5 destinations for Irish food exports, 2016



Source: CSO

22 CSO, Goods Exports and Imports December 2016 (February 2017), http://www.cso.ie/en/releasesandpublications/er/gei/goodsexportsandimportsdecember2016/.

b) Dominance of multinationals in Ireland's export performance – US MNCs the big player

Foreign multinationals have played an important and valued role in Ireland's export growth and made a vast contribution to Ireland's tax base, employment growth, development of talent and innovation, and advancement and encouragement of the Irish SMEs that are servicing and supplying multinational companies in Ireland. The impact of foreign multinationals on Irish-owned companies has been positively felt through the growth of start-ups, the growing global ambitions of SMEs, as well as the sharing of knowledge, information, global relationships and customers. It has been a successful experience for Irish businesses.

The sheer scale and presence of US multinational companies in our economy can be seen in IDA Ireland's table below. US multinationals account for 56% of the agency's foreign clients and 73% of the employment.

Any changes to US tax reform that will impact on US multinational companies active in Ireland is obviously a sensitive and important issue in the context of all of the aforementioned factors.

Origin of IDA Ireland Supported Companies 2015

Origin	No of Companies	Total Employment
United States	707	137,739
Germany	96	12,423
United Kingdom	105	6,827
France	56	6,230
Rest of Eurpoe	194	16,368
Rest of World	96	7,469
Total	**1,254**	**187,056**

Source: IDA Ireland Annual Report & Accounts 2015

The scale and success of Ireland's FDI model has led to the dominance of foreign-owned companies when it comes to Ireland's export performance. Foreign-owned agency-assisted companies account for 89% of total exports versus 11% for Irish-owned agency-assisted companies.[23]

This heavy dependency on foreign-owned global enterprises applies to both the manufacturing and the services sector:

- In services, foreign-owned agency-assisted companies account for 93% of total exports by agency-assisted companies versus 7% for Irish-owned agency-assisted companies.
- In manufacturing, foreign-owned agency-assisted companies account for 85% of total exports by agency-assisted companies versus 15% for Irish-owned agency-assisted companies.

As pointed out in Chapter 4 on the business landscape, our level of dependency on foreign companies, as measured by added value, is high and far exceeds the EU average.[24] This high level of dependency on multinationals is also borne out in Ireland's corporate tax figures for 2016, with almost 80% of Ireland's corporate tax take accounted for by

23 Department of Jobs, Enterprise and Innovation, Annual Business Survey of Economic Impact – 2015.
24 CSO, Business in Ireland 2014 (Eurostat), http://www.cso.ie/en/releasesandpublications/ep/p-bii/bii2014/ic/.

foreign-owned multinationals, a fact that indicates clearly Ireland's vulnerability to global trade changes, especially in the US.[25]

The outcomes of Brexit and US tax reform, both of which are unknown quantities at present, will have consequences for Ireland and Ireland's export model, the degree to which is as yet unclear.

With such risks hanging over Ireland's economy, there is a universal acceptance that the country needs to collectively and urgently address:

- the weaknesses in our export model
- build on the progress already made in high-growth knowledge-intensive areas.

2. Weakness in Ireland's indigenous exporting model

The key challenges in the Irish indigenous exporting sector are many – as have been identified in several published reports:[26]

- Irish manufacturing exporters are not well diversified when it comes to product range – dependent on a small number of export products.[27]
- Irish manufacturing exporters are not well diversified when it comes to export markets – reliant on a very small number of export markets.[28]
- Innovation and R&D, which drive new product development and product diversification, are very much led by larger and older companies – R&D has flatlined among smaller companies.[29] (We will deal with this in detail in Chapter 8 on innovation).
- High-performing knowledge-intensive exporting sectors have shown real progress but are coming from a very low base – as low as 5% of total exports in some sectors.[30]

Special Feature on Product and Market Weakness

The serious weaknesses in the degree of Ireland's "export concentration by partner and product" are also reflected in the international 2016 IMD Report, with Ireland ranking 52nd and 47th respectively in this world table (extract on the next page).[31] The low international rankings are easily understood when we examine the ESRI's highly detailed and granular analysis of manufacturing exports.[32] It provides in-depth data on the deficiencies in the export model and reveals that a very narrow product and market export "strategy" is being pursued generally by Irish exporting firms in the manufacturing sector. Of course, there are always exceptions, and we will look at these companies as well.

25 Revenue, *An Analysis of 2015 Corporation Tax Returns and 2016 Payments* (April 2017).
26 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*; and ESRI, Services Exports and Exporters of Services (April 2017) https://www.esri.ie/pubs/BKMNEXT334.pdf
27 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.
28 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.
29 Innovation Chapter – check source
30 Department of Jobs, Enterprise and Innovation, *Annual Business Survey of Economic Impact – 2015*.
31 Institute for Management Development, IMD World Competitiveness Yearbook, 2016, https://worldcompetitiveness.imd.org/.
32 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*.

IMD Report 2016 – economic performance measurement (Ireland)

BALANCE SHEET- FACTOR BREAKDOWN

IRELAND

WEAKNESSES

Economic performance		Rank
1.2.17	Export concentration by partner	52
1.4.06	Unemployment rate	49
1.2.18	Export concentration by product	47
1.4.08	Youth unemployment	45
1.4.07	Long-term unemployment	43
1.4.02	Employment (%)	43
1.5.05	Office rent	42
1.5.03	Cost-of-living index	40
1.1.19	Resilience of the economy	38
1.2.25	Tourism receipts	35

Source: IMD Competitiveness Report 2016

Definition of Median

The middle number in an ascending set of numbers. Because very large Irish exporting companies can distort the “average” figure, it is better to use the median when looking at exports.

a) Limited product diversification – narrow range of products to export

The narrow product range being provided by many Irish companies is evident in the ESRI’s report on the manufacturing sector. This narrow product range is a barrier to export growth and demonstrates a very “skewed model”, according to the research body. The scale of the challenge is told in the following statistics:

- 16% of Irish firms export just one product to one market and account for just 1.4% of export value – a very skewed exporting model.
- Ireland’s smaller firms are not very product diversified; in fact, 20% export a single product.
- Close to half of Irish firms export fewer than five products.
- The median number of products exported by Irish firms in 2015 was four – one less than the median of five in 2000.
- Irish-owned firms that are highly globalised manufacturing firms, defined as those exporting more than 20 products to over 20 markets, account for over 46% of the total export value despite representing just 11% of firms.
- In fact, most of the export value in manufacturing in Ireland is driven by big multinational players and large “superstar” Irish companies, where both product diversity and market diversity are part of their business model.

The ESRI graph shows the total distribution of product coverage for Irish and foreign firms, averaged over 1996 to 2015. The pattern of both distributions is very similar with a strong skew to the right, indicating that a considerable percentage of firms have exports in the smallest grouping of product count per firm".

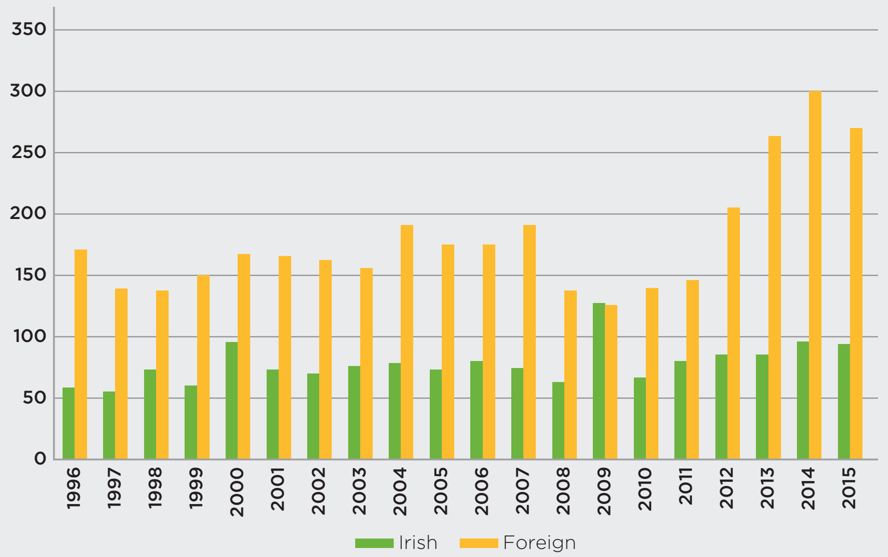
Distribution of products per firm (percentage of Irish firms)

Source: ESRI authors' analysis of CSO export data

The median number of products exported by Irish-owned companies may be low; however the figure below shows the wider product range for the larger, more diversified companies.

The ESRI[33] graph below shows the maximum number of exported products per destination in each year for Irish and foreign manufacturing firms, indicating an increase in the product range of the largest foreign exporters towards the end of the data period (1996–2015). A very small increase can also be observed for Irish firms.

Maximum number of products per destination



Source: ESRI authors' analysis of CSO export data

33 ESRI, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises.*

Concerns about product diversification in Irish-owned firms

🔔 In 2015 one product alone accounted for 23% of the exports of Irish exporting firms – "Meat of Bovine Animals, Fresh or Chilled".

🔔 9 out of 10 of Ireland's top 10 export products by Irish-owned firms in 2015 were food.

Source: ESRI, Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises, ESRI, April 2017.

Top exported products by Irish food and non-food exporters, 2015

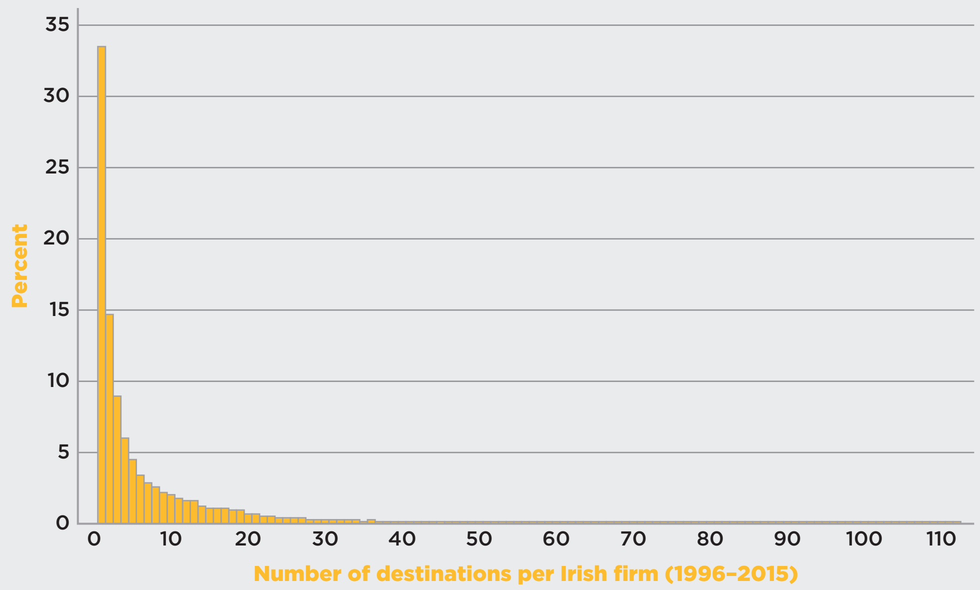
HS-4	Product name	% of exports (2015)
0201	Meat of Bovine Animals, Fresh or Chilled	23%
1602	Prepared or Preserved Meat, Meat Offal & Blood	8%
8525	Trans Apparatus for Radiotelephony etc., TV Cameras Cordless Telephone	5%
0204	Meat of Sheep or Goats, Fresh Chilled or Frozen	4%
0203	Meat of Swine (Pork), Fresh, Chilled or Frozen	4%
2309	Preparations Used in Animal Feeding	4%
0406	Cheese and Curd	4%
3501	Casein	4%
0206	Edible Offal, Bovine, Swine, Sheep, Goat, Horse	4%
0405	Butter and Other Fats and Oils Derived from Milk	4%
		64%
Source: ESRI		

b) Limited market diversification – narrow range of export destinations

- In 2015 the median number of export markets for Irish exporting firms was just three. This was the same number of median export markets that Irish manufacturers were focused on 15 years previously, in 2000.
- The median export market number has not increased.
- Ireland's narrowly focused approach to exports is very much summed up in the fact that almost 27% Irish firms export to just one market
- Most are exporting a single **product**.

The following table shows the skewed nature of our exports to different markets, with the largest share of exporters selling to very few markets. Approximately one-third of exporters sell to a single market, followed by a steep drop off to around 14% selling to two markets (accounted for by the second bar of the graph relative to the first).

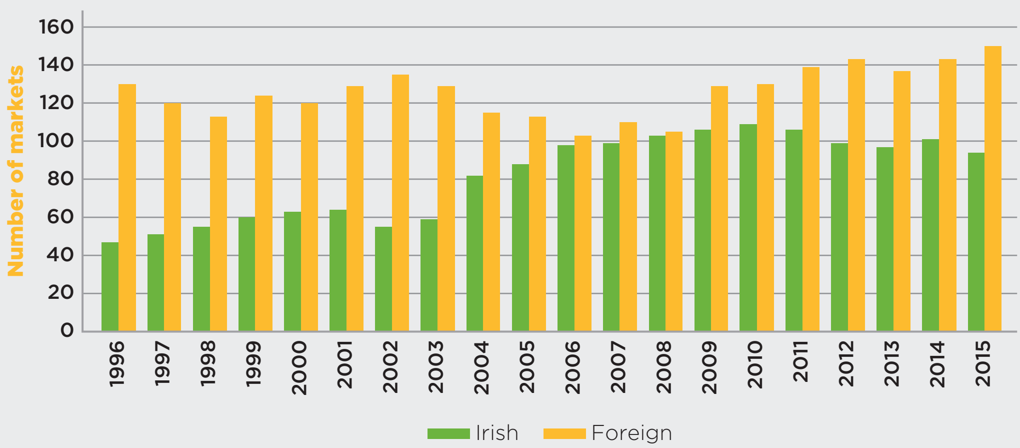
Distribution of destinations per firm (percentage of Irish firms)



Source: Authors' analysis of CSO export data

The largest number of markets to which an Irish firm's product was exported in 2015 was 94, with the corresponding number for foreign-owned firms 150. In terms of evolution over time, the maximum number of markets per product has increased for both groups, although more rapidly for Irish-owned firms. There are positives for Irish performance in that it has improved.

Maximum number of markets by product



Source: ESRI authors' analysis of CSO export data

It is not surprising that the biggest problem facing Irish SMEs surveyed for the European Commission SAFE report was "finding new markets". Some 29% of Irish SMEs consider this issue their most pressing problem. The urgency of finding customers is consistently cited by SMEs time and time again.

We appreciate that not all SMEs do, or indeed can, have an export-driven model. Given Ireland's reliance on SMEs for regional employment, and the small size of Ireland's consumer population compared to other EU countries, we need to grow and scale our SMEs to ensure that they have the skills, expertise, products and ambition necessary to capture EU markets.

The role of Irish policies and tax in driving exports

The success of Ireland's indigenous export strategy will depend on product innovation, R&D investment, the scaling of companies, driving exports in new markets, and ambitious sales and business development teams across the EU and the rest of the world, all underpinned by highly skilled leadership and key employee teams within the company.

Ambitious strategies have been published by many State bodies and Departments, including Enterprise Ireland's "Eurozone Market Strategy 2017–2020",[34] the Department of Jobs, Enterprise and Innovation's *Enterprise 2025*,[35] the Department of An Taoiseach's "Ireland Connected"[36] and Bord Bia's "Export Performance & Prospects" report.[37] Detailed sectoral and market opportunities have been outlined. For example, in *Enterprise 2025*,[38] Appendix I outlines where sectoral opportunities will come from, while "Eurozone Market Strategy 2017–2020"[39] sets out Enterprise Ireland's export growth ambition.

It is vital that these strategies are supported by tax policy and legislation that matches the ambition being set out for Ireland's exporting sector. In this publication, we look at four pillars that can help to drive export growth and the respective tax policies and tax legislative changes that can make a real difference to the key drivers of future export growth in Ireland.

1. **Market expansion – growing new export markets**

   First, we will focus on the ambition to grow our markets, as outlined in several of the reports referenced above. The two main tax measures that are relevant to this ambition are the Foreign Earnings Deduction (FED) and our double taxation agreement (DTA) network.

   Tax policies necessary to assist the other **three driving forces** for exports growth will be dealt with separately in the forthcoming chapters. They are:

2. **Innovation and new product development**

   Ireland's R&D tax credit regime and Knowledge Development Box are key to innovation in the Irish indigenous sector. We will address these tax policies in detail in Chapter 8.

3. **Skills and talent**

   Ireland's personal tax model and share option regime are central to attracting talent to Ireland. This will be addressed in Chapter 9.

4. **Finance and investment**

   Finance and investment are necessary for scaling companies, capital investment and investment in R&D. Chapter 10 will look at our capital gains tax environment and the income tax incentives that are needed to help companies to access finance and equity at key stages in their export growth plans.

34 Enterprise Ireland, "Eurozone Market Strategy 2017–2020".
35 Department of Jobs, Enterprise and Innovation, *Enterprise 2025: Ireland's National Enterprise Policy*.
36 Department of An Taoiseach, "Ireland Connected: Trading and Investing in a Dynamic World, Summary Report" (March 2017); https://www.djei.ie/en/Publications/Publication-files/Ireland-Connected-Trading-and-Investing-in-a-Dynamic-World-Full-Report-.pdf.
37 Bord Bia, "Export Performance & Prospects: Irish Food, Drink & Horticulture 2016–2017" (2017); http://www.bordbia.ie/industry/manufacturers/insight/publications/MarketReviews/Documents/Export-Performance-and-Prospects-2017.pdf.
38 Department of Jobs, Enterprise and Innovation, *Enterprise 2025: Ireland's National Enterprise Policy*.
39 Enterprise Ireland, "Eurozone Market Strategy 2017–2020".

Market expansion – the tax barriers

The first pillar is market expansion. Accessing new markets overseas is one of the key mechanics to drive Irish exports. SMEs can feel daunted by the complexity of exporting for the first time, and complex tax issues can add to this strain.

Below we consider some of the complexities that arise when dealing with overseas countries (both now and in the future) and make some recommendations that should help to support these Irish businesses. Covered are:

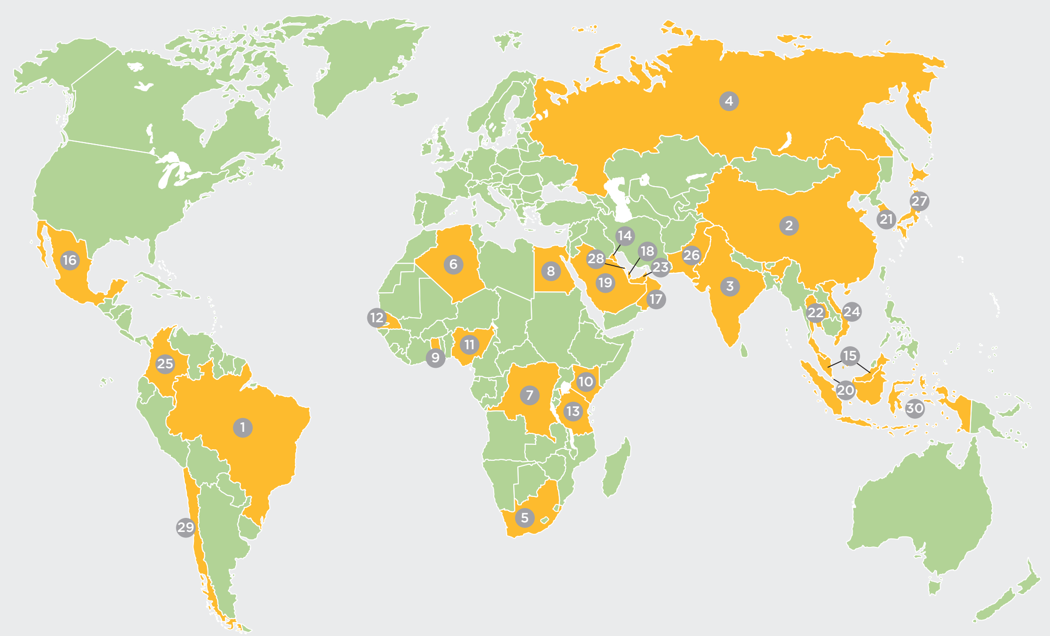
1. The Foreign Earnings Deduction (FED) for business staff working in overseas markets.
2. The importance of Ireland's double taxation agreement (DTA) network.
3. The potential Customs duty and compliance burden that exporters of goods may face in a post-Brexit environment.
4. Government support and education for small and first-time exporters.

1. Foreign Earnings Deduction

As a business expands and begins to export into new markets, it will often want to send an employee to that new market to get the business off the ground there.

The Foreign Earnings Deduction (FED) is an income tax relief available to employees who temporarily carry out their duties overseas in specific countries earmarked by the Government as potential export markets.

Foreign earnings deduction – countries that qualify



Foreign earnings deduction countries

1. Brazil	7. Democratic Republic of Congo	13. Tanzania	19. Saudi Arabia	25. Columbia
2. China	8. Egypt	14. Kuwait	20. Singapore	26. Pakistan
3. India	9. Ghana	15. Malaysia	21. South Korea	27. Japan
4. Russia	10. Kenya	16. Mexico	22. Thailand	28. Bahrain
5. South Africa	11. Nigeria	17. Oman	23. United Arab Emirates	29. Chile
6. Algeria	12. Senegal	18. Qatar	24. Vietnam	30. Indonesia

As you can see from the map there are currently 30 countries that qualify for the FED, including the "BRICS", and certain Middle Eastern, South American, Asian and African countries.

The FED is available to Irish-resident employees who work in any of these listed countries for at least 30 qualifying days in a continuous 12-month period. A day can be counted only if the employee spends that whole day working in one of the FED listed countries and that day is one of three consecutive days spent working in that country. After a change in 2014, weekends and travel days from Ireland can now be included to meet the test.

The amount of relief that can be claimed under the FED depends on the individual's salary and the number of days spent working abroad in FED listed countries in a year. In any case, the most that any employee can claim under the FED is €35,000 per year, which results in a maximum tax refund of €14,000 (€35,000 x 40%) per employee. The relief does not apply to USC and PRSI.

How the FED amount is calculated

Take an example of a full-time employee who earns €125,000 in a year and spends 95 qualifying days working in FED listed countries. The tax refund due to the employee would be calculated as follows:

- ⇨ FED amount: €125,000 x 95/365 = €32,534
- ⇨ Employee's tax refund: €32,534 x 40% = €13,014

There were 144 FED claims in 2014[40], with a cost to the Exchequer of €1.1m. Since 2014 the minimum number of eligible days needed to claim the FED has changed, but no more data on claims is yet available.

Recommendations on the FED

- The Foreign Earnings Deduction (FED) reduces the income tax bill of employees travelling to develop export markets in 30 countries, including the BRICS, some Middle Eastern, South American, Asian and African countries. With Irish companies needing new export markets more than ever, the range of qualifying countries should be reviewed and broadened.
- Relief available under the FED should be extended to include USC and PRSI.

2. Ireland's Double Taxation Agreement (DTA) network

Ireland has an extensive DTA network, with 72 tax treaties currently in force.

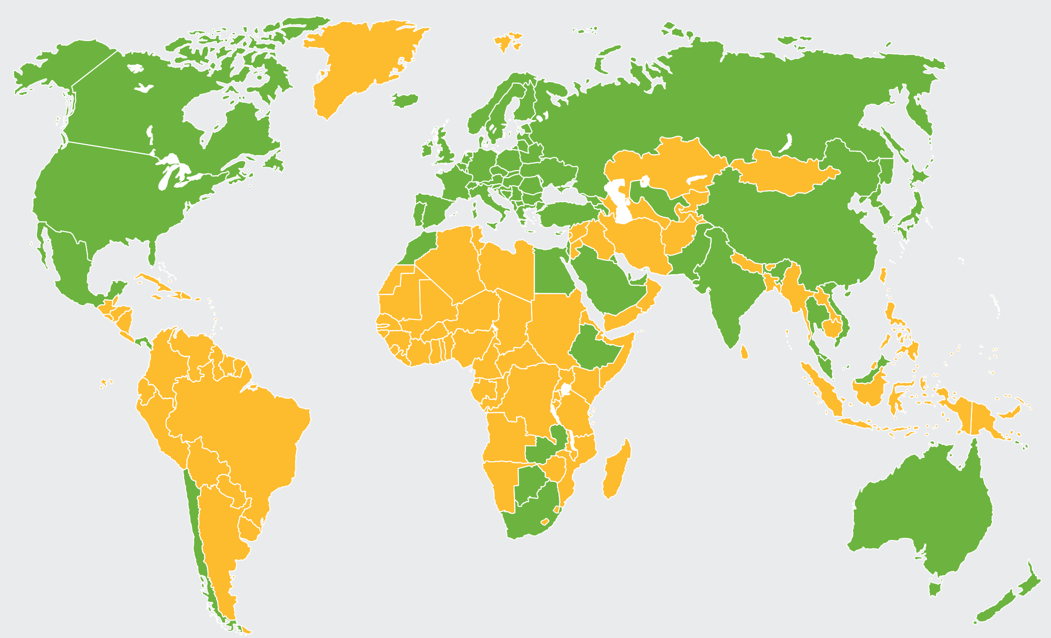
DTAs prevent the double taxation of businesses operating across borders and are an essential part of the tax framework, particularly for countries, such as Ireland, that are very export focused and doing business together.

As the map demonstrates, there are some significant gaps in Ireland's DTA network in Latin America, Africa and southern Asia. Although a DTA, by its nature, relies on the two countries involved to progress the negotiations, all efforts possible are needed to fill these gaps in the network, given the global tax challenges that we face.

This would ensure that Irish companies can easily access new markets, without suffering double taxation.

40 Revenue, Costs of Tax Expenditures (Credits, Allowances and Reliefs).

Ireland's DTA network



Ireland's DTA network countries

1. Albania	16. Czech Republic	31. Italy	46. New Zealand	61. Spain
2. Armenia	17. Denmark	32. Japan	47. Norway	62. Sweden
3. Australia	18. Egypt	33. Korea	48. Pakistan	63. Switzerland
4. Austria	19. Estonia	34. Kuwait	49. Panama	64. Thailand
5. Bahrain	20. Ethiopia	35. Latvia	50. Poland	65. Turkey
6. Belarus	21. Finland	36. Lithuania	51. Portugal	66. United Arab Emirates
7. Belgium	22. France	37. Luxembourg	52. Qatar	67. Ukraine
8. Bosnia & Herzegovina	23. Georgia	38. Macedonia	53. Romania	68. United Kingdom
9. Botswana	24. Germany	39. Malaysia	54. Russia	69. United States
10. Bulgaria	25. Greece	40. Malta	55. Saudi Arabia	70. Uzbekistan
11. Canada	26. Hong Kong	41. Mexico	56. Serbia	71. Vietnam
12. Chile	27. Hungary	42. Moldova	57. Singapore	72. Zambia
13. China	28. Iceland	43. Montenegro	58. Slovak Republic	
14. Croatia	29. India	44. Morocco	59. Slovenia	
15. Cyprus	30. Israel	45. Netherlands	60. South Africa	

Recommendation on Ireland's DTA Network

There are also some significant gaps in Ireland's double taxation agreement (DTA) network across Latin America, Africa and southern Asia. These DTAs are critical for cross-border trade as they prevent double taxation. Negotiating a DTA requires commitment and cooperation from both countries; nonetheless, all efforts possible should be applied to addressing these gaps.

3. Potential Customs duty and compliance burden for exporters post Brexit

There is massive uncertainty about the shape of Brexit and it is unclear at this stage what the outcome of the negotiations will be.

If, in the worst-case scenario, the UK fails to secure a trade agreement with the EU when it leaves in two years' time, it must rely on normal World Trade Organisation (WTO) rules for access to the EU market, including Ireland. Broadly, this would mean that the UK would be treated like any other non-EU country that does not have a free trade agreement with the EU, such as the US, Japan and China.

Irish businesses would then have to deal with Customs duty costs and compliance obligations for goods travelling to, from and through the UK.

Although the largest of Irish businesses may already have the skills to deal with Customs tariffs and compliance globally, this could be the first encounter with Customs duty for many Irish SMEs. It could have major implications for the viability of their cost base, their supply chain and logistics, their route to market, regulation and non-tariff barriers, and even the structure of the business itself.

There are 35,000 separate codes to choose from under the Integrated Tariff of the European Community (TARIC – the online Customs tariff database), with rates ranging generally from 0% to 14% but some as high as 40% for agricultural products (due to the combination of rates and agricultural levies). Some of the highest rates apply to products that feature widely across the indigenous sector – agriculture, food and beverage, retail consumer and industrial products. Therefore, this is an issue that could disproportionately impact on Irish indigenous business.

TARIC – the online Customs tariff database

Even if a free trade agreement is ultimately agreed, all goods moving cross-border (EU–UK) will have to somehow be declared and cleared through Customs (i.e. Custom declarations and proof of origin must be filed). This process will create costs, additional administration and possibly time delays.

For every movement of goods into and from the UK, the Single Administrative Document (SAD) will have to be completed, most likely with the assistance of a Customs agent.

Recommendation

Businesses that currently export goods to or through the UK, or that plan to do so, need to be preparing for the likely introduction of a non-EU border with the UK and a Customs regime. It is important to be aware of the implications for their business model and any steps that could be taken to mitigate the impact.

4. Government support and education for small and first-time exporters

First-time exporters can feel daunted by the complexity of overseas VAT rules, potential payroll taxes and perhaps even corporation tax.

Some Local Enterprise Office websites provide SMEs with information on how to manage their taxes in Ireland.


Oifig Fiontair Áitiúil
Local Enterprise Office

European Union
European Regional Development Fund

Fingal

...Let's talk business

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  - Business Networking Guide
- Grow your Business
- Business Advice & Mentoring
- Find The Right Support For You
- Fingal Enterprising Women Network
- Enterprise Europe Network

Small Business Tax Planning

Share:

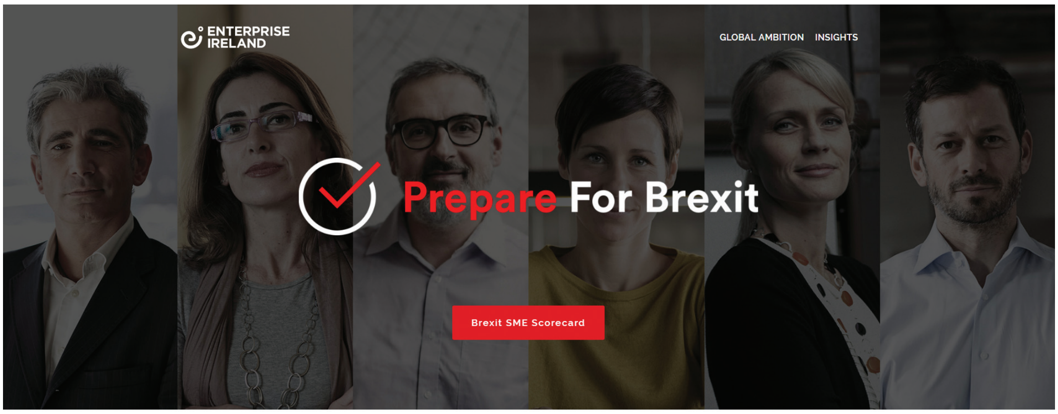
Income is hard earned these days with a high percentage going to the Revenue Commissioners. There are legitimate ways that you can reduce your tax bill. It is often reported that many of Ireland's most successful business people pay the least amount of tax. They recognise that tax is a cost just like any other and this cost can be managed and reduced with proper planning and advice.

Practical tax reduction strategies for small business

- **Keep proper records** - This might sound obvious but many businesses miss out on legitimate tax deductible expenses or incur unnecessary add backs or penalties because their accounting records are not sufficient to capture and support all of the expenses that they are entitled to claim.
- **Research your entitlements** - Ask your accountant, or take time yourself, so that you have a good understanding as to what tax deductable expenses are appropriate for your business.
- **Review your expenditure prior to year-end** - It may make sense to bring forward expenditure that you had planned on either equipment, repairs or other items prior to your year end to capture that tax relief within the current year.
- **Fund capital expenditure to maximise tax relief** - If you purchase equipment from cash flow or by loan you can get relief at 15% i.e. over six and half years. It may be appropriate to purchase equipment by lease purchase and claim the tax relief over the lease period i.e. three years.
- **Employ spouses or other family members** - It can sometimes be tax advantageous to employ spouses or other family members provided that you can create and justify their role within the business.
- **Change your year-end** - If your business is seasonal or if your profit levels are either increasing or decreasing it may be worthwhile in certain circumstances changing your year end.
- **Manage your preliminary tax** - Opt to pay your preliminary tax based on the current year estimates where your income is falling.
- Tax free mileage and subsistence - Revenue permit the payment of mileage and subsistence tax-free provided the appropriate documentation is maintained.
- **Consider incorporating to a limited company** - There are other considerations to be examined in forming a company, but it may be appropriate to achieve a tax advantage if you are generating profits over and above the level required to fund your personal living expenses.
- **Prepare management accounts prior to year end** - Quantify your potential tax liability prior to your year end to give you sufficient time to plan and manage your tax bill.

Enterprise Ireland has recently launched a free Brexit planning tool for SMEs exporting to the UK. The Brexit SME Scorecard[41] is designed to help SMEs to evaluate their businesses' readiness for Brexit.

41 Enterprise Ireland, Brexit SME Scorecard, https://ambition.enterprise-ireland.com/prepare-for-brexit?gclid=CjwKEAjw4IjKBRDr6p752cCUm3kSJAC.



Prepare for Brexit with the Enterprise Ireland Brexit SME Scorecard.

A coordinated national education campaign would improve the quality of information available to SMEs on the common VAT, payroll and PE pitfalls that can arise when they begin to sell overseas.

This would provide assurance and certainty to SMEs and help them to understand the tax issues that can arise when exporting abroad. It could also prevent them from innocently becoming non-compliant, with serious penalties attaching in those overseas countries.

The tax information on the Local Enterprise Office websites could be used as a basis for this work.

Recommendation

SMEs can sometimes lack the knowledge and cash to understand the tax implications of exporting for the first time. A Government information campaign on tax would provide some certainty for these SMEs and ensure that they begin this journey to export as compliant taxpayers.

Chapter 7

The Digital Economy – An Opportunity if Fully Grasped

The World Economic Forum (WEF) says that the world is at "the dawn of the Fourth Industrial Revolution." This revolution is better known as the "digital economy," and it means the digitisation of the entire economy, not just the ICT sector.

The WEF Networked Readiness Index[1] lists the ten countries in 2016 that are best placed to make the most of this new world as Singapore, Finland, Sweden, Norway, the USA, the Netherlands, Switzerland, the UK, Luxembourg and Japan. Ireland ranks 25th out of 139 countries. The index measures how well countries are using information and communications technologies to boost competitiveness and well-being.

A new global report, *Digitizing Europe*,[2] has named Ireland as one of nine European frontrunner countries that could see the largest benefits from a more digitised European economy. The report, by Boston Consulting Group (BCG), examined Europe-wide data on GDP, exports and workforce from a range of trusted sources such as the World Bank, the OECD and Eurostat.

Nine countries were selected in the report because they are:

1. Geographically small, with a limited domestic market (export dependent). Therefore, they have a greater need for easy access to the vast European digital market.
2. But, importantly, the frontrunners are also well digitised and innovative and so are well placed to benefit considerably if they get access to this digital market.

Although Ireland is included as a frontrunner country – together with Denmark, Belgium, the Netherlands, Sweden, Estonia, Finland, Norway and Luxembourg – it is less digitally competitive than the others.[3] However, the report recognises that Ireland is showing signs of positive development.

> In parallel with the European Commission's Skills Agenda for Europe,[4] of which a key pillar is the Digital Skills and Jobs Coalition,[5] Ireland's strategy for improving digital skills is contained in the National Digital Skills and Jobs Coalition,[6] which was launched by the Department of Jobs, Enterprise and Innovation.[7]

The potential export market that the digitised economy provides is huge, but if we fail to grasp it fully, the opportunity lost would be equally great. The report says that: "Europe is at a digital crossroads, with a unique chance to either capture an immense opportunity, or see the region fall behind other nations. And the frontrunner countries are even more sensitive than the EU as a whole to a lost digital opportunity, since a larger share of their economies is digitized, and the majority of their future growth is digitally enabled."

1 World Economic Forum 2016 Networked Readiness Index, http://reports.weforum.org/global-information-technology-report-2016/
2 See http://image-src.bcg.com/BCG_COM/BCG-Digitizing-Europe-May-2016_tcm22-36552.pdf (May 2017).
3 European Commission 2016 DESI index.
4 See http://ec.europa.eu/social/main.jsp?catId=1223.
5 See https://ec.europa.eu/digital-single-market/en/digital-skills-jobs-coalition.
6 See https://www.digitalcoalition.ie/.
7 The then Minister for Jobs, Enterprise and Innovation, Mary Mitchell O'Connor TD, speaking at the launch on 27 April 2017: https://www.djei.ie/en/News-And-Events/Department-News/2017/April/2704201.html#.

Digitizing Europe – The Frontrunner Countries

Source: BCG analysis, World bank, Eurostat, OECD

The report also highlights the critical importance of being able to "match the skills of our workforce to the skills required by the jobs that will emerge from new technologies. If this is not done properly, or if it is overlooked, a country's workforce may be left behind and become unable to provide the labour and competence that a digitized economy demands."

In Chapter 9 on human capital and talent, we observe the skills challenges that Ireland is experiencing at the moment, demonstrated by our low rankings in the PIAAC (Programme for the International Assessment of Adult Competencies) survey. If we do not take urgent action to address these gaps, then we could be squandering the opportunity presented by the dawn of the digitised world.

The BCG report also provides guidance on how to develop a national digital agenda framework, which should cover five key areas.

> "Tax policy is identified as being important across all of these areas, and the tax priorities highlighted in the report correspond with the recommendations that the Irish Tax Institute is making in this document.

Prioritizing the right things

Aspiration

To become the world's best country at leveraging digitization and technology for economic growth and job creation

Strategic priorities

Enable digital and technology innovation	Stimulate entrepreneurship	Improve access to capital	Create smart policies for the future	Build the skills and talent of tomorrow
• Fully digitize government processes and services	• Tax stock options as capital gains	• Attract world-leading and regional venture capital funds (startup and growth capital)	• Review IP and data protection legislation to reflect the needs of the innovative digital age	• Rethink primary and secondary education curriculum
• Invest in IT, telecommunication, and digital infrastructure	• Steer public tenders and procurement toward SMEs and startups	• Introduce tax breaks on angel investments	• Push for a European digital single market	• Promote equality and integration throughout the educational system
• Drive the SME transition to digital and mobile-first	• Link up tertiary education and startup communities	• Simplify public funding structures	• Promote and creatively approach the sharing economy and new business models	• Differentiate tertiary education and launch cross-disciplinary programs
• Support digital and technology clusters	• Introduce digitization and technology vouchers for SMEs	• Use public funds for matching venture capital investments	• Increase labor market flexibility	• Launch visa programs aimed at entrepreneurs and top talent
• Attract leading technology MNCs	• Recognize and promote major entrepreneurial activity at the national level	• Shift major part of pension funds' investment mix to established venture capital funds	• Simplify legal conditions for SMEs and startups	• Perform strategic workforce planning for digital at national level
• Set date for transition to electronic money only			• Support and allow for experimentation with new technology	
• Invest in IOT and big data				
• Harmonize ICT standards for new technologies				

Note: SME = Small and medium-sized enterprise. MNC = multinational corporation. IP = Intellectual property.
Source: BCG analysis

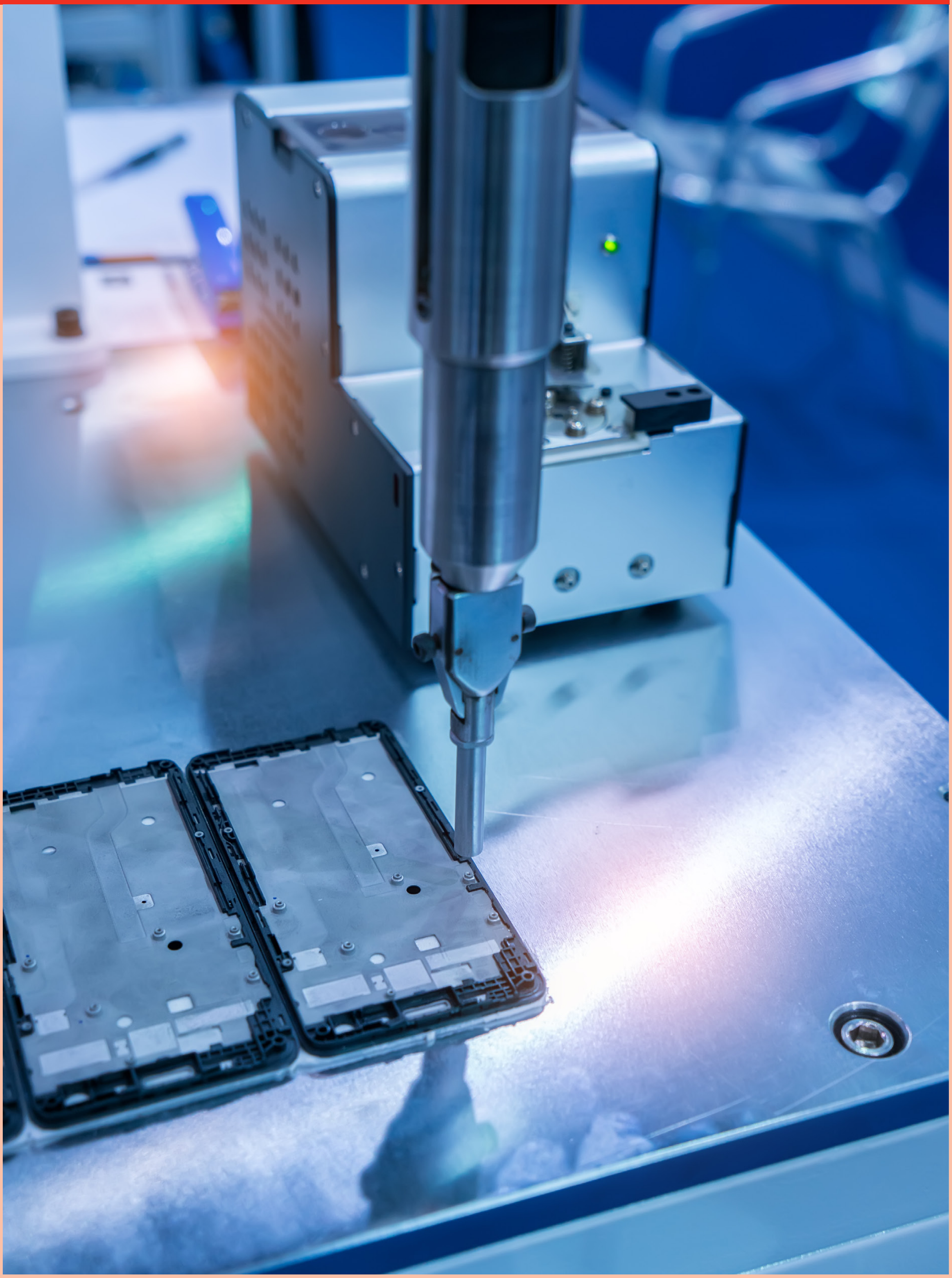
Taking full advantage of the opportunities from a digital economy will create jobs for both traditional Irish companies and small and innovative companies that are normally associated with digital technology. But we must urgently deal with the skills deficit if we want to capitalise on this opportunity. The consequences of not dealing with our skills deficit are demonstrated in research from the IEDR (the dot-ie domain registry), which paints a concerning picture of Irish SMEs' online readiness:

> "Less than one-third of SMEs are capable of processing e-commerce, and almost 25% have no website at all.[8]

8 See: https://www.siliconrepublic.com/companies/iedr-ecommerce-ireland-sme-firms

Chapter 8

Innovation



Tax recommendations for R&D and innovation

1. Limits in the R&D tax credit regime for outsourcing, restrict collaboration among Irish businesses and, crucially, between businesses and third-level institutions. No outsourcing restriction is required under the OECD Modified Nexus rules for the Knowledge Development Box (KDB), and because the rules of the two regimes should be aligned, the outsourcing restrictions in the R&D tax credit regime should be removed.
2. At a time when all global indicators tell us that growth depends on innovation, every effort should be made to remove administrative blockers for businesses that need to claim the R&D tax credit. Only 1% of all small companies consider themselves to be R&D active and 16% of medium companies consider themselves to be R&D active. If we are to be truly innovative and global, we must improve this performance, and no stone should be left unturned in supporting SMEs to claim the R&D tax credit. This includes:
   - A new SME-friendly guidance campaign supported by dedicated Revenue support lines for SMEs with dedicated Revenue experts.
   - A Revenue Centre of Excellence that deals with all taxpayer issues concerning the R&D tax credit regime.
   - Sector-specific guidance for each industry sector such as food and drink, ICT, bio-medical etc., all of which engage in very different R&D processes.
   - A Revenue pre-approval process that would bring much-needed certainty for taxpayers and subsequently prevent disagreements and costly future audits.
   - Expert checks on the science element of R&D that are grounded in business reality rather than focused on academic concepts of “new to the world.” Regardless of how innovative a food company might be, it is very difficult to invent a food that is completely new to the world.
3. Revenue’s guidelines on the KDB are very comprehensive at 82 pages. However, a separate and less complex set of guidance is needed for SMEs which have much more straightforward operations.

The importance of innovation

Innovation plays a central role in driving productivity growth and fostering competitiveness in economies. Ireland is an economy where our competitiveness depends on innovation.

In this chapter we highlight the consensus from international bodies that governments must support research and development (R&D) activity because the costs and risks for business are so high but the benefits for the economy are proven and long term. We take a look at how Irish businesses are performing when it comes to R&D, and we see that, in this country, the innovation undertaken leans heavily on companies that are:

1. Foreign owned;
2. Large (over 250 employees);
3. Established (over 16 years of age); and
4. Located in the south and east of the country.

The Irish Government has the ambitious target of reaching R&D investment of 2.5% of GNP by 2020. Given this target, together with the dependency on the four trends above and the challenges of Brexit and US tax reform, we examine whether we are doing everything possible to provide a supportive tax regime for indigenous Irish businesses that urgently need to expand their innovation activity.

The role that innovation plays in economic growth has been recognised internationally by the OECD and the European Commission. The OECD has said that innovation provides the foundation for new businesses and new jobs.[1] It has noted that innovative economies are more productive, more resilient, more adaptable to change and better able to support higher living standards.[2]

R&D is a key driver of innovation, and fiscal policies are important in fostering private R&D development. The European Commission has recognised the link between innovation and productivity through the impact of R&D investment on productivity.[3]

> The Commission believes that investing in innovation would foster the productivity and exporting potential of Irish firms at a time when diversifying exports and export destinations could help to stabilise the performance of Irish firms.[4]

In Ireland, the National Competitiveness Council (NCC) has also spoken of the need for innovation from a competitiveness perspective. The NCC regards innovation as a vital component to secure the diversification and broadening of the enterprise and exports base.[5]

In its recently launched corporate strategy for 2017–2020,[6] Enterprise Ireland (EI) has set out major strategic ambitions to increase client exports by €5bn to €26bn per annum by 2020 and to support its clients in the creation of 60,000 new jobs, as well as sustaining the existing 200,000 record level of jobs. Such is the importance of innovation that EI has made innovation one of the four pillars to reach its export goals. It aims to drive "the innovation in Irish enterprise to record levels through new supports to reach the target of €1.25bn in R&D expenditure per annum by 2020". It intends to increase the levels of investment and spend in R&D and innovation by its client companies to help them to continue to develop products and services localised for Eurozone markets.

The Economic and Social Research Institute (ESRI), as part of the recommendations in its report on the manufactured exports of Irish-owned business, has said that support for innovation is a key policy takeaway for the success of exporting firms in manufacturing.[7]

The *Engineers Journal* has asked the hard question – what will the future entail for manufacturing?[8] The potential for growth in manufacturing, as we have seen in Chapter 4 on the Irish business landscape and Chapter 6 on exports, is to move away from traditional to modern manufacturing. The transformation of the global manufacturing landscape is now compelling businesses to rethink innovation.[9]

1 OECD, *OECD Innovation Strategy 2015 – An Agenda for Policy Action,* p. 2; http://www.oecd.org/innovation/OECD-Innovation-Strategy-2015-CMIN2015-7.pdf.
2 OECD, *OECD Innovation Strategy 2015 – An Agenda for Policy Action*, p. 2.
3 European Commission, "Better Regulations for Innovation-driven Investment at EU Level", p. 8; https://ec.europa.eu/research/innovation-union/pdf/innovrefit_staff_working_document.pdf.
4 European Commission, "Council Recommendation on the 2017 National Reform Programme of Ireland and Delivering a Council Opinion on the 2017 Stability Programme of Ireland" (22 May 2017).
5 National Competitiveness Council, *Benchmarking Competitiveness: Ireland and the United Kingdom, 2017*, p. 67; http://www.competitiveness.ie/Publications/2017/NCC-IE-UK.pdf.
6 Enterprise Ireland, "Enterprise Ireland Strategy 2017-2020" (15 May 2017).
7 M. Lawless, I. Siedschlag and Z. Studnicka, *Expanding and Diversifying the Manufactured Exports of Irish-owned Enterprises*, p. 67 (April 2017); http://www.esri.ie/pubs/BKMNEXT335.pdf.
8 *Engineers Journal*, "Manufacturing in Ireland: Is the Time Right for a Renaissance?" (14 June 2016); http://www.engineersjournal.ie/2016/06/14/irish-manufacturers-association/.
9 *Engineers Journal*, "Manufacturing in Ireland: Is the Time Tight for a Renaissance?".

Innovation for SMEs

Innovation plays a particularly crucial role in the development of smaller companies, and this has been highlighted by various bodies. Again, in Chapter 6, we have seen that Irish SMEs are not as export focused as those in other countries, and innovation can and must play a role in their strategy for growth.

Start-ups and SMEs are vital to innovation drives, as is evidenced by the IMF, which has said that many radical innovations result from small entrepreneurial ventures engaging in experimentation and that innovation depends on an efficient process of entrepreneurial entry, growth and exit.[10]

We know from research by the NCC that new start-ups, particularly in ICT, are more inclined to engage in more radical innovations that enhance productivity than incumbents, who tend to adopt a more incremental approach.[11] A continuous flow of new business start-ups that can survive and thrive in international markets strengthens the productivity base not only through the creation of new businesses, products and services but also by stimulating improved performance in existing businesses. More than half of productivity growth at the industry level has been attributed to new entrants.

- Innovation plays a central role in driving growth and fostering competitiveness in economies.
- SMEs need to be innovative to develop and expand into new markets. This is particularly important post Brexit, as some SMEs cannot be as reliant on the UK export market.

The NCC, building on the OECD's research in its *Future of Productivity*[12] report, believes that the following factors are particularly important in relation to enhancing Irish productivity performance:

- Fostering innovative indigenous start-ups, scaling and improving survival rates.
- Deepening innovation capacity, capability and activity at firm level, particularly in indigenous SMEs (and Ireland's non-exporting sectors).
- Developing and nurturing business, scientists and talented people – to which innovation is crucial.[13]

Governments play an important role in fostering innovation

Governments play a key role in fostering a sound environment for innovation. The OECD says that governments need to ensure that innovation contributes to the key goals of public policy by investing in the foundations for innovation and helping to overcome certain barriers to it.[14] It sets out five priorities for policy-makers:

i. Strengthen investment in innovation and foster business dynamism.
ii. Invest in and shape an efficient system of knowledge creation and diffusion.
iii. Seize the benefits of the digital economy (see Chapter 7 on the Digital Economy).

10 V. Gaspar and R. de Mooij, "Imagine What Fiscal Policy Could Do for Innovation", IMFBlog, https://blogs.imf.org/2016/03/31/imagine-what-fiscal-policy-could-do-for-innovation/.
11 National Competitiveness Council, *Benchmarking Ireland's Productivity Performance 2004–2014*, p. 12; http://www.competitiveness.ie/Publications/2016/NCC-Benchmarking-Irelands-Productivity-2004-2014-report.pdf.
12 OECD, *The Future of Productivity;* http://www.oecd.org/eco/OECD-2015-The-future-of-productivity-book.pdf.
13 National Competitiveness Council, *Benchmarking Competitiveness: Ireland and the United Kingdom, 2017*, p. 67.
14 OECD, *OECD Innovation Strategy 2015 - An Agenda for Policy Action*.

iv. Foster talent and skills and optimise their use (see Chapter 9 on human capital and talent).

v. Improve the governance and implementation of policies for innovation.[15]

The IMF has also indicated that fiscal incentives should reduce the cost of investing in R&D by 50% on average for businesses in advanced economies to encourage them to carry out more R&D. The IMF believes that this would reap benefits for the wider economy, raising GDP in advanced economies by 5% in the long term.[16]

How innovative are Irish businesses?

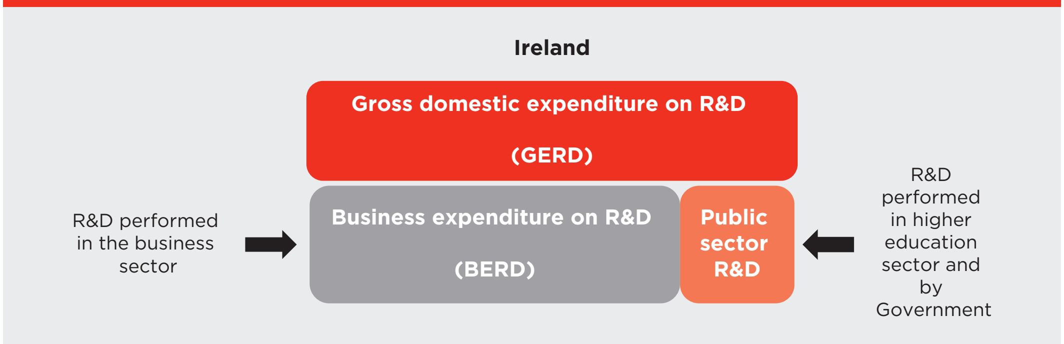
There has been a significant increase in R&D activity in Ireland over the past decade – from 1.19% of GDP in 2005 to 1.51% (or €2.8bn) in 2015. However, despite this increase, the level of expenditure in Ireland still falls some way short of the EU average of 2.03%, and the expenditure of countries such as Sweden (3.26%), Germany (2.87%), France (2.23%) and the UK (1.70%).

OECD research suggests that there is strong evidence in Ireland of under-investment by the private sector in R&D-related spending.[17]

The international indicator used to measure R&D carried out in a country is gross domestic expenditure on R&D (GERD) expressed as a percentage of GDP. GERD includes expenditure on R&D by business enterprises (also known as BERD), higher-education institutions, as well as government and non-profit organisations.

To create as full and as comprehensive a picture of the structure and shape of the Irish innovation landscape, we have used the most recently available data on GERD from Eurostat (2015)[18] and the most recent CSO BERD Survey carried out on behalf of Eurostat (2013–2014).[19]

Composition of R&D Expenditure in Ireland



GERD in Ireland in 2015 was 1.51%[20] of GDP. To realise our goal of 2.5% of GNP[21] (approximately 2% of GDP) spend on R&D by 2020 and to ensure we have a growing, exporting, indigenous enterprise base, we need to make sure that more small companies are innovating sooner.

15 OECD, *OECD Innovation Strategy 2015 – An Agenda for Policy Action*, p. 5.
16 V. Gaspar and R. de Mooij, "Imagine What Fiscal Policy Could Do for Innovation".
17 National Competitiveness Council, *Benchmarking Competitiveness: Ireland and the United Kingdom, 2017*, p. 67.
18 Eurostat statistics 2015, http://ec.europa.eu/eurostat/statistics-explained/index.php/R_%26_D_expenditure.
19 CSO, Business Expenditure on Research and Development 2013–2014 (June 2015), http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014/.
20 Eurostat statistics 2015, http://ec.europa.eu/eurostat/statistics-explained/index.php/R_%26_D_expenditure.
21 Europe 2020 targets, http://ec.europa.eu/europe2020/pdf/targets_en.pdf.

Gross domestic expenditure on R&D in 2005 and 2015 (% of GDP cost)

Source: Eurostat[22]

Some important statistics on Irish R&D spend

	% of GDP
Government's Innovation 2020 Strategy GERD goal for R&D investment[23]	2.0 (2.5% GNP)
Irish GERD in 2015	1.51
EU average of GERD in 2015	2.03
Leading EU country (Sweden) GERD in 2015	3.26

The largest component of GERD in Ireland is R&D expenditure by the business sector. The latest available figure for BERD in Ireland is 1.14% of GDP (2013–2014),[24] which is also below the EU average of 1.3% of GDP[25] for the same period.[26]

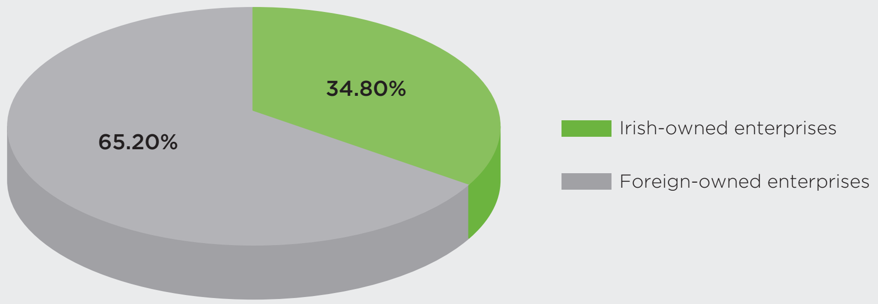
22 Eurostat statistics 2015, http://ec.europa.eu/eurostat/statistics-explained/index.php/R_%26_D_expenditure.
23 Europe 2020 targets, http://ec.europa.eu/europe2020/pdf/targets_en.pdf.
24 T. Martin and P. Fákó, *RIO Country Report 2016: Ireland*; 28493 EN; doi: 10.2760/8608 (Chapter 3); https://rio.jrc.ec.europa.eu/en/country-analysis/Ireland/country-report.
25 T. Martin and P. Fákó, *RIO Country Report 2016: Ireland*.
26 All international comparison tables use GDP – these are the only tables available for contrast with other countries. However, we appreciate that there can be distortions with the GDP measure.

The role of multinationals

When we examine the make-up of BERD in Ireland, it provides some interesting insights into the type of companies carrying out R&D and those making the largest investment in innovation activities.

- Foreign-owned companies incur two-thirds of overall R&D expenditure.[27] Again, we see the dominant role of multinationals play out.

Two-thirds of R&D expenditure is by foreign-owned enterprises



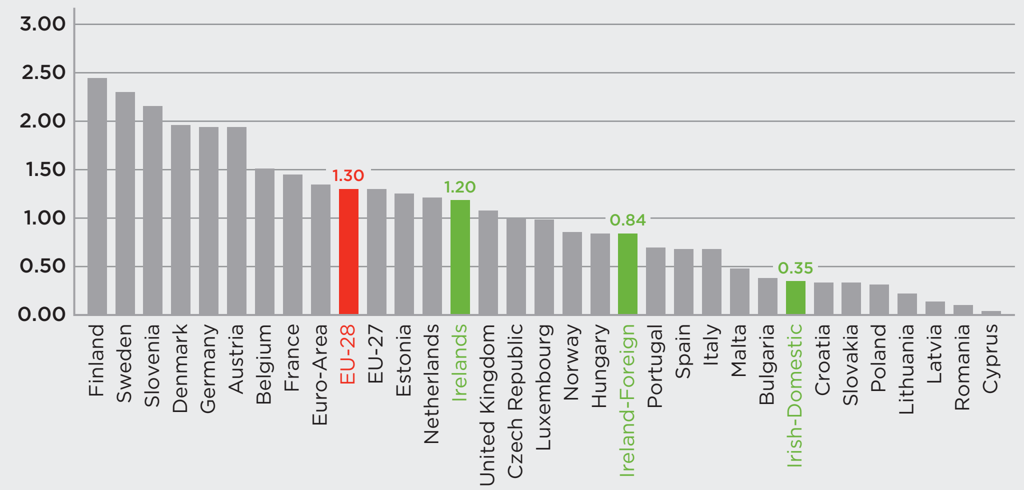
Source: CSO, Business expenditure on R&D 2013–2014

- The largest 100 enterprises in terms of R&D accounted for over €1.4bn, or 70%, of the total R&D expenditure in 2013. Of these top 100 enterprises, 80% of the spend can be attributed to foreign-owned enterprises.[28]
- Only 20% of all Irish owned businesses spent over €500,000 on R&D in 2013, compared to 55% of all foreign-owned businesses.[29]
- When comparing BERD expenditure across the EU, the latest data available is from 2012.[30] The foreign-owned sector invested €1.4bn in R&D in Ireland in 2012, which equated to approximately 0.84% of Irish GDP in that year. By contrast, domestic enterprises invested the equivalent of 0.35% of GDP in 2012.

> "Without the innovation expenditure of the foreign-owned sector, Ireland would have been one of the lowest overall performers in the EU as a share of GDP.[31]

27 CSO, Business Expenditure on Research and Development 2013–2014, p. 3, http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014/.
28 CSO, Business Expenditure on Research and Development 2013–2014, p. 3 http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014.
29 CSO, Business Expenditure on Research and Development 2013–2014, p. 9 http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014/.
30 Department of Finance, "Economic Impact of Foreign-Owned Sector – Economic Impact Assessment of Ireland's Corporation Tax Policy" (October 2014), p. 25; http://finance.gov.ie/sites/default/files/Economic%20Impact%20of%20the%20FDI%20sector.pdf.
31 Department of Finance, "Economic Impact of Foreign-Owned Sector – Economic Impact Assessment of Ireland's Corporation Tax Policy", p. 25.

Business expenditure on R&D (BERD) as a share of GDP



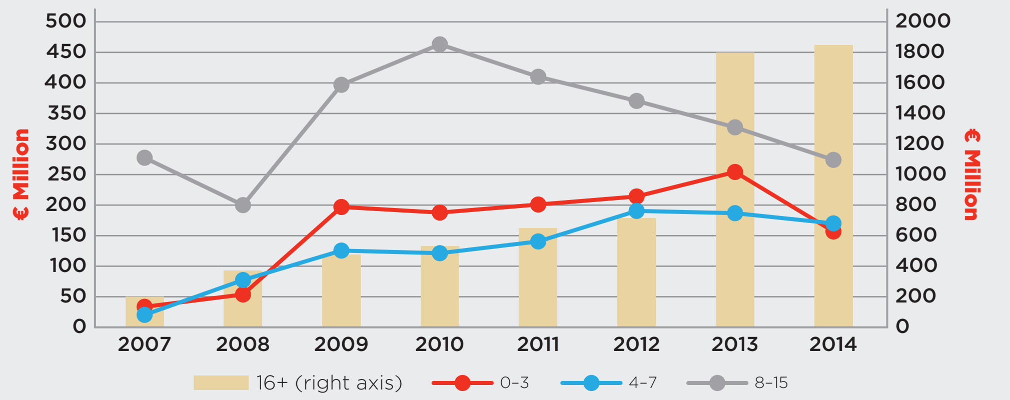
Source: Department of Finance, Economic Impact of Foreign-Owned Sector[33]

- Ireland performs relatively well on the Innovation Output Indicator and on the Innovation Union Scoreboard. This is mainly due to high-tech manufacturing sectors and knowledge-intensive services. However, this R&D is largely carried out by foreign multinationals.[33]
- Only 1% of all small companies consider themselves to be R&D active and 16% of medium companies consider themselves to be R&D active.[34]
- Small companies account for 23% of total business expenditure on R&D in 2014; medium companies account for 21% and large companies are responsible for 56% of the spend.[35]
- Older companies (over 16 years old) are investing more in R&D, and those firms have been driving the recent increases in R&D activity.[36]
- Innovation in younger companies (less than 3 years old) has stagnated since 2009, and even declined between 2013 and 2014.

> "The number of young firms claiming has declined over time, with a peak of 525 firms in 2010 and a trough of 253 firms in 2014."[37]

32 Department of Finance, "Economic Impact of Foreign-Owned Sector – Economic Impact Assessment of Ireland's Corporation Tax Policy", p. 4.
33 T. Martin and P. Fákó, *RIO Country Report 2016: Ireland*.
34 CSO, Business Expenditure on Research and Development 2013-2014, p. 9, http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014/.
35 Department of Finance, "Report on Tax Expenditures" (October 2016), p. 17, http://www.budget.gov.ie/Budgets/2017/Documents/Tax_Expenditures_Report%202016_final.pdf
36 Department of Finance, "Report on Tax Expenditures", p. 43.
37 Department of Finance, "Report on Tax Expenditures", p. 43.

Total R&D by firm age



Source: Revenue Commissioners

> Companies based in the Southern and Eastern region incurred 80% of R&D expenditure, with the remainder in the Border, Midlands and West region.[38]

In summary

A number of important characteristics emerge when you examine **who is carrying out R&D in Ireland** and who is not. The activity in terms of spend very much leans on companies that are:

1. Foreign owned,
2. Large (over 250 employees),
3. Established (over 16 years of age) and
4. Located in the south or east of the country.

This is the opposite of what should be happening according to the OECD, the IMF and the European Commission.

> Foreign-owned and internationalised domestic firms are far more likely to invest in innovation and are more likely to translate this investment into tangible gains than domestic indigenous Irish firms.

International comparisons of Ireland's R&D spend

Ireland has dropped one place to 16th in Bloomberg's 2017 Innovation Index.[39] Relatively low levels of R&D and innovation (particularly among Irish indigenous business) mean that new product development is limited, a challenge that can be seen in Ireland's export model as outlined in Chapter 6.

38 CSO, Business Expenditure on Research and Development 2013–2014, p. 4, http://www.cso.ie/en/releasesandpublications/er/berd/businessexpenditureonresearchdevelopment2013-2014/.

39 P. Hamilton, "Ireland Drops Place to 16th on Innovation Index", *The Irish Times*, 12 April 2017; http://www.irishtimes.com/business/economy/ireland-drops-down-bloomberg-s-innovation-index-1.3046178#.WO32gOjwdtc.mailto.

Irish Government policy on innovation

The Irish Government plays an important role in developing an ecosystem to foster increased investment in R&D by companies of all sizes. The Government's Innovation 2020[40] strategy is a five-year plan that seeks to make Ireland a "Global Innovation Leader." The cornerstone of this strategy is a commitment to increasing total R&D investment to 2.5% of GNP.

The Government provides a range of supports for businesses engaging in R&D activity, many of which are administered through Enterprise Ireland (EI) and aimed at small companies, such as:

- Innovation Vouchers scheme
- R&D Fund (for both small and standard projects)
- Technical Feasibility Study grant
- Innovation Partnerships programme

State supports are available for SMEs in Ireland looking to fund innovation, such as EI vouchers, which are worth €5,000 in R&D assistance from a third-level institution. EI also recently launched business innovations grants for SMEs, which pay up to 50% of the cost of a business innovation programme to a maximum of €150,000. EI is also involved in Innovation Partnerships, which bring together industry and third-level researchers across the food, manufacturing, pharmaceutical and technology sectors.

EI wants to drive access to research funding and partnership opportunities in Ireland as part of the EU's €80bn Horizon 2020 strategy and also support market-led product, process and service innovation for companies across all sectors. The other objectives focus on competitiveness, diversification and global ambition.

The NCC has said that there should be increased emphasis on the promotion of R&D and innovation programmes to assist companies overcome the challenges posed by Brexit.[41]

The critical role of tax policy in innovation

We have seen that direct funding of innovation by governments in areas such as higher education and basic research is critical. It provides a basis for firms to build their own R&D. However, fiscal policies also have an important role to play in fostering R&D investment by the private sector.[42]

The main fiscal policies in Ireland to drive innovation are:

1. the R&D tax credit and
2. the Knowledge Development Box (KDB).

The Department of Finance carried out an economic evaluation of the R&D tax credit in October 2016 to consider "why R&D is important for economic growth and why government intervention may be warranted."[43]

The paper evaluated whether the tax credit resulted in additional R&D expenditure by firms, meaning R&D that would not have taken place without the availability of the tax credit. The Department's analysis indicated that the tax credit achieves

40 Department of Jobs, Enterprise and Innovation, "Innovation 2020", https://www.djei.ie/en/Publications/Publication-files/Innovation-2020.pdf.
41 National Competitiveness Council, *Ireland's Competitiveness Challenge 2016* (December 2016), p. 91; http://www.competitiveness.ie/Publications/2016/Competitiveness-Challenge-2016-NCC.pdf.
42 V. Gaspar and R. de Mooij, "Imagine What Fiscal Policy Could Do for Innovation".
43 Department of Finance, "Economic Evaluation of the R&D Tax Credit" (October 2016); http://www.finance.gov.ie/sites/default/files/170214%20R-and-D-Credit-Evaluation-2016.pdf.

reasonable additionality and estimated that, on average, the "bang for buck" ratio for the Irish R&D tax credit is 2.4.

> From a cost perspective the R&D tax credit provides a 'bang for buck' ratio of 2.4. This means that for every one euro in forgone revenue to the state, €2.40 of additional R&D is being conducted.[44]

A report by the Small Firms Association (SFA) confirms that the R&D tax credit has been a successful model in encouraging Irish companies to invest in R&D and create value in the economy.[45] The report shows that 30% of the value of the credit went to small companies in 2013 (€126m). It suggests that increasing the value of the take-up of the R&D tax credit among small firms by 50% (€63m) could add as much as €225m to R&D spending across the economy over the long run.

Global speakers at a conference hosted by the European Commission and the IMF in 2016 highlighted that Europe has a growth challenge and that the route out of it is through innovation.[46] Tax is a critical topic right now, according to the IMF, and has major implications for entrepreneurship by reducing the reward to success. The IMF believes that high taxes may reduce the incentive to innovate and the entrepreneurial spirit. It has noted that the design of growth-friendly tax policy favouring entrepreneurship is required and that several governments can do better in this regard.[47]

There are other benefits, too, from innovation, a view shared by a number of professors from Harvard, Kent and Berkeley universities at the conference. R&D tax incentives increase productivity growth. There is much evidence to show that social returns from R&D are much higher than private returns, as there is a close link between R&D and both productivity and living standards.[48]

A close look at the tax measures

The R&D tax credit and the KDB (together with the 12.5% corporation tax rate) are the cornerstones of tax policy that supports innovation in Ireland.

These two initiatives work hand in hand to incentivise businesses to carry out R&D work and then to commercialise that work by applying a lower tax rate to the income generated using the KDB.

The R&D tax credit

The R&D tax credit was introduced in 2004. It provides an additional 25% tax credit to companies engaged in R&D activity, thereby increasing the maximum relief that they can claim on R&D costs to:

	%
Tax relief for the R&D expenditure (as for any other cost)	12.5
Additional R&D tax credit	25.0
Total relief available	37.5

44 Minister for Finance, Michael Noonan TD, response to written parliamentary question, 18 May 2017.
45 Small Firms Association, "Next Generation Business – A Vision for Small Firms in Ireland", p. 10.
46 European Commission and IMF Conference on Taxation, Investment and Innovation: A Triptych for Balanced Growth, 17 and 18 November 2016; https://ec.europa.eu/taxation_customs/sites/taxation/files/2016_tax-invest-innov_programme.pdf.
47 European Commission and IMF Conference on Taxation, Investment and Innovation.
48 European Commission and IMF Conference on Taxation, Investment and Innovation.

The cost of the R&D tax credit to the State is very significant (€639m in 2015),[49] and therefore R&D claims are closely scrutinised by Revenue.

Ireland's R&D tax credit regime is vital to innovation

The R&D tax credit regime is a very important benefit for all Irish companies carrying out R&D work, and it has been improved in a number of ways over the past ten years. However, some limiting factors remain that merit further consideration, given the urgent focus that we need to place on innovation by the indigenous sector.

1. Outsourcing and collaboration is restricted

An R&D environment that supports collaboration with the university sector is regarded as the best-practice model internationally. Furthermore, businesses carrying out R&D work often find that some elements or stages of that work cannot be completed in-house and have to be outsourced. Yet, in Ireland, we significantly limit tax relief on the cost of work outsourced or undertaken in collaboration with others.

The Innovation Policy Platform,[50] a joint endeavour between the OECD and the World Bank, explains the benefits of collaboration. Universities and public research institutes serve as important facilitators and promoters of the overall innovation process by sharing knowledge, expertise, innovation skills and technological applications. One of the major objectives of R&D collaboration between universities and industry is to ensure a smooth transfer of knowledge and technologies from scientists and engineers to entrepreneurs.

According to the NCC, competitive economies need sufficient and effective investment in R&D by the private sector.[51] High-quality scientific research institutions are also required, together with extensive research collaboration between universities and industry. However, overall levels of investment in R&D in Ireland remain below the best-performing countries.

Outsourcing to third parties is particularly common in certain sectors, such as food, pharmaceuticals and biotech, and can be of particular importance to the SME sector. Outsourcing can result in quicker and more cost-effective completion of innovation projects. For example, the Tufts Center for the Study of Drug Development reports that clinical trials conducted by specialist third-party clinical research organisations are completed on average 30% quicker than those conducted in-house.

Food testing is integral to the efficient production of safe, high-quality products. Outsourcing shelf-life testing, nutritional analysis, and testing for allergens, residues and contaminants is common in the sector, especially in the case of smaller companies, which may not have the necessary technical expertise in-house.

Outsourcing case study

"Dairymaster has consistently invested in R&D. This investment is at a multi-million-euro level, both in-house, and through collaboration with higher education institutes. Through this collaboration, the company has accessed additional expertise and capability and has widened its product portfolio to improve market penetration to 10,000 farms worldwide. Dairymaster has collaborated with a number of higher education institutions on four Enterprise Ireland-funded Innovation Partnership projects, worth more than €1m over the past five years, and has also collaborated with Technology Gateways and Technology Centres. Dairymaster is also collaborating at a European level through a pan-EU research consortium dealing with robotics. This sustained investment in R&D, both in-house and through collaboration, has resulted in significant sales growth and in a 100% increase in sustainable and high added-value employment over the past six years."[52]

49 Revenue, *An Analysis of 2015 Corporation Tax Returns and 2016 Payments* (April 2017).
50 See https://www.innovationpolicyplatform.org/content/rd-collaboration-universities-and-pris-firms?topic-filters=11976.
51 National Competitiveness Council, *Benchmarking Competitiveness: Ireland and the United Kingdom, 2017*, p. 67.
52 Department of Jobs, Enterprise and Innovation, "Innovation 2020".

In its Innovation 2020 report the Department of Jobs, Enterprise and Innovation notes the importance of greater use by businesses of research assets of the Higher Education Institutes, by engaging with research centres and technology centres, to support Ireland's vision of becoming a global innovation leader.[53] According to the report, the most impactful science can come from international collaborations between academia and industry.[54]

However, the Irish R&D tax credit restricts collaboration with others, and this is unusual by international standards.

- Outsourcing R&D work to **third parties** is restricted to 15% of the in-house R&D expenditure or €100,000 (whichever is greater).
- Outsourcing R&D work to **universities** is restricted to 5% of the in-house R&D expenditure or €100,000 (whichever is greater).

Any outsourcing to a **related party** (such as another company in the group) prohibits a claim entirely.

As part of its Base Erosion and Profit Shifting (BEPS) project, the OECD developed a Modified Nexus approach for patent box regimes that is explained in more detail in the section on the KDB. The OECD considered the treatment of outsourced R&D costs for the purpose of patent box calculations and decided that it was not necessary to restrict them, as companies are unlikely to outsource the fundamental value-creating activities to an unrelated party.[55]

2. The two Revenue tests that apply to the R&D tax credit

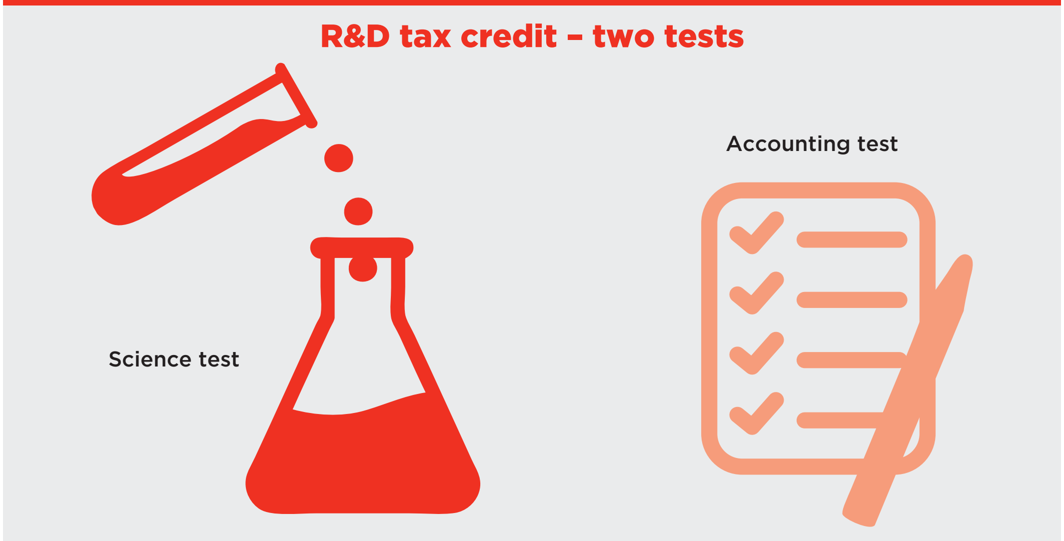
Broadly, any business that wants to claim the R&D tax credit must be able to satisfy two tests:

a. The science test, which tests that the activities being carried on qualify as R&D; and

b. The accounting test, which tests that the costs being claimed relate to the R&D part of the business.

The conditions for both tests are explained in more detail below.

Innovation – the tax environment



53 Department of Jobs, Enterprise and Innovation, "Innovation 2020".
54 Department of Jobs, Enterprise and Innovation, "Innovation 2020".
55 OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing, 2014); http://dx.doi.org/10.1787/9789264218970-en.

a. The science test

To qualify for the R&D tax credit, the activities must be:

- systematic, investigative or experimental activities;
- in a field of science or technology;
- involving one or more of the following categories of R&D:
  - basic research,
  - applied research, or
  - experimental development.

And the activities must:

- seek to achieve scientific or technological advancement; and
- involve the resolution of scientific or technological uncertainty.

Revenue will often ask the business to prove that it passes this science test in order to secure the R&D tax credit.

Revenue streamlines the R&D validation process for many SMEs

Revenue confirmed in February 2017[56] that, in certain circumstances, SMEs will not have to undergo the science test as part of any validation checks on their R&D tax credit claims. The new practice will apply to small or micro businesses where:

- an IDA Ireland/Enterprise Ireland R&D grant has already been approved for the project;
- the credit claim in any year is no more than €50,000; and
- the project is undertaken in a qualifying field of science or technology.

The accounting test (i.e. the record-keeping requirements) will still have to be passed by the SME.

b. The accounting test

Only those revenue expenses that are incurred by the business wholly and exclusively **in the carrying on** of R&D activities can qualify for the R&D tax credit. These include:

- Salaries and wages of staff directly involved in the R&D activity.
- Cost of raw materials used in the R&D activity.
- Fuel, power, water etc. used in the R&D process.

In many cases the company will have to carry out an allocation exercise to determine how much of its overall costs relate to its R&D activity and how much relates to other work that it carries out. Proving this allocation of costs to Revenue is called the "accounting test" and can be complex.

The claims process

The processes and documentation needed to support an R&D claim can be daunting. This is a particular challenge for business sectors such as food, software and IT, which traditionally do not document their processes and costs to anything like the extent that highly regulated sectors such as pharmaceuticals and financial services do.

The time and resources required to prepare this documentation can deter some taxpayers, and particularly SMEs, from claiming the credit. For them, the compliance cost for the business is greater than the potential benefit of the tax credit.

An R&D tax credit claim must be made within 12 months of the year-end.

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56 Revenue eBrief 17/17.

There are 25 separate fields for an R&D tax credit claim on the tax return. However, completing the tax return form is sometimes the easiest part of the process.

Extract from Corporation Tax Return (Form CT1)

10 - RESEARCH & DEVELOPMENT CREDIT and ALLOWANCES

10.1 (a) Amount of credit claimed under Sec. 766 in this accounting period (include here any amounts surrendered under Sec. 766(2A)) .00

(b) If any amount at Line 10.1(a) refers to expenditure on machinery & plant, enter that amount here .00

10.2 (a) Amount of credit included at Line 10.1(a) that has been surrendered in accordance with Sec. 766(2A) .00

(b) In relation to the amount of credit surrendered, enter details of each employee receiving the credit

PPS Number	Amount	PPS Number	Amount
	.00		.00
	.00		.00
	.00		.00
	.00		.00
	.00		.00

10.3 Amount of unused credit claimed under Sec. 766 carried forward from a previous accounting period excluding unused credit carried forward under Sec. 766(4B)(b)(ii)(I) and Sec. 766(4B)(b)(iii)(I) .00

10.4 Amount of unused credit carried forward under Sec. 766(4B)(b)(ii)(I) .00

10.5 Amount of unused credit carried forward under Sec. 766(4B)(b)(iii)(I) .00

10.6 Amount of credit claimed on the construction or refurbishment of a building under Sec. 766A in this accounting period .00

10.7 Amount of unused credit claimed on the construction or refurbishment of a building under Sec. 766A carried forward from a previous accounting period excluding unused credit carried forward under Sec. 766A(4B)(b)(ii)(I) and Sec. 766A(4B)(b)(iii)(I) .00

10.8 Amount of unused credit carried forward under Sec. 766A(4B)(b)(ii)(I) .00

10.9 Amount of unused credit carried forward under Sec. 766A(4B)(b)(iii)(I) .00

10.10 (a) Amount of unused credit carried forward under Sec. 766(4C) .00

(b) Enter the Tax Reference Number of the predecessor company

Company 1

Company 2

Company 3

10.11 (a) Amount of unused credit carried forward under Sec. 766A(3A) .00

(b) Insert ☒ in the box to confirm that the building or structure, which was the subject of the claim by the predecessor company, has been transferred to the successor company in accordance with Sec. 766A(3A) ☐

10.12 Amount of Group Relief claimed under Sec. 766A (excess credit claimed) .00

10.13 Amount of Group Relief surrendered under Sec. 766A(4)(b) (excess credit surrendered) .00

10.14 Excess Research & Development Credit claimed under Sec. 766(4A)(a) (carry back of R&D from succeeding accounting period) .00

10.15 Excess Research & Development Credit claimed under Sec. 766A(4A)(a) (carry back of R&D from succeeding accounting period) .00

10.16 Total Research & Development Credit claimed in this accounting period .00

Claim for payment of excess Research & Development Tax Credit (subject to Sec. 766B(3)(a) and Sec. 766B(3)(b))

10.17 First Instalment - amount of claim under Sec. 766(4B)(b)(i) .00

10.18 First Instalment - amount of claim under Sec. 766A(4B)(b)(i) .00

10.19 Second Instalment - amount of claim under Sec. 766(4B)(b)(ii)(II) .00

10.20 Second Instalment - amount of claim under Sec. 766A(4B)(b)(ii)(II) .00

10.21 Third Instalment - amount of claim under Sec. 766(4B)(b)(iii)(II) .00

10.22 Third Instalment - amount of claim under Sec. 766A(4B)(b)(iii)(II) .00

10.23 (a) Research & Development expenditure on sub-contracted expenditure to universities (Sec. 766(1)(b)(vii)) .00

(b) Research and Development expenditure on sub-contracted expenditure to other persons (Sec. 766(1)(b)(viii)) .00

(c) Indicate, by inserting ☒ in the appropriate box, if you have notified the 'other persons' that they may not claim the tax credit for such sub-contracted expenditure Yes ☐ No ☐

10.24 (a) Base year expenditure (2003) (Sec. 766) .00

(b) If any amount at Line 10.24(a) refers to expenditure on machinery & plant, enter that amount here .00

Allowances

10.25 Allowance claimed for capital expenditure on scientific research (Sec. 765) .00

The verification process by Revenue

Revenue's guidelines[57] on the R&D tax credit run to 47 pages, and experience from our members shows that a range of very detailed information is likely to be required by Revenue when it checks a claim.

Revenue's Research & Development Tax Credit Guidelines

Research & Development Tax Credit Guidelines

Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

These Guidelines should be read in conjunction with Section 766, Section 766A and Section 766B of the Taxes Consolidation Act 1997

This document is not a legal instrument. While every effort is made to ensure that the information given in this guide is accurate, responsibility cannot be accepted for any liability incurred or loss suffered as a consequence of relying on any matter published herein.

Updated April 2015

57 Revenue, "Research & Development Tax Credit Guidelines" (updated April 2015) [http://www.revenue.ie/en/companies-and-charities/documents/research-and-development-tax-credit-guidelines.pdf

In most cases a letter issues from Revenue to the business with 25 detailed questions, seeking the following types of information:

- A detailed project plan.
- Records on dozens of line items of expenditure.
- Comprehensive information on the science involved in the claim.

However, we would expect that Revenue will not seek information on the science involved in claims going forward from small or micro businesses[58] that qualify for Revenue's new streamlined validation process.[59]

Example of an Aspect Query Letter from Revenue

www.revenue.ie

Reference: **Office of the Revenue Commissioners** *Address* *Address* *Address* *Address* *Address*

Oifig na gCoimisineiri Ioncaim *Address* *Address* *Address* *Address* *Address*

Date X/X/20XX

Mr/ Mrs Name

Company Name

Address

Address

Address

This matter is being dealt with by

Re:

Your Ref:

Dear Sir/Madam,

I refer to claim for refund for corporation tax for year ended X/X/XX. Please supply the following information from the company in relation to its R&D claim for the year ended X/X/20XX and X/X/20XX:

1 State the number of R&D projects undertaken.

2 Please provide a summary of the R&D activities in relation to each project.

3 Confirm the date on which each project commenced.

4 Confirm the date on which each project ceased (if applicable).

5 Confirm whether the claim made is in respect of Section 766 or Section 766A of the Taxes Consolidation Act 1997.

6 Please state the amount of the 2003 expenditure threshold amount.

7 Confirm that **all** group expenditure has been included in the threshold amount.

8 Outline the specific scientific or technological advancement, which the company sought to achieve at the start of each project.

9 Outline the specific scientific or technological uncertainty, which the company sought to resolve at the start of each project.

10 Once the uncertainty was resolved confirm that no further expenditure has been attributed to the R&D claim.

11 Was the solution already known and available to a competent professional in the field?

12 What were the qualifications of each project leader?

13 Please state the field of science or technology involved.

14 Please confirm which of the following categories do the activities fall under:

- Basic research
- Applied research
- Experimental development.

15 Where did the R&D activities take place?

16 Please state the number of staff employed in R&D activities.

17 Confirm the amount of expenditure incurred (if any), in respect of third party contractors or service providers (excluding utilities).

18 Confirm the amount of expenditure incurred (if any), in respect of payments made to a university or institute.

19 In respect of (13) and (14) above, briefly outline the work carried out by the other parties.

20 Where expenditure has been allocated to R&D by apportionment, please state in respect of each item, the method and basis used.

21 If the claim includes expenditure on plant & machinery state the percentage used of such equipment on R&D over the useful economic life of the asset.

22 Please provide details of any grants received in respect of R&D.

23 Please also provide your computation of the tax credit claimed, showing an itemised analysis of each expenditure item.

24 Details of any R&D work carried out on behalf of other parties and details of payments received.

25 Please provide a computation of the R&D claimed, showing the figures as input in the CT Return taking into account the limits as applied if applicable as per Revenue Guidelines.

Please also provide a copy of the unabridged financial statements and corporation tax computations for the company for the years ended X/X/20XX and X/X/20XX.

Yours faithfully,

Name

Title

58 A "small business" is defined as an enterprise with fewer than 50 employees and whose annual turnover and/or annual balance sheet total does not exceed €10m. A "micro business" is defined as an enterprise with fewer than 10 employees and whose annual turnover and/or annual balance sheet total does not exceed €2m.

59 Revenue eBrief 17/17.

Some more detail on the evidence that Revenue requires to answer these questions:

a) Expense records:

- ✓ A project plan with milestones and deliverables
- ✓ A record of start dates, progress and completion dates
- ✓ Records of staff working on each R&D project and their qualifications, as well as timesheets for each employee working on the R&D project
- ✓ Itemised records of expenditure directly connected with each R&D project
- ✓ The business's methodology for apportioning overheads, e.g. light, heat etc.
- ✓ Records of any outsourcing costs

b) Back-up information to prove that the science test has been met. For bigger projects, in particular, this usually involves a detailed report containing the following information:

- ✓ A description of the R&D activities and methods, outlining what the business is trying to achieve with the R&D
- ✓ Evidence that the uncertainty that the business is trying to resolve has not already been addressed or could be resolved currently
- ✓ Detailed information on the science itself:
  - what you did
  - how you did it
  - what you found
  - your conclusions

What happens if you do not pay enough corporation tax to claim the credit in full?

Many businesses carrying on R&D activities will be in a loss-making position, particularly in the early years of development. If the business is not paying enough tax in any year to offset the R&D tax credit in full, it has several options:

- The credit will be first offset against the corporation tax for the previous period.
- Any balance can either be carried forward indefinitely or be allocated to another member of the group.

If the company exhausts all of these options and there is still a surplus credit, it can make a claim to have that excess paid to it in cash by Revenue in three instalments over a period of 33 months. However, the cash refund is limited to:

- the total amount of corporation tax paid by the company in the previous ten years; or
- the total payroll taxes liability of the company in the period in which the R&D expenditure is incurred.

In summary

The R&D tax credit is a very important element of Ireland's strategy to reach its intensity target of 2.5% of GNP by 2020.[60]

The credit itself is very valuable, but there is undue cost and uncertainty involved in the claims process, which significantly reduces its attractiveness to smaller businesses. Removing the need for SMEs to pass a science test has helped to some extent. However, compliance costs need to be reduced, and greater clarity and certainty should be provided to SMEs about whether, and to what extent, they qualify for the R&D tax credit.

60 See https://www.djei.ie/en/Publications/Publication-files/Innovation-2020.pdf.

The UK SME-friendly R&D regime

The fundamentals of the UK R&D regime are similar to that in Ireland, but it has also introduced a separate, "SME-friendly" version of the regime for businesses with fewer than 500 staff. The SME regime has much more straightforward administrative conditions .

A number of steps have been taken in the UK to make it easier for SMEs to claim R&D tax relief:

R&D tax relief administrative supports in the UK

1. HMRC has written **separate guidelines**[61] in plain English for SMEs, with step-by-step instructions on the claims process and practical case studies.


HM Revenue & Customs

Research and development tax relief

Making R&D easier for small companies

61 HMRC, "Research and Development Tax Relief: Making R&D Easier for Small Companies", http://www.hmrc.gov.uk/gds/cird/attachments/rdsimpleguide.pdf.

HM Revenue & Customs – easy to follow guides

How to show that your project is R&D within the tax definition

When you submit a claim it helps if you give details of your project. The questions below will help you decide if your project is within our definition for R&D. If your claim clearly sets out how you approach these questions, it helps HMRC see that your company really is doing R&D.

1. What is the scientific or technological advance?

Concentrate on the science and technology

Rather than stating the product, process or functionality being developed, consider what scientific or technological advance is being sought. This focuses attention on the project's aim for an advance. This is important in judging whether or not R&D for tax relief purposes is being undertaken.

Some activities aren't science

Science doesn't include work in the arts, humanities and social sciences (including economics).

'Commercially innovative' isn't enough

It's not enough that a product is commercially innovative. You can't claim in respect of projects to develop innovative business products or services that don't incorporate any advance in science or technology.

2. What scientific or technological uncertainties were encountered?

Did you really encounter 'uncertainty'?

Scientific or technological uncertainty exists when knowledge of whether something is scientifically possible or technologically feasible, or how to achieve it in practice, isn't readily available or deducible by a competent professional working in the field.

Not every problem is an uncertainty

But uncertainties that can be resolved through relatively brief discussions with peers are routine uncertainties rather than technological uncertainties. Technical problems that have been overcome in previous projects on similar systems aren't likely to be technological uncertainties.

Set out what happened

In your claim, you should set out at a high level, in a way that can be understood by someone who's not an expert, what the uncertainties were and when they started and ended.

12 Research and development tax relief: Making R&D easier for small companies

2. There is also guidance available on the UK Government's websites about "Schemes to help your business innovate and grow,"[62] which covers a range of topics including the R&D tax credit. The emphasis is on "making full use of the extensive range of government supports available."

Schemes to help your business innovate and grow

From: Department for Business, Energy & Industrial Strategy
Part of: Scientific research and development
Published: 12 December 2012
Last updated: 24 March 2016, see all updates

A guide to help companies find the practical support to invest in research and development (R&D).

Contents

Company research and development (R&D) professionals and accountants will want to ensure that their businesses are making full use of the extensive range of government support available for businesses undertaking R&D and innovation. This support helps companies to develop the new products and services they need to remain competitive and grow.

Help through the tax system

R&D tax credits

This is the single biggest government scheme supporting business investment in R&D and innovation. Claims totaled £1.2 billion in the financial year 2011 to 2012. Don't let your company miss out on claiming your share.

The small and medium-sized business relief is for companies with fewer than 500 full-time employees and is worth about 28p for every £1 spent. The large company scheme and the 'Above the Line' credit are both worth about 7p for every £1 spent.

R&D tax credits include enhanced relief from Corporation Tax on qualifying R&D expenditure, and in some cases payable credit. HMRC have specialist units that can advise companies on how to make a first claim. More information on R&D tax credits.

62 See https://www.gov.uk/guidance/research-and-development-in-the-business-sector.

3. The HMRC website guidance is published in “plain English.”

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Guidance

Corporation Tax: Research and Development tax relief for small or medium sized enterprises

From: HM Revenue & Customs
Part of: Corporation Tax
Published: 23 December 2015
Last updated: 19 October 2016, see all updates

Find out about Research and Development (R&D) tax relief for small or medium sized enterprises (SME), qualifying projects and costs, claiming and keeping records.

Contents

— Overview
— The SME tax relief scheme
— Subsidies and grants
— State aid
— Rate of tax relief
— R&D tax credits

Overview

A small or medium sized enterprise (SME) is a company with less than 500 employees with either:

- an annual turnover under €100 million
- a balance sheet under €86 million

Your company isn’t an SME if it’s part of a larger enterprise that, when taken as a whole, would fail these tests.

When considering these limits, you should also include any linked, partnership or shareholding companies that have at least a 25% share in your company and/or any company that your company holds a 25% share in.

The definition of an SME for R&D tax relief purposes isn’t necessarily the same as that used by HM Revenue and Customs (HMRC) in relation to other areas of Corporation Tax (CT) or other tax areas like PAYE, or by other government agencies.

4. Small companies claiming R&D tax relief for the first time can avail of “**Advance Assurance**.”[63]

This means that, when a company claims R&D relief for the first time, it can apply to HMRC for the relief without the need for HMRC to carry out any further checks on the claim for the first three accounting periods.

Advance Assurance allows a company to spend time concentrating on its business, rather than focusing on its R&D tax claims. It can be given as proof that a company will get R&D tax relief, which may help the company secure funding.

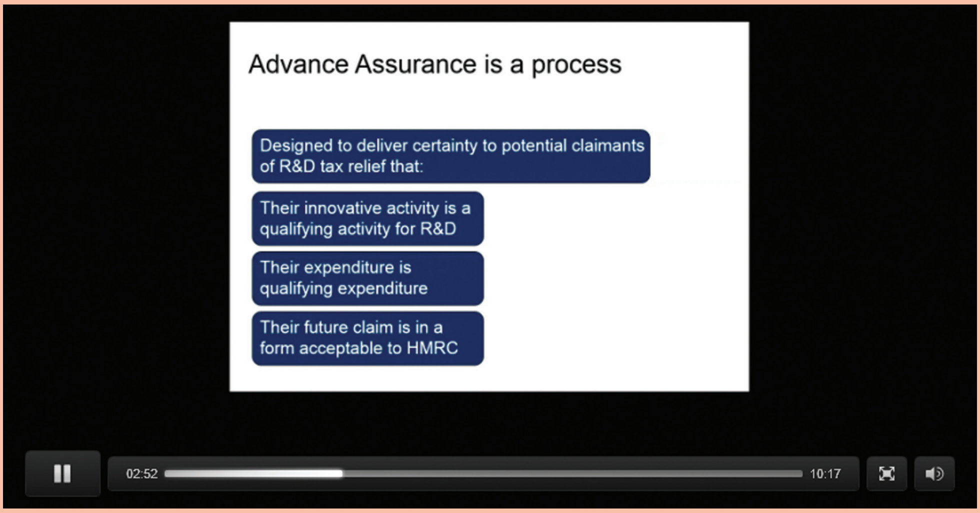
A company can apply for Advance Assurance if it is planning to carry out, or has previously carried out, R&D. However, a company has to meet certain conditions:

a. It has not claimed R&D tax relief before.

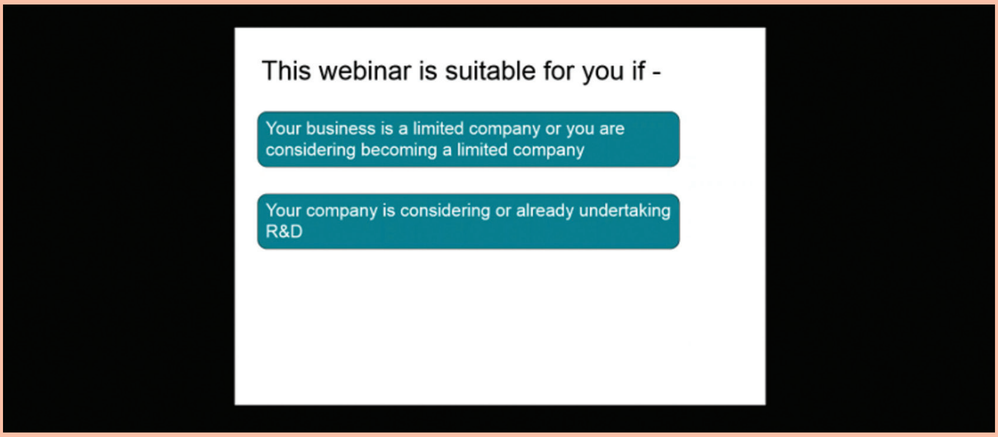
b. Its annual turnover is Stg£2m or less.

c. It has fewer than 50 employees.

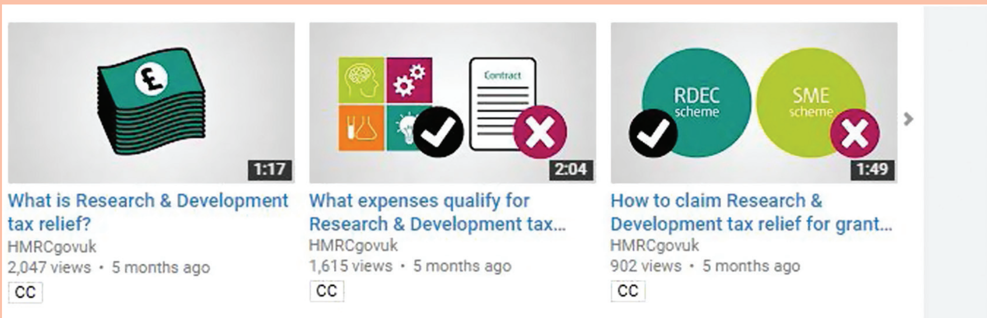
63 See https://www.gov.uk/guidance/research-and-development-tax-relief-advance-assurance.



5. Specialist HMRC R&D units help taxpayers with their claims. There are four specialist R&D units[64] in the UK tasked with providing this help:
   a. Croydon R&D Unit
   b. Leicester R&D Unit
   c. Manchester R&D Unit
   d. Portsmouth R&D Unit
6. Webinars have been recorded for taxpayers, explaining the basics of the R&D tax relief and the patent box.



7. HMRC **videos** are available on YouTube explaining who is eligible to claim relief, how to make a claim and where to get further help for your business.



64 See https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird80350.

The Knowledge Development Box (KDB)

- The KDB is similar to "patent box" regimes that have existed in other countries for many years. There are currently 16 patent box regimes[65] internationally, in countries such as Belgium, France, Italy, Spain and the UK, the most recent of which was introduced in Israel in 2017.
- The Irish KDB reduces to 6.25% the corporate tax rate on income from commercialised R&D such as patents, copyrighted software and IP equivalents of a patentable invention.
- New rules for these patent boxes were developed by the OECD as part of the BEPS project.
- When Ireland introduced the KDB in 2015, it was the first OECD-compliant patent box in the world, applying these new rules and adopting the "Modified Nexus Approach," which directly links the patent box (KDB) relief to the R&D incurred.
- The higher the level of R&D undertaken by the company, the greater the level of income that may qualify for the KDB rate.
- The qualifying profit is determined by reference to the following formula:

KDB — An overview

KDB Formula

30% uplift

$$\frac{\text{Qualifying expenditure on qualifying asset}}{\text{Overall expenditure on qualifying asset}} \times \text{Profit of the specified trade relevant to the qualifying asset} = \text{Qualifying profit}$$

Qualifying Taxpayer	Qualifying Asset	Qualifying Expenditure	Overall Expenditure	Profit of the specified trade relevant	Assessment
• Resident companies • PEs of foreign companies • Companies operating through partnerships	• Patents (including supplementary protection for plant protection products and medicinal products, and plant breeders' rights) • Copyrighted Software • IP for small companies Can be grouped into asset families	Broadly aligned to R&D credit regime: • Salary costs • Consumables • Plant and machinery • Certain overheads • 3rd party outsourcing **Plus** uplift of 30%	Qualifying expenditure Plus costs incurred on: • Acquisition of IP (inc. licence) • Related-party outsourcing	• Treated as separate trade • Profit is overall income less related expenses • Apportionment of expenses subject to Transfer Pricing rules (except SMEs) • Overall income does not include gains	• Allowance equal to 50% of qualifying profit (e.g. effective rate of 6.25%) • Claim must be made within 24 months from year end

It can be very costly to obtain and protect a patent. In recognition of this, Irish SMEs have been given the option to claim KDB relief on assets that have not been patented but have been certified as being "novel, non-obvious and useful" by the Controller of Patents, Designs and Trade Marks.

65 PwC, Global Research and Development Incentives Group (February 2016).

In a welcome move, Revenue published detailed guidelines[66] on the operation of the KDB in August 2016. These guidelines run to 82 pages and **include** worked examples.

Revenue's Guidance Notes on the Knowledge Development Box

Guidance Notes

On the

Knowledge Development Box

These Guidelines should be read in conjunction with Chapter 5 of Part 29 of the Taxes Consolidation Act 1997.

Updated August 2016

Tax returns with the first KDB claims are being received this year, and the full extent of claims made will not be known until after the end of September 2017.

The challenges within the KDB regime

The main challenge with the KDB regime is its complexity.

- KDB relief is a very complex regime for businesses to operate.
- This is mainly because the Modified Nexus rules require that any income qualifying for the 6.25% rate be linked back to the underlying R&D costs.
- Many businesses will carry out interconnected work on multiple projects and IP simultaneously (particularly in the technology sector), and it will prove difficult to track and trace expenditure to individual assets.

66 Revenue, "Guidance Notes on the Knowledge Development Box" (August 2016) [http://revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-29/29-03-01.pdf]

Recommendations for R&D and innovation

1. Limits in the R&D tax credit regime for outsourcing, restrict collaboration among Irish businesses and, crucially, between businesses and third-level institutions. No outsourcing restriction is required under the OECD Modified Nexus rules for the KDB, and because the rules of the two regimes should be aligned, the outsourcing restrictions in the R&D tax credit regime should be removed.
2. At a time when all global indicators tell us that growth depends on innovation, every effort should be made to remove administrative blockers for businesses that need to claim the R&D tax credit. Only 1% of all small companies consider themselves to be R&D active and 16% of medium companies consider themselves to be R&D active. If we are to be truly innovative and global, we must improve this performance, and no stone should be left unturned in supporting SMEs to claim the R&D tax credit. This includes:
    - A new SME-friendly guidance campaign supported by dedicated Revenue support lines for SMEs with dedicated Revenue experts.
    - A Revenue Centre of Excellence that deals with all taxpayer issues concerning the R&D tax credit regime.
    - Sector-specific guidance for each industry sector such as food and drink, ICT, bio-medical etc., all of which engage in very different R&D processes.
    - A Revenue pre-approval process that would bring much-needed certainty for taxpayers and subsequently prevent disagreements and costly future audits.
    - Expert checks on the science element of R&D that are grounded in business reality rather than focused on academic concepts of “new to the world.” Regardless of how innovative a food company might be, it is very difficult to invent a food that is completely new to the world.
3. Revenue’s guidelines on the KDB are very comprehensive at 82 pages. However, a separate and less complex set of guidance is needed for SMEs which have much more straightforward operations.

Chapter 9

Human Capital and Talent

Tax recommendations for human capital and talent

1. Ireland's urgent skills gap warrants a comprehensive review of our high effective tax rates that apply above the average wage. A phased plan is needed to reform the overall shape of our personal tax system. This includes a review of our high marginal tax rates, the breadth of our tax base and the entry points to income tax, USC and PRSI.
2. A workable share-based employee scheme is also required for SMEs that would enable them to attract and retain the best talent. The UK's Enterprise Management Incentive (EMI) is a good model to consider – capital gains tax is payable by taxpayers when they sell their shares and have the funds to pay the tax. A simple administrative process for collecting the information and paying the tax due is an important element of any new scheme.
3. Entrepreneurs are the job creators of Ireland and personal tax disparities that require them to pay higher taxes than PAYE taxpayers should be removed. These include the additional 3% USC rate that they pay on income above €100,000 and the €700 lower tax credit they receive.
4. Consideration should be given to developing a new talent regime similar to the Special Assignee Relief Programme (SARP) but targeted at SMEs, so that they can attract the talent and skills they need from outside Ireland to grow their businesses.
5. Uncertainty about the tax treatment of travel expenses is creating concern and cost for many home workers, freelancers, employers with staff sent abroad to build the business and those dealing with the new working patterns of the modern world. Legislation in this area urgently needs to be brought up to date to deal with this issue.
6. Irish companies sending employees abroad for short-term visits often experience burdensome administrative difficulties when dealing with tax, payroll and double taxation issues. A new streamlined approach to these tax compliance issues is needed, complemented by further specialised Revenue support.

> “Talent is the single factor that shows the differences in prosperity between countries
>
> – National Competitiveness Council.[1]

Game on globally as companies compete for talent

The “war for talent”, often referred to by management in companies, is an all too real problem. Globally, the search is on, and Ireland is in the hunt for talent. According to a recent survey, 77% of CEOs worldwide say that they are worried about skills.[2]

Similarly, nearly six out of ten CIOs believe that skills shortages will prevent their organisation from keeping up with the pace of change[3] – one-third more than just three years ago.

1 Peter Clinch, “Competitiveness Must Be at the Heart of a New Programme for Government”, *The Irish Times*, 21 April 2016; http://www.irishtimes.com/opinion/competitiveness-must-be-at-the-heart-of-a-new-programme-for-government-1.2618962.
2 PwC, 20th Annual Survey of CEOs Worldwide 2016.
3 Harvey Nash/KPMG, CIO Survey 2016.

The World Economic Forum (WEF)[4] is also concerned: "77% of the CEOs we surveyed voiced concern that skills shortages could hinder their organisation's growth, and 52% plan to hire more employees over the next year."

And the skills are not limited to just tech and digital; in fact, the talent gap is broad based, according to the WEF. "Despite greater automation in the workforce, CEOs realise they can't rely on digital skills alone. To innovate, they need good problem-solvers and people with creative skills and high emotional intelligence. These are also the hardest skills to find."

Ireland's skills search – the urgency

In 2017 57% of Irish entrepreneurs said that "recruiting experienced hires had been a challenge in the past year", with 43% saying they have struggled to compete for talent against larger companies.[5] This reflects the growing challenge for small and medium-sized businesses to match the benefits that larger employers can use to attract and retain talent.

Human Resources teams are finding it difficult; 67% are reporting a delayed or cancelled strategic activity or new market opportunity due to the skills shortage, and 81% found that the lack of availability of key skills was a top business threat to growth.[6]

The impact of the skills shortage in Ireland

Ireland's leading entrepreneurs[7] spell out the impact facing entrepreneurs and their companies going forward:

- The war for talent is impacting businesses large and small and must be addressed.
- This, coupled with the fact that basic salaries and share options for employees cannot be delivered tax-efficiently in Ireland, creates a further challenge for entrepreneurs, who must look at the whole package they can offer current and prospective employees in order to compete in the market.
- Larger companies have deeper pockets, and Ireland must level the playing pitch for entrepreneurial businesses, through initiatives such as more favourable treatment for the various employee share ownership programmes.

Real-life concerns in Ireland: thousands of roles need to be filled

Highlighting this issue is the finding by the Department of Jobs, Enterprise and Innovation that Ireland is also experiencing skills shortages in a number of occupations and sectors, including: chemical and biological scientists; biochemists; biotechnology technicians; production and process engineering; product development and design engineering; chemical engineering; risk and compliance skills in the business and financial sectors; and quantity surveyors and building information modelling skills in construction.[8] Many of the skills required are for the very areas where we have highlighted growth potential in Chapter 6 on exports. These are skills that are critical to the development of a company or sector, such as modern manufacturing, and the available talent pool may be quite small.[9]

4 WEF, "4 Concerns that Keep CEOs Awake at Night" (January 2017).
5 EY, Entrepreneur of the Year Alumni Survey 2017.
6 PwC, "Shaping Ireland's Future Talent Landscape: 2017", PwC HRD Pulse Survey.
7 Kevin McLoughlin, Partner Lead, EY, "Irish Entrepreneurs Continue to Invest in Future Growth, but the Cost of Doing Business in Ireland Identified as a Key Challenge" (3 April 2017).
8 Department of Jobs, Enterprise and Innovation, Enterprise 2025 Background Report.
9 Department of Jobs, Enterprise and Innovation, Enterprise 2025 Background Report.

Skills shortages in tech are also a reality. TechLifeIreland.com, an online hub to attract tech workers to Ireland, was established in June 2016 by the Department of Jobs, Innovation and Enterprise, IDA Ireland and Enterprise Ireland.[10] At the time of publishing, it lists over 2,800 vacancies across many ICT roles.[11]

This forms part of the overall strategy by the Department of Jobs, Enterprise and Innovation and the Department of Education and Skills.[12] The departments are working together with an ambitious target to meet 74% of demand through domestic supply by 2018. Their Expert Group on Future Skills Needs predicted that there will be a total of 44,500 job openings in the ICT sector over the period 2014–2018.

The Irish skills shortage is part of a wider, EU issue. Roberto Viola, Director General of DG Connect, European Commission, told *The Irish Times* on 30 November 2016 that the EU was at a point where there were 1m job vacancies in ICT.[13] The shortage is severe, but according to Mr Viola, the opportunities are "huge" if the gap can be addressed. Although the number of people with digital skills in Ireland has not increased in the past three years, Mr Viola told *The Irish Times* that "the Irish Government is doing a lot and has clearly identified this as a priority".

We have seen in the Chapter 6 on exports how knowledge-intensive sectors are driving growth, both in services and in manufacturing. The Irish Manufacturers Association focuses on how the talent issue is affecting its particular sector right now: "A lot of manufacturers struggle when it comes to accessing and retaining the skilled people they require. Ireland can be a world leader in quality manufacturing, but we need to get the business environment right...[We] must focus on maintaining business and input costs, at the same time ensuring that there is a tax system in place that helps manufacturers retain staff and also encourages skilled people to come back to Ireland."[14]

The need to attract talent from overseas

"Developing our own talent will always provide the vast bulk of our skills requirements and it is critical that there is sustained focus in this area. However, the reality is that there will be a requirement for enterprises in Ireland to source talent from overseas." This is according to the Department of Jobs Enterprise and Innovation,[15] which recognises the importance of attracting talent from overseas to meet our skills gap.

The World Economic Forum has said: "To find these employees, CEOs are increasingly tapping into a more diverse hiring pool – and looking across borders."[16]

Attracting talent from overseas is also important when it comes to developing start-up businesses and building entrepreneurial hubs. Russ Shaw, the founder of Global Tech Advocates, is clear that a key part of the success of the tech sector in London has been global and local talent coming together, sharing ideas and transferring knowledge. No single tech hub has all of the answers, so bringing in talent really helps to round out that knowledge base.[17]

As we compete against other countries to attract new talent to Ireland, we need to ensure that our overall offering is strong enough. Potential workers will consider taxation, as

10 See http://www.idaireland.com/newsroom/techlife_ireland/.
11 Figure taken on 26 June 2017.
12 ICT Skills Action Plan 2014–2018, http://www.hea.ie/sites/default/files/action_plan_ict_2014_4final_spr.pdf.
13 Elaine Edwards, "Shortage of Digital Skills an 'emergency' for Ireland and EU", *The Irish Times*, 30 November 2016; http://www.irishtimes.com/business/technology/shortage-of-digital-skills-an-emergency-for-ireland-and-eu-1.2887769.
14 Aviné McNally, Director of the Irish Manufacturers Association.
15 Department of Jobs, Enterprise and Innovation, Ireland's National Skills Strategy 2025.
16 WEF, "4 Concerns that Keep CEOs Awake at Night" (January 2017).
17 Silicon Republic, "Dublin Calling: Could Brexit Push London's European Start-up Talent Elsewhere?" (7 June 2017), https://www.siliconrepublic.com/careers/brexit-talent-fears-london-dublin.

well as education provision, the cost of living, childcare, leisure and recreational facilities, languages spoken etc. If they are from outside the European Economic Area, visas and work permit provisions are crucial.

Ireland's challenges with regard to "across the board skills"

The future of work in Ireland, Europe and globally is going to be defined by the rise of digitalisation. The European Commission's Director General of DG Employment, Social Affairs and Inclusion, Michel Servoz, spoke on the topic in Ireland in June 2017, saying that "skills are the number one issue for the EU". He also said that there were challenges for the Irish population, that it has very basic skills and that this is something that the Commission wants Ireland to focus on for the future. This is evidenced in publicpolicy.ie's report "Low Skills of the Irish Workforce".[18] It finds problems in two areas:

- The first concern is based on the findings of the OECD PISA programme,[19] that "Ireland's human capital stock is in line with, or slightly above the EU average, but well below the leading international performers."
- The second concern is highlighted by the OECD's Programme for the International Assessment of Adult Competencies (PIAAC),[20] which measures proficiency in a range of information processing skills: literacy, numeracy and problem solving in technology-rich environments in the 16–64 age group. It found that the mean proficiency scores for Ireland are "significantly below the average of the other OECD countries" and that, on most skills indicators, "Ireland ranks among the bottom quintile of the countries surveyed". The ranking is poor for older age cohorts but also, worryingly, for younger Irish people.

The OECD also found that almost 25% of workers in Ireland believe that they are under-qualified for their current roles and do not possess the necessary skills.[21]

The IMF in its "Ireland: Staff Concluding Statement of the 2017 Article IV Consultation" report[22] said: "Steps to complement the strong primary and secondary education system with vocational programs and broader training would help align educational paths with enterprise needs and contribute to lower disparities of skills, income, and employment across regions." It continued: "trade, tax or competition policies aimed at fostering performance in some industries may not be supported by policies ensuring these industries have the skills they need."

The National Competitiveness Council has also highlighted the importance of lifelong learning and upskilling: "Ireland has scope to improve participation levels in apprenticeship programmes and lifelong learning. Demographic change means increased investment in the sector is necessary over the medium term."[23]

Ireland has been named as one of nine European frontrunner countries in a new global report, *Digitizing Europe*.[24] The opportunities from digitisation are huge, and the report highlights the critical importance of being able to: "match the skills of our workforce to the skills required by the jobs that will emerge from new technologies. If this is not done properly, or if it is overlooked, a country's workforce may be left behind and become unable to provide the labour and competence that a digitized economy demands."

18 PublicPolicy.ie, "Low Skills of the Irish Workforce" (17 February 2014).
19 This focuses on the performance of the schooling system in different countries as measured by both the test scores of 15-year-olds and the enrolment rates in tertiary education. See http://www.oecd.org/pisa/.
20 See http://www.oecd.org/skills/piaac/.
21 OECD, *Getting Skills Right: Assessing and Anticipating Changing Skill Needs* (June 2016).
22 IMF, "Ireland: Staff Concluding Statement of the 2017 Article IV Consultation" (May 2017).
23 National Competitiveness Council, *Benchmarking Competitiveness: Ireland and the United Kingdom, 2017*, p. 9.
24 Boston Consulting Group, "Digitizing Europe: Why Northern European Frontrunners Must Drive Digitization of the EU Economy" (May 2017).

The tax environment for human capital and talent

Finding and keeping skilled human capital and talent are fundamental to growing Irish businesses to scale in the face of some major risks and uncertainties ahead.

So we must ask ourselves whether we have a personal tax system in Ireland that reflects the urgency of this issue in light of the global skills shortage and a shortage in Ireland.

As a country, we are now leaning very heavily on personal taxes paid by a relatively small group of people to fund our services. At the same time, we know that personal taxes are the second most damaging taxes for economic growth (after corporation tax).[25]

- Personal taxes account for 40% of Ireland's total tax yield[26] – up from 32% in 2008 (this is the point before the punitive taxes were introduced).
- The next highest-yielding tax is VAT, at 26%.[27]

Ireland's personal tax model: the challenges

1. Personal tax rates

Personal tax policy is important for both Irish entrepreneurs personally and for the staff whom they are struggling to employ and retain. Below we consider the tax issues for entrepreneurs themselves and those relating to their business employees.

(a) Personal tax for employees

A 52% marginal tax rate

- USC reductions in recent Budgets have been capped at €70,044, and the resulting marginal tax rate for key employees earning over €70,044 is 52%. Between €33,801 and €70,044 the marginal rate for employees is 49%.

The low entry point to the 40% income tax rate

- Workers on the average wage of approximately €35,000 are paying tax at the top, 40%, income tax rate because the entry point to the 40% rate is €33,801. Their total marginal rate is 49% including USC and PRSI. By comparison, the entry point to the 45% rate in the UK is Stg£150,000.
- The combination of this low entry point to the 40% income tax rate and the 49% marginal rate (52% above €70,044) creates very high effective tax rates for employees. Their effective tax rate is the amount of tax that they actually pay as a proportion of their total income.
- Employees have an effective tax rate of 18.9% at a salary level of €35,800, rising to 29.4% on a salary of €55,000 and to 39.5% on a salary of €100,000.
- As salaries increase, the highly progressive nature of our personal tax regime means that associated tax bills increase rapidly.

25 OECD, *Tax Policy Reform and Economic Growth* (Paris: OECD Publishing, 2010); http://dx.doi.org/10.1787/9789264091085-en.
26 Department of Finance, Fiscal Monitor (May 2017), p. 21. http://www.finance.gov.ie/sites/default/files/fiscal%20monitor%20May%202017.pdf
27 Department of Finance, Fiscal Monitor (May 2017), p. 21. http://www.finance.gov.ie/sites/default/files/fiscal%20monitor%20May%202017.pdf

The Multiples – How Progressivity Works				
Salary of €18,000 versus	**€25,000**	**€35,000**	**€75,000**	**€100,000**
Earning X times the salary of an individual on €18,000	1.4	1.9	4.2	5.6
Paying X times the tax of an individual on €18,000	5.6	12.5	51.2	76.7
Paying X more tax than an individual on €18,000	€2,768	€5,958	€25,619	€38,619

- These high rates and their highly progressive nature are damaging for productivity and remove the incentive for staff to earn bonuses and achieve promotion and higher salaries.
- Ireland's highest rate of income tax starts to apply at just below the average industrial wage; by comparison, the UK top marginal rate applies at 4.2 times the average industrial wage.[28]
- The global war for talent means that there is clear recognition that we are going to have to rely on foreign talent to help fill the thousands of vacancies in Ireland.

Recommendations on personal tax rates for employed talent

- Ireland's urgent skills gaps warrants a comprehensive review of our high effective tax rates that apply above the average wage. A phased plan is needed to reform the overall shape of our personal tax system. This includes a review of our high marginal tax rates, the breadth of our tax base and the entry points to income tax, USC and PRSI.

(b) Personal tax for entrepreneurs

Their marginal tax rate is 55%

- Entrepreneurs are generally either self-employed individuals or proprietary directors in their companies.
- Their marginal personal tax rate is 55% for earnings over €100,000.
- This is an increase of 8.5% from 46.5% in 2008.

Ireland's job creators pay a 3% levy above everyone else

- The marginal tax rate on Ireland's entrepreneurs and job creators is 3 percentage points higher than the equivalent rate on employees. This is because their top USC rate is 11% on income over €100,000 rather than the 8% paid by PAYE employees.

Their effective tax rates are also very high

- Because of the low entry point to the 40% income tax band (outlined above), coupled with the 55% marginal tax rate, Ireland's entrepreneurs pay very high effective tax rates.

They receive lower tax credits than PAYE employees

- The Government went some way further towards achieving more equal treatment for the self-employed in Budgets 2016 and 2017. However, some discrimination remains.
- Employees are entitled to a PAYE tax credit of €1,650.
- Entrepreneurs are entitled to an earned income tax credit of €950.

28 National Competitiveness Council, "Cost of Doing Business in Ireland" (June 2017), p. 5.

Recommendations on the personal income tax policy for entrepreneurs

- Entrepreneurs are the job creators of Ireland and personal tax disparities that require them to pay higher taxes than PAYE taxpayers should be removed. These include the additional 3% USC rate that they pay on income above €100,000 and the €700 lower tax credit that they receive.

2. High tax bills on share options

SMEs cannot compete with larger companies for highly skilled people in knowledge-intensive services and highly skilled modern manufacturing, sectors critical to an export growth plan.

We know from Irish Tax Institute research that skills are the priority issue from the strength of feeling among Irish businesses.

Share-based remuneration can play an important role in attracting and rewarding key employees at all stages of a business's development. Incentivising staff with equity can significantly reduce fixed labour costs and free up business cash-flow.

Research has shown that employee share ownership can be a key contributor to profitability, productivity and employment creation, with the resulting positive impact on economic growth and Exchequer yield.[29]

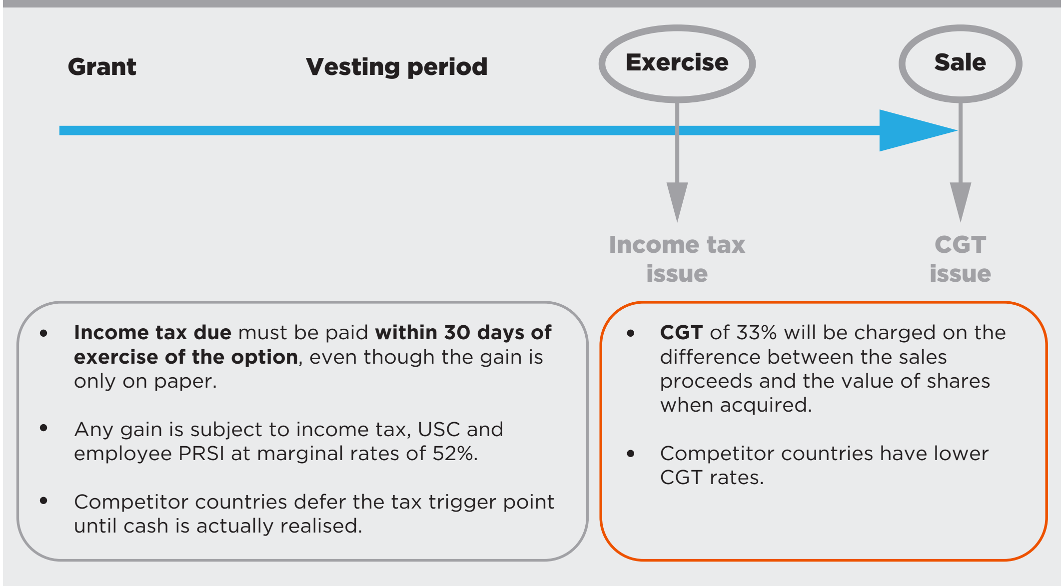
There are currently three types of Revenue-approved share schemes in Ireland, but they are very limited in practice:

- Approved Profit Sharing Schemes (APSS).
- Employee Share Option Trusts (ESOT).
- Savings Related Share Option (SAYE) schemes.

Although these provide some tax benefits to employees, their use is very limited in practice. Most SMEs and start-up businesses that want to reward employees using shares need the flexibility to make these awards to key staff on a selective basis. They cannot afford to award equity to all employees on similar terms, and that is what is required with the Revenue-approved share schemes above.

As a result, most companies have to use unapproved share schemes to reward employees, and these schemes result in high tax costs for those employees and a very unusual "income tax bill upfront", even though the employees own the shares only on paper.

Life cycle of a share option



29 "Sharing Success: The Nuttall Review of Employee Ownership" (July 2012).

Employees are liable to income tax, USC and employee PRSI at their full marginal rate (up to 52%), immediately on the receipt of a share award or on the exercise of a share option.

The employee is also liable to CGT at 33% on any subsequent disposal of the shares.

The combination of this double charge to tax (both at high tax rates) makes equity less attractive to employees by significantly reducing the value of their share awards.

Start-ups and SMEs therefore face five major challenges in promoting share ownership:

- There may be no market for their shares.
- Calculating the tax due can be difficult due to problems in valuing the shares in the absence of a ready market.
- Employees must pay tax on the receipt of shares or on the exercise of share options. They may have to fund this tax on a "paper gain" from their own resources or from borrowings.
- A repurchase of shares (buy-back) by the employer can give rise to an income tax liability for the employee on disposal of the shares (rather than CGT), due to the legislative rules on share buy-backs.
- Income tax due on the exercise of a share option must be paid within 30 days through the self-assessment system, rather than payroll. Complying with this tight reporting and payment deadline can be difficult, especially for individuals who are used to paying their income tax liability through the PAYE system.

Targeted share-based remuneration schemes for SMEs and start-ups

Countries such as the UK have identified that SMEs and start-ups are at a disadvantage in offering share-based remuneration and need greater supports. The UK has designed a share scheme specifically targeted at helping SMEs and start-ups to attract key staff.

Spotlight on the UK's Enterprise Management Incentive (EMI)

The UK's EMI is designed to help small companies and start-ups to attract and retain key employees. It is commonly used in the technology sector. It affords companies a high level of flexibility in choosing how the terms of the options will operate.

Share options with a market value of up to Stg£250,000 can be granted tax-free to employees of independent trading companies that have fewer than 250 employees and gross assets not exceeding Stg£30m. Certain requirements on working time must be met, and the employee cannot control 30% or more of the shares in the company.

There is no charge to income tax and National Insurance Contributions on the exercise of an EMI option, provided it is granted at market value. CGT is payable once the shares are ultimately sold. However, the UK's entrepreneurs' relief, which allows for a CGT rate of 10%, is available on the sale of EMI shares (subject to the lifetime limit on gains of Stg£10m).

Recommendations on employee share schemes

- A workable share-based employee scheme is also required for SMEs that would enable them to attract and retain the best talent. The UK's EMI is a good model to consider – capital gains tax is payable by taxpayers when they sell their shares and have the funds to pay the tax. A simple administrative process for collecting the information and paying the tax due is an important element of any new scheme.

3. Special Assignee Relief Programme

The Special Assignee Relief Programme (SARP) provides income tax relief to a particular group of employees who are assigned to work in Ireland from another group company abroad. Some important features of this relief are:

- It is an assignment relief, so that it applies only to individuals already working for an international group abroad for six months who are then assigned to Ireland – it does not apply to new hires.
- SARP relief is available only for employees earning more than €75,000, and it works to reduce the excess salary by 30%.
- SARP relief does not apply to USC or PRSI.

There were 586 SARP claims made in 2015, with a cost to the Exchequer of €9.5m.[30]

There are some other detailed criteria that apply. However, the combination of the "international assignment" feature and the high salary entry level effectively precludes Irish SMEs from using the relief. The SMEs who are export focused and producing products and services in knowledge-intensive areas need to be able to access international talent.

Given the high marginal tax rates payable by talented individuals whom these SMEs are trying to attract, combined with the lack of any workable share option scheme, this restriction on the SARP means it cannot be used by scaling businesses to find key talent.

Recommendation

- Consideration should be given to developing a new talent regime similar to SARP but targeted at SMEs, so that they can attract the talent and skills they need from outside Ireland to grow their businesses.

4. Tax compliance complexities in a modern working world

a. Tax rules on travel and subsistence expenses

b. Tax compliance for employees travelling abroad on short-term visits

The vast majority of taxpayers worry about their tax affairs and want to get things right. They do not want to stumble into non-compliance, resulting in a Revenue audit with possible interest and penalties. This truth is borne out by the overall tax compliance rates in Ireland, which regularly reach levels in the high 90s.[31]

Simplicity and certainty are very important in helping businesses to be tax compliant.

At a recent European Commission/IIEA event,[32] Michel Servoz, Director General of DG Employment, Social Affairs and Inclusion at the European Commission, highlighted the changing nature of the world of work. Right across the EU, countries are experiencing huge increases in the levels of self-employment or combined traditional employment/self-employment among their citizens. He remarked that this is due to:

- Digitalisation;
- The way economies are being organised; and
- The desire for flexibility by workers.

30 SARP Analysis 2015, p. 5. http://www.finance.gov.ie/sites/default/files/SARP%20Analysis%202015.pdf
31 Revenue, Annual Report 2016 (April 2017).
32 Joint European Commission/Institute of International and European Affairs event, Inclusive Growth – Recommendations for Ireland and Europe, 2 June 2017.

However, new and complex working patterns create challenges for countries and for tax administrations. Tax rules and tax practices can struggle to keep up with the complexities of the modern working world and the evolving working patterns of employees.

Businesses across Ireland currently face two particular areas of difficulty:

- Understanding how to apply the tax rules for employee travel and subsistence expenses; and
- Dealing with the tax compliance obligations when sending employees abroad for short periods of time.

a. Tax rules on travel and subsistence expenses

At one time, all workers would have been employed in businesses based in one office from 9am to 5pm each day. There would have been limited travel requirements to fulfil in their roles.

However, work patterns have transformed in the past ten years in Ireland, as they have globally. Individuals are expected to travel and be generally more mobile in their roles both across Ireland and in foreign markets, seeking new business opportunities. Also, the rise in technology capabilities has led to more individuals working from home-based offices. Businesses with employees who do not operate out of one fixed base can struggle to understand how to apply the tax rules on travel and subsistence expenses. Currently, small businesses that have to operate from a home-based office but travel to clients' premises experience similar difficulties.

Freelance work has also grown exponentially in the past ten years. These individuals are engaged by businesses on short-term contracts, and it can be very difficult for them to understand how to account correctly for their travel expenses.

Tax legislation governing these expenses was written almost 100 years ago, and the case law that applies is of a similar vintage. It is very difficult to apply these rules to modern fact patterns.

The current legislation does not deal adequately with the challenges of modern working patterns, and this is reflected in the wide array of Revenue guidance, some of which is conflicting.

Revenue has issued seven separate pieces of guidance on travel expenses over the last number of years, and the area is shrouded in complexity.

i. Employees' Motor/Bicycle Expenses[33]
ii. Employees' Subsistence Expenses[34]
iii. Tax treatment of the reimbursement of Expenses of Travel and Subsistence to Office Holders and Employees[35]
iv. Exemption in respect of certain expense payments for resident relevant directors[36]
v. Exemption in respect of certain expense payments for relevant directors[37]
vi. Reimbursement of travel and subsistence by intermediaries [38]
vii. Revenue's Contractors' Project [39]

33 Revenue Leaflet IT 51.
34 Revenue Leaflet IT 54.
35 Revenue Statement of Practice SP IT/02/2007.
36 Revenue eBrief 43/2017.
37 Revenue eBrief 8/2016.
38 Revenue eBrief 30/2013.
39 Revenue eBrief 48/2013.

Although the new Revenue website[40] has attempted to consolidate these separate pieces of guidance into one manual,[41] the tax treatment of travel expenses paid to contractors has not been dealt with in the updated manual.

The Government carried out a consultation on this difficult issue in July 2015, to which the Institute made a comprehensive submission, along with others.

Legislative changes have been introduced both for "foreign" and (in a more restrictive way) for Irish non-executive directors (NEDs) on foot of this consultation. However, the law needs to be updated to address the tax regime for travel and subsistence expenses on a broader basis than NEDs alone.

At the time of writing, we are still awaiting the publication of a Feedback Statement on this consultation.

Recommendations on travel expenses

- Uncertainty about the tax treatment of travel expenses is creating concern and cost for many home workers, freelancers, employers with staff sent abroad to build the business and those dealing with the new working patterns of the modern world. Legislation in this area urgently needs to be brought up to date to deal with this issue.

b. Tax compliance for employees travelling abroad on short-term visits

As outlined in Chapter 6 on exports, the need for Ireland to grow its export market is one of urgency, and sales and business development teams are crucial to the overall mission at a national level. This is why the particular tax issue below is of such importance.

When an Irish company sends an employee overseas to work for a short period, it can trigger an obligation to deduct payroll taxes in the foreign country, even though the employee continues to be subject to Irish PAYE on his/her salary.

Revenue introduced a "real-time" credit regime in 2015, which allows employees to claim a credit for an estimated amount of foreign tax against their Irish PAYE liabilities for each pay period. Although this "real-time" approach is welcome, the mechanism for calculating the relief is unnecessarily complex.

Employees must provide information on their total income for the year to their local tax district before Revenue can calculate their effective tax rate and corresponding estimated credit. The employee's Tax Credit Certificate is then amended to reflect the estimated foreign tax credit. This can potentially create time delays and cash-flow implications for employees who suffer double taxation.

The UK has a more streamlined approach to real-time relief for outbound employees. Under its "Appendix 5" procedures, the UK PAYE liability is reduced each pay period by the amount of foreign tax paid. The employer notifies HMRC upfront that it wishes to avail of this procedure, provides HMRC with details of the relevant employees and updates HMRC on any changes during the year. A year-end review is carried out by HMRC to adjust for any tax under-/overpayments.

A more streamlined approach, similar to that in the UK, would be welcome in Ireland.

Recommendations on employees travelling abroad on short-term visits

- Irish companies sending employees abroad for short-term visits often experience burdensome administrative difficulties when dealing with tax, payroll and double taxation issues. A new streamlined approach to these tax compliance issues is needed, complemented by further specialised Revenue support.

40 Launched on 7 June 2017.

41 Part 05-01-06, http://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-05/05-01-06.pdf.

Chapter 10

Accessing Finance

Tax recommendations for accessing finance

1. Ireland's 33% CGT rate is the fourth highest rate in the OECD and it is having a negative impact on investment in Irish business. This is a matter of real concern because investment in innovation, talent and equipment is essential if Irish businesses are to increase their level of exports abroad. By contrast, Germany outstrips the rest of the EU with its excellent record of business investment and its export prowess – it has a CGT rate of 25%. As well as hampering investment, the high rate is also dampening business activity in the Irish market and creating reluctant business owners who may hold onto businesses beyond the point where they have the capacity to grow them to the scale required in a new global exporting environment. The CGT rate needs to be reduced to a level that is closer to the median CGT rate amongst OECD countries, currently 23%.
2. Revised entrepreneur relief is tightly restricted to owner-managers and locks out much needed external investors from the possibility of a lower CGT rate. This disparity should be removed. The €1m lifetime threshold for entrepreneur relief also needs to be increased to a minimum of €10m to compete effectively with other countries for international capital.
3. The Irish market contains a limited number of individuals who have funds to invest in business through the Employment and Investment Incentive (EII). At a time when these businesses need a diverse range of finance, the annual cap of €150,000 for these investors is further limiting the funding available for companies through the scheme. The equivalent UK EIS scheme has an annual Stg£1m investment limit and the limit for the Irish scheme should be increased to an equivalent amount.
4. As well as being capped, the EII income tax relief for investors is also split into two tranches - 30% in the year of investment and an additional 10% after three years. This concept of a split relief has been a feature of the EII since it replaced BES in 2011. However, it significantly reduces the attractiveness of EII and should be removed.
5. The EII rules require the investor to hold less than 30% of the company's shares, effectively denying relief to the founder shareholder who may want to inject more funding into the business. This restriction does not apply in the UK and should be removed from our regime.
6. The Start-Up Refunds for Entrepreneurs (SURE) scheme should be extended to include new business founders who were previously self-employed and starting up another business (as well as those coming from employment).
7. Dividend income in Ireland is taxed at high marginal personal tax rates of up to 55%, which does not encourage equity investment in Irish business. Most countries internationally tax dividends at a lower or flat rate. We recommend a lower flat rate of taxation on dividend income.

One of the four pillars needed to drive growth in Irish indigenous companies is funding – it is the lifeblood of businesses, particularly SMEs. Irish businesses require capital to innovate, to hire and train the best staff, and ultimately to achieve greater export levels.

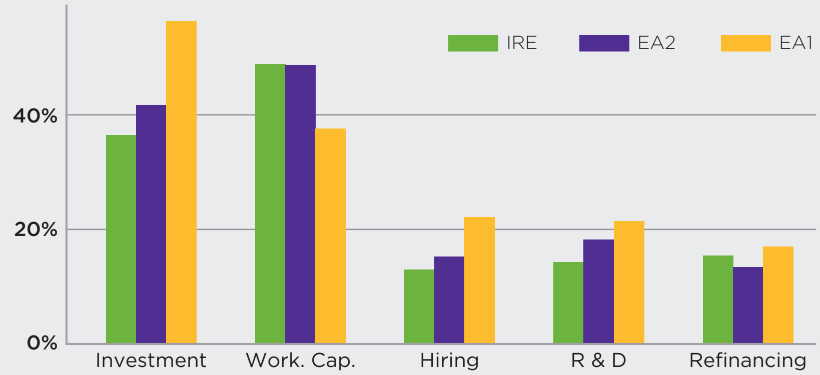
In this chapter we examine the challenges that Irish businesses face when trying to access both bank and alternative sources of finance, challenges that are only going to grow in light of Brexit. We look at countries that took the decision to focus intently on attracting capital for their businesses and at the difference this has made to their economies – the UK, Israel and Sweden. We also highlight German businesses that lead Europe in the extent of the funding that they obtain for future investment. Against this landscape, we examine Ireland's tax policy for business investment, particularly the damaging impact of our high CGT rate and some improvements that could be made to our income tax incentives, which would address the low levels of take-up at present.

This critical link between access to finance and business growth is recognised by international bodies such as the European Commission and the OECD.

The European Commission recognises that having sufficient access to finance is an important factor for the development of a business.[1] The OECD understands that SMEs and entrepreneurs are an important source of economic growth and social unity and that appropriate access to finance is a "critical prerequisite to enable these businesses to invest, grow and create jobs."[2]

However, Irish businesses lag behind their European counterparts when it comes to the use of finance, particularly for investment capital. This is clearly demonstrated in the Central Bank chart below.

Purpose of financing for SMEs, September 2016[3]



Source: Central bank, SME market report 2016 H2

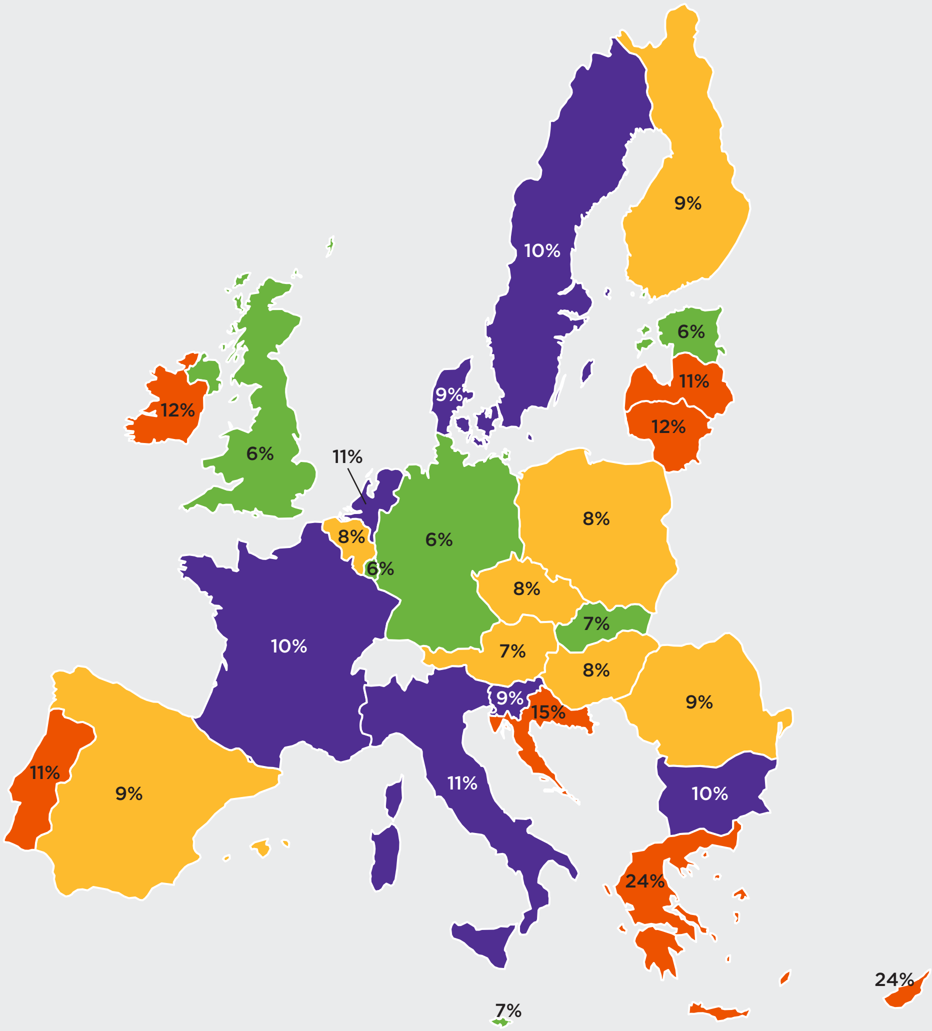
EA2 comprises Portugal, Spain, Italy and Greece. EA1 comprises Austria, Germany, Belgium, Finland, The Netherlands and France.

1 European Commission, Survey on the Access to Finance of Enterprises (SAFE) – Analytical Report 2016, (November 2016), p. 11.
2 OECD, "Financing SMEs and Entrepreneurs 2016 – An OECD Scoreboard" (2016), p. 1; https://www.oecd.org/cfe/smes/SME-Scoreboard-2016-Highlights.pdf.
3 Central Bank of Ireland, "SME Market Report 2016H2" (30 January 2017), p. 14.

These relatively low levels of financing are undoubtedly linked to the fact that Irish businesses are having more difficultly than businesses in other countries when it comes to sourcing and accessing the finance needed.

The 2016 Survey on the Access to Finance of Enterprises (SAFE)[4] was a survey of EU businesses conducted by the European Central Bank and the European Commission between September and October 2016. It asked SMEs what their most significant problems had been in the previous six months. Below is an analysis (by country) of the number of businesses that rated access to finance as their biggest problem – more businesses in Ireland rated this as their number-one problem than in most other EU countries. Irish businesses are in the "red zone" as far as finance is concerned.

Proportion of SMEs by EU country that said access to finance was their most important problem (April–September 2016)



Source: European commission (2016), Survey on the Access to Finance of Enterprises (SAFE), analytical report 2016, page 137.

We also know that access to finance is an issue that arises for Ireland in global rankings such as the Global Innovation Index and the World Economic Forum Global Competitiveness Report.[5]

4 European Commission, Survey on the Access to Finance of Enterprises (SAFE) – Analytical Report 2016, (November 2016).
5 See https://www.globalinnovationindex.org/gii-2016-report# and http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf.

The funding challenges for Irish business

Irish businesses face funding challenges on two fronts:

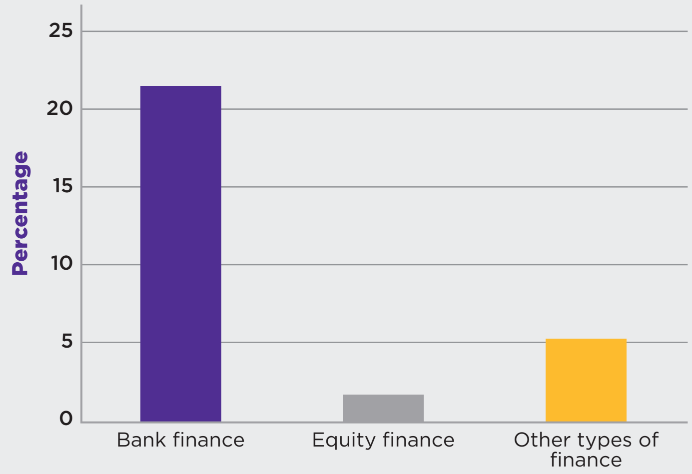
1. They are overly reliant on debt finance from banks, particularly in the form of expensive bank overdrafts and related products; and
2. Their funding is not diversified, i.e. they are not making sufficient use of alternative sources of equity finance.

These challenges are discussed in more detail below.

1. Irish businesses have a high reliance on bank finance

The CSO has examined sources of external financing for the SME sector in Ireland. Of all SMEs that sought funding in 2014, over a fifth looked for bank finance.[6] By European standards, Irish SMEs are considered among the most reliant on banks.[7]

Types of finance applied for by SMEs in 2014



Source: CSO Ireland

Interestingly, of those SMEs that were unsuccessful in a bank financing application, almost 42% did not seek alternative sources of funding,[8] which begs the question of whether their growth and expansion were hindered by not having obtained the finance sought.

This heavy reliance on bank finance has a number of important consequences for Irish businesses. Bank finance can be difficult to obtain, particularly for businesses without a proven track record of trading in the start-up and early growth years. If Irish businesses are successful in obtaining bank finance, they then pay higher interest rates for it than businesses in other EU countries, as evidenced in the 2016 SAFE Analytical Report.[9] Some Irish commentators have suggested that the concentrated market share of the three main lenders (currently at 93%[10]) is contributing to these higher rates. Irish banks also tend to seek personal guarantees from businesses and particularly SMEs. In one study, approximately one-third of successful applications had a personal guarantee attached.[11]

6 CSO, Access to Finance 2014 (March 2016), http://www.cso.ie/en/releasesandpublications/er/atf/accesstofinance2014/.
7 Central Bank of Ireland, "The Importance of Banks in SME Financing: Ireland in a European Context" (2013).
8 CSO, Access to Finance 2014 (March 2016), http://www.cso.ie/en/releasesandpublications/er/atf/accesstofinance2014/.
9 European Commission, Survey on the Access to Finance of Enterprises (SAFE) – Analytical Report 2016.
10 Central Bank, "SME Market Report 2016 H2".
11 J. Carroll, F. McCann and C. O'Toole, "The Use of Personal Guarantees in Irish SME Lending", Central Bank of Ireland Economic Letter Series, Vol. 2015, No. 6.

2. There is less diversification into alternative sources of financing

Ireland is making great progress in scaling its start-up communities across the country. The life sciences sector has been very successful in developing clusters of business and expertise – with Galway and the west of Ireland being a good example. In technology, important work is also being done to develop clusters across Dublin, Cork and nationwide.

However, these start-up businesses are struggling to obtain bank finance, which is in relatively short supply and, when available, is expensive by EU standards. It is therefore critical that other forms of finance are available to them, and it seems that more Government support may be needed here too. In a 2015 survey 79% of Irish entrepreneurs noted that it was extremely difficult to get access to early-stage funding.[12]

When funds flow at scale from a range of sources into an entrepreneurial ecosystem, the results can be transformative for the economy involved.

Spotlight on Stockholm – the "poster child" of European innovation[13]

- According to Silicon Republic,[14] Stockholm is "on fire" when it comes to start-ups, with $1.4bn of venture capital raised by 247 companies in 2016 alone – more than half of the total investments in the Nordic region last year. Although Sweden has an industrial base that goes back to the 19th century, and major industrial and engineering giants from Ericsson to ABB and Scania, it was only in the last seven years that the digital start-up culture gained its current frenetic pace.
- The success of entrepreneurs such as Niklas Zennström – co-founder of Skype and Kazaa and head of venture capital firm Atomico – played a pivotal role in inspiring this new generation of entrepreneurs.
- Stockholm has a population of less than 1m people. "Stockholm is 4pc of the Nordic population. There has been an investment for every working day in Stockholm in 2016."
- "The Nordics are 3pc of the European population but attract between 11pc and 13pc of venture investment. Some 50% of billion-dollar exits came from the Nordics and over half of these came from Sweden."
- 18pc of the working population of Sweden works in tech, ahead of the European average of 10%.
- Of the 2016 investments, some 33 were in fintech, 12 in the "internet of things" (IoT), 16 in gaming, 29 in enterprise/cloud, 28 in e-commerce, 20 in health and wellness, 23 in entertainment and media, and 14 in social and communications.
- Entrepreneurship has always been highly respected in Swedish society but more associated with family-run companies. Now there is a start-up boom.
- Stockholm has the second-highest number of "unicorns" per capita outside of Silicon Valley. "In the US, the hero is usually a doctor or a lawyer. In Sweden, it is the engineer."

We are not unique in Ireland in needing diversified sources of alternative finance for SMEs, but the challenging banking position here makes the issue more urgent. The OECD has expressed concern about funding shortages globally and about the over-reliance by SMEs on bank credit, especially in the case of "start-ups and young companies, small

12 Startup Ireland and Amárach Research, 2015 National Startup Survey (November 2015).
13 See http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/11689464/How-Sweden-became-the-startup-capital-of-Europe.html.
14 See https://www.siliconrepublic.com/start-ups/stockholm-startup-city.

businesses with a high-risk profile and companies in periods of transition, such as a change of ownership, spurts of growth or expansion into foreign markets".[15] It has suggested that "a large financing gap persists"[16] and that governments should continue to monitor closely SME access to finance and take steps to allow them to access to a broader range of financing instruments.

Our own National Competitiveness Council (NCC) has also highlighted that the Irish lending market is less diversified than that in other countries and that increasing the levels of private equity, crowdfunding and venture capital funding remains a challenge.[17]

So, what are these alternative sources of financing? Here is a full explanation.

Founder

An individual setting up a company will typically use a significant portion of personal savings, often accumulated from previous employments. For early-stage entrepreneurs, the personal funds available will often be limited.

Family and friends

Close family and friends are also a good source of finance for budding companies, with their investment not purely financially motivated. Again, the pool of funds from family and friends can be limited.

Angel investors

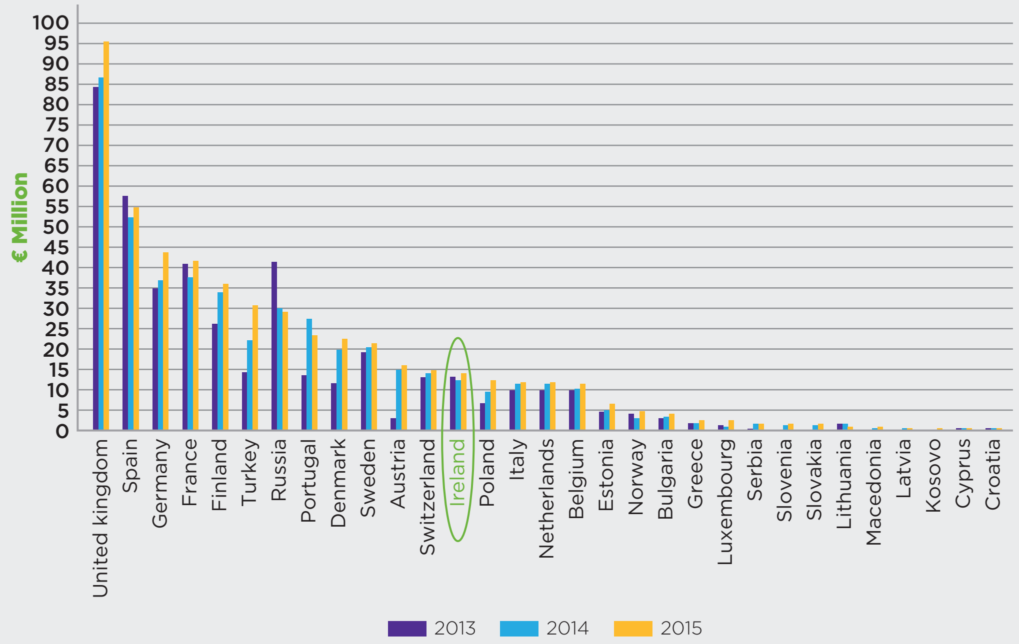
Business angels are often successful entrepreneurs or executives with access to wealth to invest in SMEs. They will typically invest in early-stage companies operating in industries in which they themselves have expertise, providing equity investment and industry know-how to help the companies flourish.

The average initial investment by business angels in Ireland is between €50,000 and €250,000 individually,[18] although some business angel syndicates, such as those being created by Halo Business Angel Network (HBAN), can give rise to larger investments. HBAN is an all-island umbrella group for business angels investing across Ireland, and it brings angels together into syndicates.

Investment from business angels is becoming more prevalent in Ireland, and they invested €13.6m in 50 Irish start-ups in 2016.[19] However, the rate of business angel investment in Ireland is low compared with other countries competing for start-up capital such as the UK, Spain, France, Germany and Sweden.[20] We are also behind economies of a similar size such as Denmark and Finland. The UK has made a determined decision to attract angel investment, as demonstrated by its tax lead strategy (see later in this chapter). The result is that the UK is attracting by far the highest levels of angel investment in Europe.

15 OECD, "Financing SMEs and Entrepreneurs 2016 – An OECD Scoreboard".
16 OECD, "Financing SMEs and Entrepreneurs 2016 – An OECD Scoreboard".
17 National Competitiveness Council, *Benchmarking Competitiveness: Ireland and the United Kingdom, 2017*, p. 58; http://www.competitiveness.ie/News-Events/2017/NCC-Benchmarking-Competitiveness-for-Publication.pdf.
18 See https://www.enterprise-ireland.com/en/Invest-in-Emerging-Companies/Source-of-Private-Capital/Business-Angels-BES,-Angel-Networks-.html.
19 Halo Business Angel Network, "HBAN Angels Invested €13.6m in 50 Irish Start-ups in 2016", http://www.hban.org/News/HBAN-angels-invested-%25E2%2582%25AC136m-in-50-Irish-start-ups-in-2016.1004.html#sthash.CxISURwt.dpuf.
20 EBAN, "European Early Stage Market Statistics 2015" (May 2016), p. 6; http://www.eban.org/wp-content/uploads/2016/06/Early-Stage-Market-Statistics-2015.pdf.

Amount of angel investment by country, 2013-2015



Source: EBAN, "European Early Stage Market Statistics 2015" (May 2016)

Crowdfunding

Crowdfunding is a growing phenomenon in which companies seek to raise finance from a large number of people via an online platform. Crowdfunding is often used for community and not-for-profit activities, but it is also becoming an increasingly common source of finance for many SMEs. In the UK, for example, companies raised Stg£332m in equity-based crowdfunding in 2015.[21]

Both the OECD and the European Commission have endorsed crowdfunding as an alternative source of finance. The OECD believes that equity crowdfunding can complement or substitute seed financing for entrepreneurial ventures and start-ups, which can experience difficulties in raising capital from more traditional sources.[22]

Indeed, the European Commission has invited EU Member States to amend domestic legislation to facilitate alternative forms of financing for start-ups and SMEs, in particular platforms for crowdfunding.[23]

There are a number of crowdfunding platforms in Ireland, but it is currently an unregulated industry, thus limiting its uptake. However, a public consultation to consider the future of crowdfunding in Ireland was published on 21 April 2017 by the Department of Finance.[24]

Seed funds

Seed funds generally form the first round of capital for a start-up business. Seed money provides start-up companies with the capital required for their initial development and growth. Business angels and early-stage venture capital funds often provide seed money.[25]

21 B. Zhang, P. Baeck, T. Ziegler, J. Bone and K. Garvey, "Pushing Boundaries: The 2015 UK Alternative Finance Industry Report" (February 2016), p. 11; https://www.sbs.ox.ac.uk/sites/default/files/Entrepreneurship_Centre/Docs/OxEPR2/pushing-boundaries-2015-alt-finance-report.pdf.

22 OECD, "New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments" (2015).

23 European Commission, Entrepreneurship Action Plan 2020 (2013).

24 Department of Finance, Regulation of Crowdfunding: Public Consultation Paper (April 2017), http://www.finance.gov.ie/sites/default/files/200417%20Final%20Crowdfunding%20Consultation%20Paper.pdf.

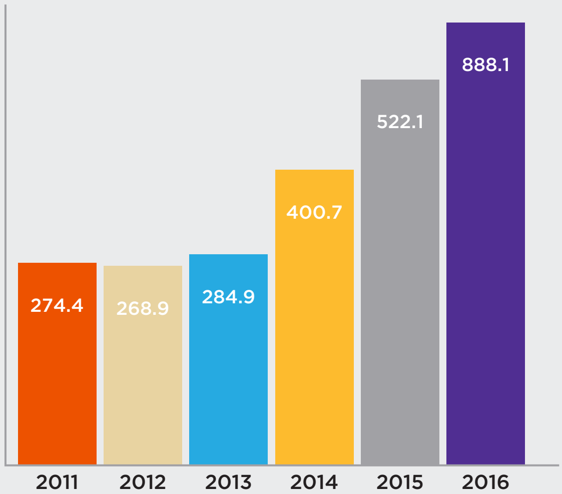
25 Irish Venture Capital Association, IVCA Venture Pulse 2016, http://www.ivca.ie/wp content/uploads/2017/02/IVCA-Venture-Pulse-2016-060217-2.pdf.

Venture capital

Certain companies, particularly those in fast-growth, high-potential industries, can raise private finance from venture capital firms. Venture capitalists invest equity capital in these businesses while also adding management and industry expertise. Venture capitalists typically look for a return on their investment within five years, through either a sale of the company or a public listing.

Venture capital funding has become increasingly popular for innovative, growth-driven Irish companies. In 2016 Irish SMEs raised over €888m in venture capital funding, up from €274m in 2011.[26] Although this is a significant increase, it is from a relatively low base, and we remain well behind more successful countries such as Israel (see later in this chapter).

Venture capital funding in Ireland, 2011–2016 (€m)

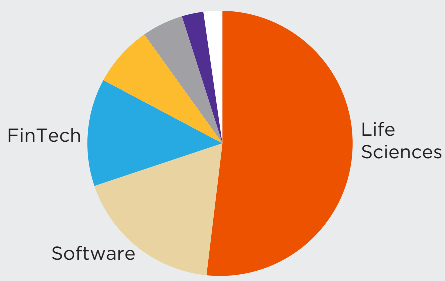


Source: Irish Venture Capital Association, IVCA Venture Pulse 2016

Over 50% of this funding has been concentrated in the life sciences sector, with software and fintech companies also attracting significant investment.

Funds raised by sector, 2016 (€m)

Life Sciences	465.1
Software	157.8
FinTech	117.6
Telecomms/Communications	54.9
EnviroTech	43.4
Electronic Components	27.9
Other	21.4
Total	**888.1**



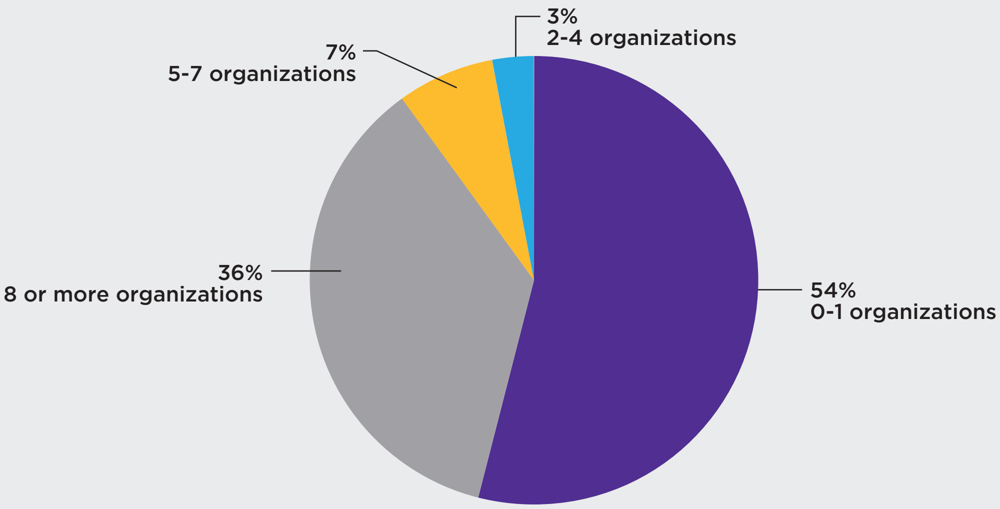
Source: Irish Venture Capital Association, IVCA Venture Pulse 2016

26 Irish Venture Capital Association, IVCA Venture Pulse 2016, http://www.ivca.ie/wp-content/uploads/2017/02/IVCA-Venture-Pulse-2016-060217-2.pdf.

If we take a look at the global arena, EY Entrepreneur of the Year winners such as the founders of Google, Dell and LinkedIn created new categories of businesses. Venture capitalists bought into their visions to help to make them a reality. Venture capital was also responsible for creating superstars such as the founders of Starbucks and Whole Foods, who transformed traditional industries.[27]

Many of the EY entrepreneurs who have been successful in one business go on to reinvest in a new business. They are serial entrepreneurs and can become angel investors to other start-ups. EY entrepreneurs are giving back and bringing their expertise to new ventures.

Number of organisations founded by EY Entrepreneur of the Year Winners



Source: "The Entrepreneur's Purpose", Harvard Business Review (2016)

Israel has identified venture capital as an important source of funding for SMEs and has introduced a regime for them that has had very positive results. Israel was ranked the second most innovative nation in the world for 2016.[28]

In the early 1990s the Israeli Government implemented the Yozma programme, which offered tax incentives to foreign investors and pledged to use Government funds to double any outside investment in an Israeli company. Since inception the Yozma Group has managed more than US$220m in its three funds, Yozma I, Yozma II and Yozma III, which have made direct investments in about 50 portfolio companies. The Group helped a significant number of its portfolio companies to go public on major stock exchanges in the US and Europe.[29]

Venture capital investments made in Israel in 2014 were 14 times greater than those in Ireland for the same period.[30]

The UK has also employed a very successful strategy to encourage venture capital investments. In 2015 venture capital funds of US$951.93m invested in the UK represented the highest investments made in Europe for 2015.[31]

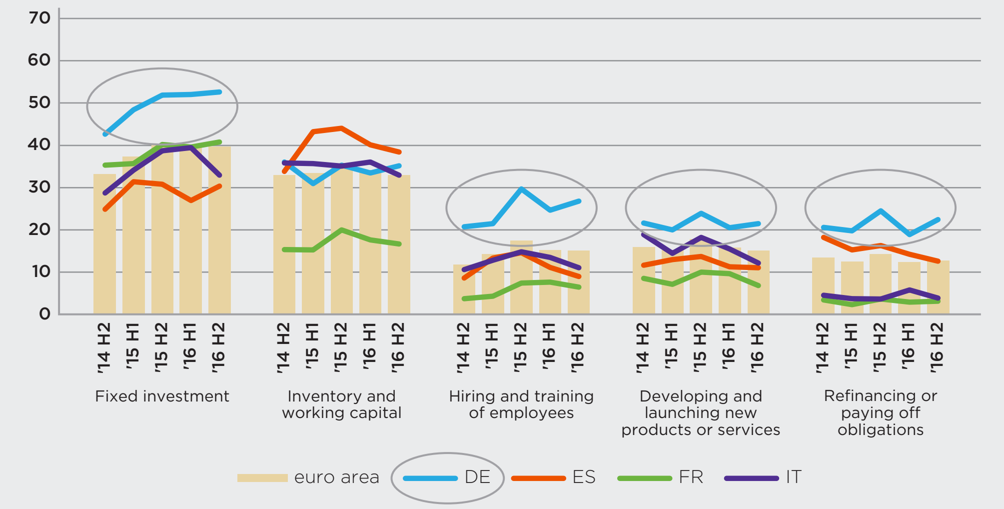
27 Harvard Business Review, "The Entrepreneur's Purpose — How EY Entrepreneur of The Year® Award Winners Outperform and Outlast the Competition", http://cdn.ey.com/parthenon/pdf/perspectives/ey-the-entrepreneurs-purpose.pdf.
28 World Economic Forum, Global Competitiveness Report 2016–2017.
29 Yozma Group, http://www.yozma.com/overview/.
30 OECD, *Entrepreneurship at a Glance 2016* (Paris: OECD Publishing, 2016), p. 137.
31 OECD, *Entrepreneurship at a Glance 2016*, p. 137.

German companies use financing wisely

The European Central Bank's Survey on the Access to Finance of Enterprises in the Euro Area[32] provides an interesting analysis of the purposes for which German SMEs borrow money (see the figure below). They stand out among Eurozone countries for their pattern of borrowing to invest in fixed capital infrastructure, staff training and investment and innovation.

Purpose of financing for SMEs in Germany (DE), Spain (ES), France (FR), Italy (IT) and the Euro area, 2014–2016

(over the preceding six months; percentage of respondents)



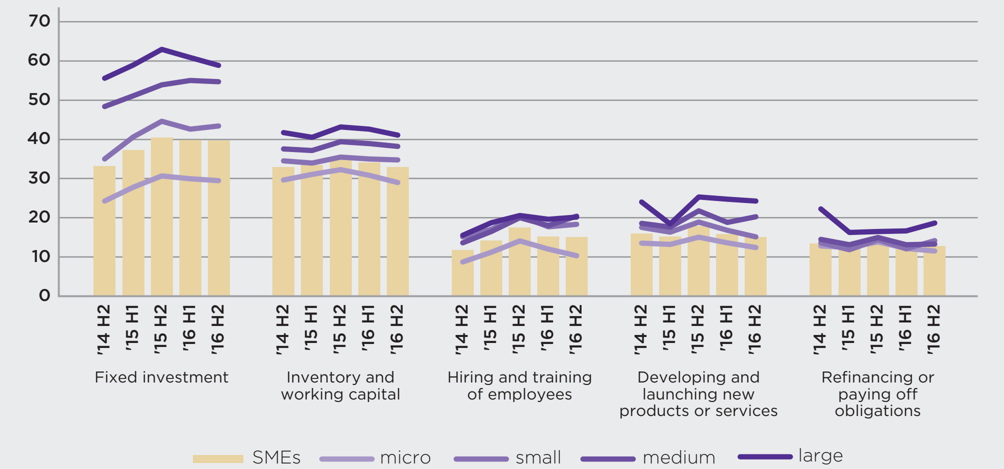
Q6A. For what purpose was financing used by your enterprise during the past six months?

Base: All SMEs. Figures refer to rounds eleven (April-September 2014) to sixteen (October 2016-March 2017) of the survey.
Note: See the note to Chart 12.

German SMEs are borrowing for future growth and, in this way, they are behaving much like the largest of companies in the Eurozone.[33]

Purpose of financing for SMEs in the Euro area by enterprise size, 2014–2016

(over the preceding six months; percentage of respondents)



Q6A. For what purpose was financing used by your enterprise during the past six months?

Base: All enterprises. Figures refer to rounds eleven (April-September 2014) to sixteen (October 2016-March 2017) of the survey.
Note: The figures are based on the new question introduced in round eleven (April-September 2014).

32 European Central Bank, Survey on the Access to Finance of Enterprises in the Euro Area – October 2016 to March 2017, p. 17.
33 European Central Bank, Survey on the Access to Finance of Enterprises in the Euro Area – October 2016 to March 2017, p. 16.

This stand-out approach to funding and investment by German companies translates into truly impressive results when it comes to world-leading exports and innovation.

Enterprise Ireland's summary of the German market

Germany

- The German market is one of Ireland's most resilient export markets. German companies employ 12,000 people in Ireland. However, 60 Irish indigenous companies employ more than 14,000 people in their operations in Germany. The largest of these are CRH, Smurfit Kappa and Glen Dimplex.
- There were over 440 Irish companies actively exporting to Germany in 2015 and over 130 clients have a market presence (direct hire or channel).
- Germany is the leading industrial nation in automotive, life sciences, agritech, software and engineering services:
  - 1st in Europe and 5th in the world for dairy production
  - 1st in Europe in the semiconductor industry
  - 1st in EU for construction investment (€280 Billion and 20% of investments in the EU)
  - Largest financial services sector in the Eurozone
  - 2nd largest European online retail market
  - 3rd largest med-tech market in the world
  - 3rd largest spender world-wide on Travel
  - A leader in renewables. 34% of Energy consumption is renewable with a target of 80% by 2050.

Source: Enterprise Ireland[34]

Positive steps that the Irish Government has taken so far on funding

The Irish Government has taken welcome steps in recent years to help SMEs to raise finance, through the tax system and other initiatives. Given the difficulties of obtaining bank finance in the current environment, the importance of equity finance for SMEs has increased.

The issue of "access to appropriate forms of finance" was noted as remaining a key concern for many Irish entrepreneurs and microenterprises in the Department of Jobs, Enterprise and Innovation's Action Plan for Jobs, 2017.

The Government has recognised the difficulties that SMEs have in accessing finance, and a number of non-tax measures have been introduced in recent years to improve the supply of credit.

34 Enterprise Ireland, "Export Performance in Global Markets 2016: Enterprise Ireland Client Company Export Results 2016" (May 2017), p. 8

Irish Government initiatives to help SMEs to access finance	
Initiative	**How it works**
Credit Guarantee Scheme	Provides a 75% State guarantee to banks against losses on qualifying loans to certain SMEs.
Microenterprise Loan Fund	Provides loans of up to €25,000 to start-up, newly established or growing microenterprises employing fewer than 10 people that cannot obtain bank financing.
Innovation Ireland Fund	Aims to attract global venture capital firms to invest in innovative small and medium-sized Irish firms.
Irish Strategic Investment Fund	Sovereign fund that is mandated to invest across industry sectors, regions and asset classes in Ireland. It is the main investor in two SME-focused funds.
Seed and Venture Capital Scheme	Aims to provide additional funding for high-growth Irish companies with the potential to generate large amounts of additional export sales and grow jobs.
Strategic Banking Corporation of Ireland (SBCI)	Aims to provide access to flexible funding for Irish SMEs by facilitating the provision of finance by both bank and non-bank specialist on-lenders.

At the end of December 2016[35] the SBCI had lent €544m to 12,593 SMEs, with 84.8% of them based outside Dublin. The average loan size was €43,200. The Credit Guarantee Scheme offers a partial Government guarantee to banks against losses on qualifying loans to eligible SMEs. The Microenterprise Loan Fund, administered by Microfinance Ireland, provides loans of up to €25,000 to start-up, newly established or growing microenterprises employing fewer than 10 people.

But the funding challenges for Irish businesses will be amplified by Brexit

Improving the funding environment now is essential to mitigate the challenges facing Irish business. In a post-Brexit world SMEs, in particular, will have to invest in new markets. These may be far afield, such as China or India, or closer to home, in Europe. Either way, planning for such diversification could take three to five years. Huge structural changes will be required to drive expansion and diversification in these sectors.

Changes to supply chains and logistics may be needed in certain sectors such as the food industry, and these can be complex and expensive. This investment will have to be supported by capital and a strong balance sheet, and funding from a range of possible sources (including angel investors and venture capital funds) will be a vital component.

Further Government support will be needed to help businesses to deal with funding shortages – this is an unassailable truth. The main challenge is to make the correct policy choices about how this support should be provided, and the design of the best tax environment to support entrepreneurial funding is a key element.

35 Minister for Finance, Michael Noonan TD, response to written parliamentary question, 11 May 2017, http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/takes/dail2017051100045#N11.

Ireland's tax environment – a barrier to funding

Governments globally recognise that they need to support the funding of SMEs and start-up businesses and that the social and economic rewards are great if this can be achieved. At its best, government support comes in the form of both direct grant assistance and a supportive tax environment. In Ireland, much of the grant assistance and funding from the Government for Irish businesses is provided through Enterprise Ireland, which supports client companies at different stages in their development. The remainder of this chapter will focus on tax and the changes that need to be made to deliver a better environment in Ireland for entrepreneurs and their businesses.

Providing entrepreneurial funding for a business is risky, particularly when the business is in the start-up and early scale-up stages. The majority of these investments will be loss making, and therefore tax policy can play an important role in mitigating the risk and thereby reducing some of the barriers to investment.

The European Commission in its Entrepreneurship Action Plan encourages Member States to review current tax policy in the area of funding, in particular to "consider the need for simplification of tax legislation to stimulate further development of alternative financial markets such as business angel investments."[36]

The right tax policy helps to increase activity in the market and raise investor confidence, making for a more attractive funding location. As noted earlier when Israel decided in the 1990s to place an intense focus on attracting venture capital from abroad, it designed its tax policy to match this goal. The result was that by 2014 venture capital investments made in Israel were 14 times higher than in Ireland for the same period. Furthermore, for the past ten years the UK has placed an unrelenting focus on its tax policy to drive indigenous business and investment. In our Spotlight on the UK in this chapter we outline how it has done this through reduced capital gains tax and extensive income tax reliefs. Again, we see the results of this policy direction in the fact that the UK now has the highest level of venture capital investment in Europe.

There are three important prongs of taxation that need to be considered when designing a policy that promotes investment:

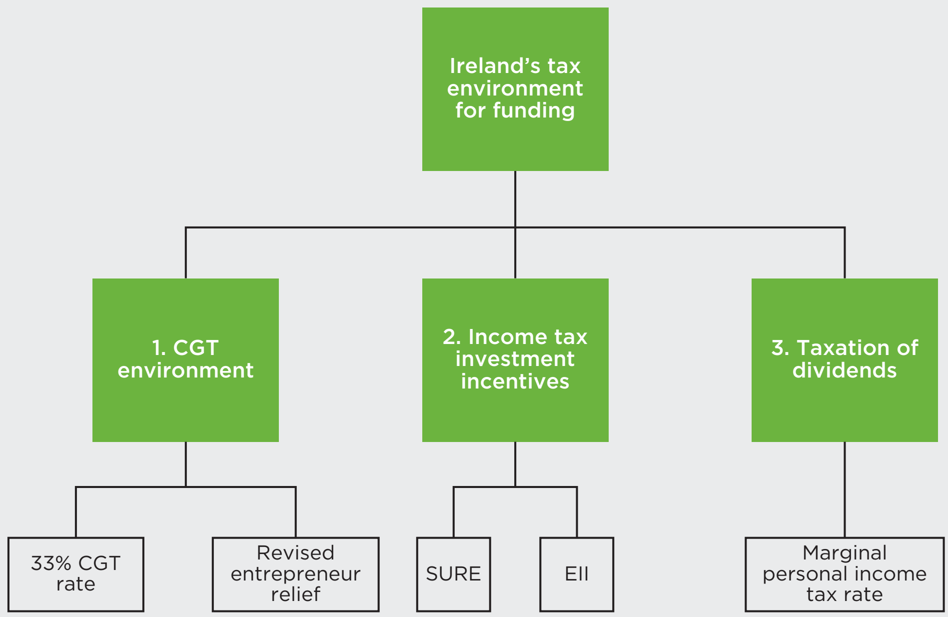
1. The capital gains tax (CGT) that will be due on the ultimate disposal of the investment. Any investor will want to assess the cost of exiting the investment before he/she decides to go into it.
2. The availability of income tax relief when the investment is made.
3. The tax treatment of any dividends received while the investment is held.

At a time when Irish businesses are already challenged by funding constraints and are facing the prospect of major business restructuring in the light of Brexit, our tax policy choices on these three fronts can no longer be the barrier to investment that they currently are.

BREXIT

36 European Commission, Entrepreneurship Action Plan 2020.

Ireland's tax environment for funding business



1. Ireland's high CGT regime and its impact on investment

In this section, we review:

a) The choices that Ireland has made on CGT policy and the impact of this policy on investors.

b) The impact of high CGT rates on business sales.

c) The Exchequer impact of reducing the CGT rate.

a) The choices that Ireland has made on CGT policy and the impact on investors

CGT is a key determining factor for investment in the economy.[37] It is unquestionably the tax that matters most to entrepreneurs and that drives their behaviour. Indeed, the IMF recognises that entrepreneurs can generate a significant portion of their income in the form of capital gains, and so "low capital gains taxation may encourage entrepreneurial ventures."[38]

37 Small Firms Association submission to the Taxation and Entrepreneurship Review, July 2015, http://www.sfa.ie/Sectors/SFA/SFA.nsf/vPages/News-sfa-submission-on-tax-and-entrepreneurship-16-07-2015/$file/Tax+and+Entrepreneurship_SFA+2015.pdf.
38 IMF, Tax Policies to Encourage New Business Ventures.

Irish entrepreneurs are subject to CGT at a headline rate of 33%, which is the fourth-highest rate among the 35 countries in the OECD.

Capital gains tax rates in OECD countries, 2016–2017[39]

	OECD country	CGT rate (%)
1	France	60.5
2	Denmark	42
3	Turkey	35
4	**Ireland**	**33**
5	Finland	30
6	Sweden	30
7	Portugal	28
8	Austria	27.5
9	Canada	27
10	Italy	26
11	Germany	25
12	Israel	25
13	Norway	25
14	Slovak Republic	25
15	Slovenia	25
16	Chile	24
17	United States	23.8
18	Spain	23
19	Australia	22.5
20	Estonia	20
21	Iceland	20
22	Japan	20
23	Korea	20
24	United Kingdom	20
25	Poland	19
26	Greece	15
27	Hungary	15
28	Latvia	15
29	Mexico	10
30	Belgium	0
31	Czech Republic	0
32	Luxembourg	0
33	Netherlands	0
34	New Zealand	0
35	Switzerland	0

The French tax regime allows for significant but complex tapering reductions, and a more usual rate to pay would be in the mid-20s.

MEDIAN OECD RATE

39 CGT rates applying on the sale of business assets, based on EY's Worldwide Personal Tax and Immigration Guide 2016/17. In some jurisdictions, gains are taxable at income tax marginal rates.

Ireland has introduced a "revised entrepreneur relief", which recognises the importance of encouraging and promoting the growth of Irish business. It allows for a lower 10% rate on business gains, but this is subject to a lifetime limit of €1m and a series of other restrictions. Critically, the 10% rate is available only to the actual owners and managers of a business and not to third-party investors such as angel investors. The restrictions are that the entrepreneur:

- must hold at least 5% of the company's shares,
- must have held them for three out of the five years immediately before disposal and
- must have worked as a "full-time" director or employee in the business, i.e. spent at least 50% of his/her time working for the company, continuously for three out of the past five years.

These restrictions rule out the possibility of external investors benefiting from the 10% rate. Therefore, any investor who makes a gain will have to pay one-third of that gain over to the State in CGT, and this is a real barrier to investment in Ireland. If the 33% headline rate were reduced and/or the conditions attaching to revised entrepreneur relief were changed, it could make the difference between angels, venture capital investors and others deciding to take the risk of investing in an Irish company or not.

The Minister for Finance gave a commitment in Budget 2017 "to review the €1 million lifetime limit in future budgets."[40]

b) High CGT rates can also delay business sales unnecessarily

High CGT rates can not only deter external investment in Irish businesses but also lead to delayed decisions about the sale of businesses, which can impact on the growth of those businesses and potential future jobs.

Although the owner/manager of a business may be able to claim revised entrepreneur relief, the lower, 10%, rate can be claimed only on the first €1m gain that arises in that person's lifetime. The balance of the gain is payable at the full 33%, meaning that on a €10m gain the effective rate of CGT is 30.7%. Highly successful businesses that have taken years of effort and commitment to grow and that have paid substantial corporation tax every year can often generate more than a €1m gain.

Capital gains tax on a €10m gain

	€m
Gain	10
CGT under revised entrepreneur relief: €1m at 10%	(0.1)
CGT on balance of €9m at 33%	(2.97)
Net gain	6.93
Effective CGT rate	30.70%

There comes a stage in the life of many businesses when they reach the limit of their potential with the current ownership structure and funding. If the business is not sold at the point when the owners are ready to sell, then it is effectively left in the hands of reluctant owners and can stagnate. Feedback from our members indicates that some owners are delaying business sales to third parties because of the high CGT bills that they could face.

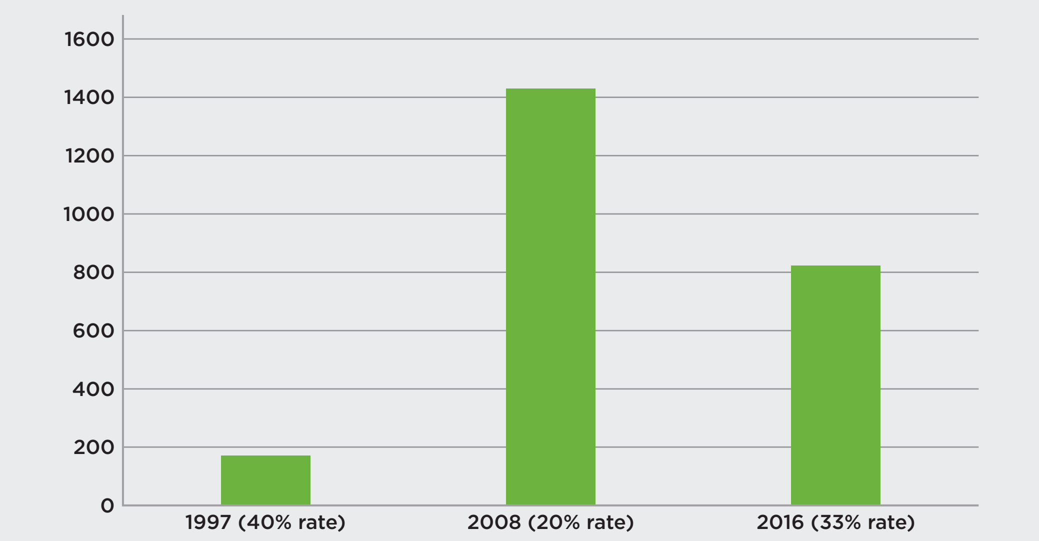
40 Minister for Finance, Michael Noonan TD, Budget 2017 speech to the Dáil, 11 October 2016.

In the majority of cases, the sale or part-sale of a company is a positive decision. The business does not stop with the sale; it simply continues with new funding and under a new ownership and governance structure. The purchase and sale of businesses is an indication of health in an economy and is to be encouraged. It provides a vibrant environment for investment and creates confidence in that ecosystem.

c) The Exchequer impact of a change in the CGT rate

Ireland's tax regime for investors in Irish business is one of the most challenging globally and creates a significant barrier to any individual considering investing here. When the policy decision was adopted to lower CGT in 1998, the CGT yield that resulted in subsequent years was much higher than it had previously been (albeit in an improving economic environment).

Exchequer CGT receipts (€m) and rates for 1997, 2008 and 2016



Source: Based on Revenue's Annual Reports, 1997, 2008 and 2016

Revenue's Ready Reckoner shows that a 1% reduction in the Irish CGT rate would cost the Exchequer €25m[41] for a full year. However, behavioural change that might arise due to a reduction in the CGT rate is also important. This behavioural change is borne out by the movement in the CGT receipts over the last 20 years, as illustrated by the chart above. When the rate was as high as 40% in 1997, CGT receipts represented 0.74% of the overall tax yield. The level of CGT receipts immediately increased after the rate was dropped to 20% in 1998, and by 2008 CGT accounted for 3.5% of the total tax yield. Although the economic environment at the time was a driver of the CGT receipts, the movement between the years is still very marked. CGT receipts remain low in 2016 (1.7% of the total tax yield), despite the higher tax rate imposed on gains.

41 Revenue, Ready Reckoner – Post Budget 2017, p. 13.

Recommendations to grow the existing Irish enterprise start-up environment and unlock its full potential in terms of jobs, tax receipts and economic activity

(I) Reduce the headline CGT rate

Ireland's 33% CGT rate is the fourth highest rate in the OECD and it is having a negative impact on investment in Irish business. This is a matter of real concern because investment in innovation, talent and equipment is essential if Irish businesses are to increase their level of exports abroad. By contrast, Germany outstrips the rest of the EU with its excellent record of business investment and its export prowess – it has a CGT rate of 25%. As well as hampering investment, the high rate is also dampening business activity in the Irish market and creating reluctant business owners who may hold onto businesses beyond the point where they have the capacity to grow them to the scale required in a new global exporting environment. The CGT rate needs to be reduced to a level that is closer to the median CGT rate amongst OECD countries, currently 23%.

(II) Broaden the revised entrepreneur relief

Revised Entrepreneur Relief is tightly restricted to owner managers and locks out much needed external investors from the possibility of a lower CGT rate. This disparity should be removed. The €1m lifetime threshold for Entrepreneur Relief also needs to be increased to a minimum level of €10m to compete effectively with other countries for international capital.

Income tax incentives for investment in Irish business

Ireland currently offers two "income tax" incentives to individuals who invest in Irish business:

a) The Employment and Investment Incentive (EII)
b) Start-Up Refunds for Entrepreneurs (SURE)

a) EII

The Employment and Investment Incentive is the main income tax incentive available to individuals investing in Irish business. It is aimed mainly at supporting early-stage business and is a very important relief that can mitigate risk for investors in these businesses, including family, friends and angel investors.

These businesses often have great difficulty in obtaining bank finance, and so this tax measure is a very important element of Government support for this sector, which is so critical to Ireland's future growth.

EII Relief – The Investor Perspective

- The EII entitles individuals buying shares in certain types of trading companies to claim income tax relief up to 40% of the value of their investment.
- However, the relief is split into two tranches: 30% is granted in the year of investment, and a further 10% is granted after three years.
- The maximum EII investment is €150,000 in any one year.
- No relief is granted for USC or PRSI under the EII, even though USC has become a very fixed feature of the personal tax system (giving high marginal rates of 52%/55%) against which taxpayers do not receive any additional benefits.

Benefit of the EII to the Irish business receiving the funds

- The target company can raise a maximum of €5m EII funding a year, subject to a lifetime limit of €15m.
- Most trading activities qualify for funding, except once-off speculative transactions; financing activities, including dealing in commodities, securities etc.; dealing in and developing land; forestry; film production; operations in the coal, steel and shipbuilding sectors; and professional services.
- The investor must not be connected to the company or own more than 30% of it. However, there is an exception to this rule for an individual investing in his/her own company where the total capital of the company does not exceed €500,000 after investment.

The success of the EII

EII v BES

The EII replaced a previous incentive known as the Business Expansion Scheme (BES) in 2011. The EII is broader in scope than the BES was, so that a wider variety of trading activities can avail of the funding.

However, the tax relief available under the EII is lower than that under the BES. The BES provided for tax relief at the investor's highest rate of income tax in year 1, whereas EII income tax relief is split into two tranches over three years.

Although the economic environment has been challenging in recent years compared to the peak year for BES investment, it is nonetheless true that just over half the number are using EII compared to BES when it was most successful.

EII and BES investments compared, 2008 and 2016

	No. of investors	Cost to the Exchequer
BES in 2008 (peak)	3,200	€135.7m[42]
EII in 2016	1,768	€32.5m[43]
Drop from peak	(1,432)	(€103.2m)

At the time of writing, companies that are seeking follow on EII investment which is sought after seven years in business are encountering difficulties getting outline Revenue approval for the funding. This issue has arisen because of restrictions within the General Block Exemption from EU State Aid.

Recommendations that would increase EII investment

In light of the low levels of EII investment currently being made, a number of enhancements to the regime are urgently required to broaden its appeal to investors.

(i) Raise the €150,000 annual investment limit

The Irish market contains a limited number of individuals who have funds to invest in business through the EII. At a time when these businesses need a diverse range of finance, the annual cap of €150,000 per annum for these investors is further limiting the funding

42 Parliamentary question of April 2014, PQ 16419/14.
43 Revenue, Employment and Investment Incentive (EII) Statistics 2012–2016, p. 5.

available for companies through the scheme. The equivalent UK EIS scheme has an annual Stg£1m investment limit and the limit for the Irish scheme should be increased to an equivalent amount.

(ii) Provide full EII relief in year 1

As well as being capped, the EII income tax relief for investors is also split into two tranches - 30% in the year of investment and an additional 10% after three years, if the company meets certain employment targets. This concept of a split relief has been a feature of the EII relief since it replaced BES in 2011. However, it significantly reduces the attractiveness of EII and should be removed.

(iii) Extend EII relief to USC and PRSI

Currently, EII relief is available only against income tax and not either USC or PRSI. This reduces the relief available to 40%, when the investor's marginal tax rate may be as high as 55%.

(iv) Extend EII to include the founder shareholder

The EII rules require the investor to hold less than 30% of the company shares, effectively denying relief to the founder shareholder who may want to inject more funding into the business. This restriction does not apply in the UK and should be removed from our regime.

b) SURE

- SURE is an income tax refund scheme available to individuals who start their own business.
- Anyone who has recently been in employment can claim a tax refund of up to €100,000 for the investment they make in their new business.
- The refund is limited to the amount of PAYE income tax that the person has paid over the previous six years.
- There is no refund for USC or PRSI previously paid.
- There is no refund for any tax paid by a person who was previously self-employed in another business before starting this business. It is available only to people previously in PAYE employment, previously unemployed, recently made redundant or retired.

The conditions for SURE

- The person must set up a new company to operate the business and must buy shares in that company.
- The company must carry on a qualifying trading activity. Most trading activities are permitted, except for once-off speculative transactions; financing activities, including dealing in commodities, securities etc.; dealing in and developing land; forestry; film production; operations in the coal, steel and shipbuilding sectors; and professional services.
- The person must hold shares in the company for four years after the shares are issued and must hold at least 15% of the share capital for 12 months after the shares are issued.

Restrictions in the SURE scheme are limiting its use, and these restrictions need to be reviewed in light of current circumstances.

- The impact that SURE can have on a new business is limited by the fact that it comes in the form of a tax refund “after the event”.
- What the new business needs most in its early days is cash upfront to pay any salaries and other running costs. However, the SURE refund can be claimed only after the investment has been made by the new business owner. He/she must find the cash upfront from elsewhere to invest in the new business first and then make the claim – this is often a significant barrier to the usefulness of SURE.
- To qualify for the relief, the individual needs to have paid sufficient income tax through the PAYE system in the previous four years. However, income in the year immediately before the investment can be from any source.
- A previously self-employed person, who has paid equivalent levels of income tax through the self-assessment system, does not qualify.

The latest data available indicate that the relief costs €1.8m a year and that only 59 people claimed it in 2014.[44]

Recommendations on the SURE scheme

The SURE scheme should be extended to include new business founders who were previously self-employed and starting up another business (as well as those coming from employment).

3. The taxation of dividends

Dividends and interest[45] are taxed in Ireland at a person’s full marginal personal tax rate (including USC and PRSI), at rates of up to 55%.

Other countries recognise dividends as being a unique form of income, and they generally apply a special tax regime to them – often a lower, flat rate. For example, flat rates of between 25% and 30% usually apply to dividends in Sweden, Germany and Israel. Reduced rates of income tax also apply to dividend income in the UK, and there is a tax-free threshold for dividends of £5,000 per annum. Furthermore, UK National Insurance Contributions do not apply to dividend income.

Recommendations on dividend income

Dividend income in Ireland is taxed at high marginal personal tax rates of up to 55%, which does not encourage equity investment in Irish business. Most countries internationally tax dividends at a lower or flat rate. We recommend a lower flat rate of taxation on dividend income.

44 Revenue, Costs of Tax Expenditures (Credits, Allowances and Reliefs).
45 Other than bank deposit interest.

Spotlight on the UK's approach to entrepreneurs – CGT and income tax incentives

In response to the global financial crisis, the UK Government launched the Enterprise Strategy[46] on 12 March 2008. The Strategy's vision was to make "the UK the most enterprising economy in the world and the best place to start and grow a business".

It was designed to unlock the UK's entrepreneurial talents; boost enterprise skills and knowledge; help new and existing business get funding to start up and grow; and ease the burden of regulation, particularly on small firms.

As part of the Government's overall strategy, entrepreneurs' relief was introduced in 6 April 2008 to encourage and support entrepreneurship.

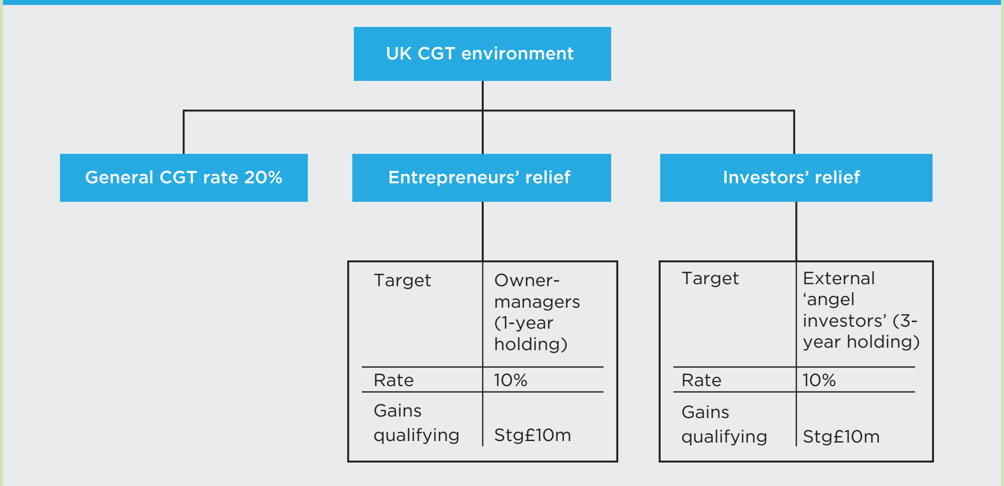
The strategy was further improved by the launch of the Seed Enterprise Investment Scheme (SEIS) in Budget 2011 as part of the Government's 2010–2015 policy on business enterprise – funding, loan programmes, tax incentives, regulation and enterprise awards.[47] The scheme was introduced in Chancellor George Osborne's 2011 Autumn Statement,[48] which heralded a big shake-up of tax incentives for investors, with the EIS and Venture Capital Trusts also being revamped.

UK's CGT environment

The UK has a much more competitive CGT regime for entrepreneurs than Ireland in four very important respects:

1. The headline CGT rate is only 20% in the UK, compared with 33% in Ireland.
2. The value of entrepreneurs' relief is more generous in the UK than in Ireland.
3. Since 2016, the UK has had a new relief, "investors' relief", specifically targeted at external investors, including angel investors (see below).
4. UK administrative supports to claim reliefs are provided in "plain English".

UK CGT environment



46 HM Treasury and Department for Business Enterprise and Regulatory Reform, "Enterprise: Unlocking the UK's Talent" (March 2008), http://webarchive.nationalarchives.gov.uk/20090902162708/http://www.berr.gov.uk/files/file44992.pdf.
47 HM Treasury and Department for Business, Innovation and Skills, "2010 to 2015 Government Policy: Business Enterprise", https://www.gov.uk/government/publications/2010-to-2015-government-policy-business-enterprise/2010-to-2015-government-policy-business-enterprise.
48 Chancellor of the Exchequer (George Osborne), Autumn Statement 2011, http://webarchive.nationalarchives.gov.uk/20130129110402/http://cdn.hm-treasury.gov.uk/autumn_statement.pdf.

Comparison of entrepreneurs' relief in Ireland and the UK		
	Ireland	**UK**
Gain	€10m	€10m
€1m subject to 10% rate – Ireland	€0.1m	
Balance of €9m subject to 33% rate – Ireland	€2.97m	
Subject to 10% rate – UK	______	€1m
Total CGT	€3.07m	€1m
Effective CGT rate	**30.70%**	**10%**

Entrepreneurs' relief is available in the UK at 10% on the first Stg£10m gain (compared with €1m in Ireland). This means that the overall tax rate on a gain of €10m is 30.7% in Ireland compared with 10% in the UK.

On any gain above Stg£10m, the balance in the UK is taxed at just 20%, rather than 33%, as in Ireland.

Investors' relief in the UK

The UK Government wanted to create a strong enterprise and investment culture and to ensure that companies can access the capital that they need to expand and create jobs. To further encourage this investment culture and foster access to capital for companies, the UK introduced a new relief in 2016 for external investors purchasing shares in unlisted trading companies.

Business angels and other investors are no longer required to have a minimum shareholding in the business or to be an employee or director of the company to avail of the lower CGT rate of 10% on gains from newly issued shares in unlisted companies (with a lifetime gains limit of Stg£10m).

Comparison of Irish and UK regimes for entrepreneurs and investors			
	Ireland	**UK**	
	Revised entrepreneur relief	**Entrepreneurs' relief**	**Investors' relief**
Business owners	Yes	Yes	No
Angel investors	No	No	Yes
CGT rate	10%	10%	10%
Shareholding period	3 years	1 year	3 years (newly issued shares only)
Employee/ director working requirement	3 years	1 year	None
Gains that qualify	€1m	Stg£10m	Stg£10m

Although the UK undoubtedly has challenges to face with Brexit, it embarked on a very successful comprehensive strategy to develop its entrepreneurial sector 19 years ago.[49] Since then, the UK has introduced:

- A headline CGT rate of 20%.
- A preferential rate for entrepreneurs of 10% that applies to lifetime gains of up to Stg£10m.
- A preferential rate for external investors of 10% on gains on the disposal of newly issued shares in unlisted companies (with a lifetime gains limit of Stg£10m).
- An exemption from CGT on the sale of SEIS shares after three years.
- An exemption from CGT on the sale of EIS shares after three years.

And the UK's ratings on the global indices have spiked – it ranked third on the Global Innovation Index and tenth on Global Competitiveness Index in 2016.

UK tax regime for funding

The UK operates two separate tax investment schemes:

- The Enterprise Investment Scheme (EIS), aimed at raising significant investment in medium-sized companies; and
- A more favourable 50% tax relief for more risky seed funding – the Seed Enterprise Investment Scheme (SEIS).

Comparison of Irish and UK investment regimes

	Ireland	UK	
	EII	EIS	SEIS
Rate of relief	30% in year 1 10% after 3 years	30%	50%
Company investment limit	• €5m limit per year • €15m lifetime limit	• Stg£5m limit per year • No lifetime limit	• Stg£150,000 lifetime limit
Investor limit	€150,000 per year	Stg£1,000,000 per year	Stg£100,000 per year
Shareholding period	4 years	3 years	3 years
Eligible companies	Most trading SMEs	Most trading SMEs	Small companies (<25 employees and <£200,000 in assets)
Treatment of capital gains	Gain on disposal of shares subject to CGT	Gain on disposal of shares exempt from CGT	Gain on disposal of shares exempt from CGT

49 Chancellor of the Exchequer (Gordon Brown), Budget Speech, 17 March 1998 http://webarchive.nationalarchives.gov.uk/20100407010852/http:/www.hm-treasury.gov.uk/bud_budget98_speech.htm.

This table provides some interesting insights into the more favourable approach to entrepreneurship adopted by the UK.

1. The UK has recognised that a separate scheme is required for fledgling seed businesses – the SEIS. Due to the risks involved, a higher, 50%, level of tax relief is offered to investors in these businesses.
2. The Irish EII scheme caps the amount of investment that a company can raise in its lifetime. It is unclear why this is the case. This is restricting the incentive to make larger investments as part of the scheme, thereby restricting the scaling up of the business.
3. The UK has also recognised the importance of aligning tax policy on income tax incentives with CGT treatment. Gains on both EIS and SEIS shares are exempt from UK CGT. In Ireland, a 33% CGT rate on the disposal of EII shares dilutes any personal tax relief granted and may remove the incentive for someone to invest.

Administrative supports for UK reliefs

The UK has introduced a number of administrative supports to help individuals and businesses understand and avail of the reliefs and to ease the administrative burden associated with making claims, including:

- A Venture Capital Schemes Manual in "plain English", which clearly sets out the different schemes in place, e.g. EIS and SEIS.
- Regular consultations with stakeholders before changes to guidance on the reliefs are implemented.
- Advance assurance for the EIS available to companies issuing shares.
- A Small Company Enterprise Centre to process advance assurance requests for SEIS users and to provide information on claims.

Chapter 11

20 Key Tax Recommendations

Why tax policy is important

The role of tax policy in driving entrepreneurship was clearly outlined by the IMF recently.[1] Tax is a critical topic right now and has major implications for entrepreneurship by reducing the rewards for success. The IMF believes that high taxes can reduce the incentive to innovate and the entrepreneurial spirit; the design of growth-friendly tax policy favouring entrepreneurship is required, and several governments can do better in this regard.[2]

A new tax strategy for the Irish indigenous sector

1. It is recognised that a seismic shift in Ireland's exporting strategy is required to grasp new global opportunities and meet global uncertainties and challenges.

The urgency of this issue requires:

a. A tax policy strategy that helps Irish businesses to be ambitious and removes any blockers that prevent this ambition; and

b. That tax policies are implemented and administered in a seamless way that is easy to understand and apply and is barrier-free for SMEs.

The new strategy would enshrine the recommendations set out below.

Supported by an extensive Government information campaign

2. An early and extensive information campaign should be rolled out for Irish businesses, explaining both the tax policies in the strategy and how they will be administered.

Ireland's capital gains tax (CGT) regime

3. Ireland's 33% CGT rate is the fourth-highest rate in the OECD and is having a negative impact on investment in Irish business. This is a matter of real concern because investment in innovation, talent and equipment is essential if Irish businesses are to increase their level of exports abroad. By contrast, Germany outstrips the rest of the EU with its excellent record of business investment and its export prowess – it has a CGT rate of 25%. As well as hampering investment, the high rate is dampening business activity in the Irish market and creating reluctant business owners who may hold on to businesses beyond the point where they have the capacity to grow them to the scale required in a new global exporting environment. The CGT rate needs to be reduced to a level that is closer to the median CGT rate among OECD countries, currently 23%.
4. Revised entrepreneur relief is tightly restricted to owner-managers and locks out much-needed external investors from the possibility of a lower CGT rate. This disparity should be removed. The €1m lifetime threshold for entrepreneur relief also needs to be increased to a minimum of €10m to compete effectively with other countries for international capital.

Tax measures for R&D and innovation

5. Limits in the R&D tax credit regime for outsourcing, restrict collaboration among Irish businesses and, crucially, between businesses and third-level institutions. No outsourcing restriction is required under the OECD Modified Nexus rules for the Knowledge Development Box (KDB), and because the rules of the two regimes should be aligned, the outsourcing restrictions in the R&D tax credit regime should be removed.

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1 European Commission and IMF Conference on Taxation, Investment and Innovation: A Triptych for Balanced Growth, 17 and 18 November 2016; https://ec.europa.eu/taxation_customs/sites/taxation/files/2016_tax-invest-innov_programme.pdf.

2 European Commission and IMF Conference on Taxation, Investment and Innovation: A Triptych for Balanced Growth.

6. At a time when all global indicators tell us that growth depends on innovation, every effort should be made to remove administrative blockers for businesses that need to claim the R&D tax credit. Only 1% of all small companies consider themselves to be R&D active and 16% of medium companies consider themselves to be R&D active. If we are to be truly innovative and global, we must improve this performance, and no stone should be left unturned in supporting SMEs to claim the R&D tax credit. This includes:
   - A new SME-friendly guidance campaign supported by dedicated Revenue support lines for SMEs with dedicated Revenue experts.
   - A Revenue Centre of Excellence that deals with all taxpayer issues concerning the R&D tax credit regime.
   - Sector-specific guidance for each industry sector such as food and drink, ICT, bio-medical etc., all of which engage in very different R&D processes.
   - A Revenue pre-approval process that would bring much-needed certainty for taxpayers and subsequently prevent disagreements and costly future audits.
   - Expert checks on the science element of R&D that are grounded in business reality rather than focused on academic concepts of "new to the world." Regardless of how innovative a food company might be, it is very difficult to invent a food that is completely new to the world.

7. Revenue's guidelines on the KDB are very comprehensive, at 82 pages. However, a separate and less complex set of guidance is needed for SMEs, which have much more straightforward operations.

The personal tax environment and talent

8. Ireland's urgent skills gap warrants a comprehensive review of our high effective tax rates that apply above the average wage. A phased plan is needed to reform the overall shape of our personal tax system. This includes a review of our high marginal tax rates, the breadth of our tax base and the entry points to income tax, USC and PRSI.
9. A workable share-based employee scheme is also required for SMEs that would enable them to attract and retain the best talent. The UK's Enterprise Management Incentive (EMI) is a good model to consider – capital gains tax is payable by taxpayers when they sell their shares and have the funds to pay the tax. A simple administrative process for collecting the information and paying the tax due is an important element of any new scheme.
10. Entrepreneurs are the job creators of Ireland, and personal tax disparities that require them to pay higher taxes than PAYE taxpayers should be removed. These include the additional 3% USC rate that they pay on income above €100,000 and the €700 lower tax credit that they receive.
11. Consideration should be given to developing a new talent regime similar to SARP but targeted at SMEs, so that they can attract the talent and skills they need from outside Ireland to grow their businesses.
12. Uncertainty about the tax treatment of travel expenses is creating concern and cost for many home workers, freelancers, employers with staff sent abroad to build the business and those dealing with the new working patterns of the modern world. Legislation in this area urgently needs to be brought up to date to deal with this issue.

Tax measures to expand export markets

13. The Foreign Earnings Deduction (FED) reduces the income tax bill of employees travelling to develop export markets in 30 countries, including the BRICS, some Middle Eastern, South American, Asian and African countries. With Irish companies needing new export markets more than ever, the range of qualifying countries should be reviewed and broadened.
14. There are also some significant gaps in Ireland's double taxation agreement (DTA) network across Latin America, Africa and southern Asia. These DTAs are critical for cross-border trade as they prevent double taxation. Negotiating a DTA requires commitment and cooperation from both countries; nonetheless, all efforts possible should be applied to addressing these gaps.
15. Irish companies sending employees abroad for short-term visits often experience burdensome administrative difficulties when dealing with tax, payroll and double taxation issues. A new streamlined approach to these tax compliance issues is needed, complemented by further specialised Revenue support.

Income tax measures to support investment

16. The Irish market contains a limited number of individuals who have funds to invest in business through the Employment and Investment Incentive (EII). At a time when these businesses need a diverse range of finance, the annual cap of €150,000 for these investors is further limiting the funding available for companies through the scheme. The equivalent UK EIS scheme has an annual Stg£1m investment limit, and the limit for the Irish scheme should be increased to an equivalent amount.
17. As well as being capped, the EII income tax relief for investors is also split into two tranches – 30% in the year of investment and an additional 10% after three years. This concept of a split relief has been a feature of the EII since it replaced the BES in 2011. However, it significantly reduces the attractiveness of the EII and should be removed.
18. The EII rules require the investor to hold less than 30% of the company's shares, effectively denying relief to the founder shareholder, who may want to inject more funding into the business. This restriction does not apply in the UK and should be removed from our regime.
19. The Start-Up Refunds for Entrepreneurs (SURE) scheme should be extended to include new business founders who were previously self-employed and are starting up another business (as well as those coming from employment).
20. Dividend income in Ireland is taxed at high marginal personal tax rates of up to 55%, which does not encourage equity investment in Irish business. Most countries internationally tax dividends at a lower or flat rate. We recommend a lower flat rate of taxation on dividend income.

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