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Minister Paschal Donohoe TD
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

1 November 2018

Re: Finance Bill 2018

Dear Minister

In our submissions in advance of Budget 2019 and Finance Bill 2018, we set out a number of policy and technical amendments to existing tax legislation, which we believe are necessary to further the productivity and prospects of Irish companies.

The Programme for a Partnership Government recognises the importance of supporting the capacity and performance of our enterprise sector. The effectiveness of tax measures, such as the Employment and Investment Incentive (EII), the Key Employee Engagement Programme (KEEP) and Revised Entrepreneur Relief are central to the growth of our indigenous businesses.

We welcome steps taken in Finance Bill 2018 to address some of the operational difficulties encountered when claiming EII and one of the limitations within the KEEP scheme. However, the amendments made in Finance Bill 2018, as initiated, do not in our view go far enough to ensure that these measures are operating effectively in practice and ultimately achieving their policy aims.

Employment Investment Incentive (EII)

Given the blockages that have existed to date in the processing of EII applications, we believe that self-certification is a positive move, which should enable investments to flow more easily into Irish companies. However, it will be important that Revenue promptly issues revised guidance that ensures that the new regime will be administered in a way that meets the new policy objective of simplifying the funding process.

We understand that there may be a number of Committee Stage amendments to the new provisions. It is essential that the period of retention required before an initial investor can redeem their shares be addressed at Committee Stage, to ensure that it does not act as a barrier to future investment.

As currently drafted, the provisions prevent an initial investor from redeeming their investment until the retention period has expired for all subsequent investors under the EII scheme. This means that the initial investor will have to wait longer than any subsequent EII investors to

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redeem their shares and an investor has no certainty regarding when they will be able to redeem their shares.

We welcome the recommendations in the Indecon Evaluation of the EII and SURE and we look forward to the full adoption of those recommendations to further improve the EII, in particular the granting of the relief over one year, as opposed to two tranches.

Key Employee Engagement Programme (KEEP)

Irish SMEs are experiencing difficulties recruiting and retaining skilled workers. Given the high personal tax rates, a workable share option scheme (the KEEP) that can help Irish SMEs to attract talent to grow their business is vital. We understand from feedback from our members that there has been little uptake of the KEEP by SMEs, due to the restrictive nature of the various conditions.

We welcome the Finance Bill 2018 amendment to the definition of a “qualifying share option” in the KEEP, which now permits the maximum market value of shares that can be awarded to be equivalent to an employee’s annual salary, rather than 50%. This is positive step to address one of the limitations within the KEEP, particularly for early stage businesses paying small salaries.

However, the scheme contains other significant limitations, which will continue to impact the feasibility of the scheme and ultimately its success in achieving the policy aim of helping SME’s attract and retain talent, in particular the narrow definition of a qualifying holding company and providing assured liquidity in KEEP shares. We highlighted these limitations in our Pre-Finance Bill 2018 submission and we have included our recommendations on how to address these limitations in the legislation at Appendix 1.

Revised Entrepreneur Relief

Revised Entrepreneur Relief helps to reduce the high CGT burden on the sale of a business to a limited extent. Nevertheless, this tax measure is uncompetitive when compared with the UK. In the UK, the relief applies to Stg£10 million, while in Ireland the gain is limited to €1million. This means the overall effective tax rate on a gain of €10 million in Ireland is 30.7% compared with 10% in the UK. The 10% Irish CGT reduced rate is available only to actual owners and managers of a business and not to third party investors, such as angel investors, who are willing to invest money, experience and industry expertise in ambitious young companies.

The application of the measures reflected in Revised Entrepreneur Relief is also limiting its use in three common situations; where there is a dormant company in a group, where a group is party to a joint venture and where a company/group holds investments or leases trading premises. We have set out further details on how to address these limitations in the relief at Appendix 1.

Considering Brexit, it is disappointing that Finance Bill 2018 does not contain any amendments to Revised Entrepreneur Relief, which would help foster and support Ireland’s enterprise sector. Ireland’s high CGT rate of 33% is restricting external investment in Irish business. It is creating reluctant business owners who may hold onto businesses beyond the point where they have capacity to grow them to the scale required to expand into new markets.

The potential impact of section 135 TCA 1997 on the sale of family businesses/SMEs

Finance Act 2017 inserted a new subsection 3A into section 135 TCA 1997. The policy intent at the time of introduction was *"to deal with a number of specific tax avoidance schemes which have been uncovered by the Revenue Commissioners."*[1]

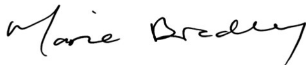
However, unlike other targeted anti-avoidance measures in Irish tax legislation; section 135 TCA 1997 does not include a *bona fide* test, which is normally used to prevent unintended consequences from arising.

The effect of the new subsection 3A is to impose income tax (rather than CGT) treatment on selling shareholders in any situation where Revenue take the view that a company has retained profits in excess of the company's commercial needs. Without a *bona fide* test to target this measure, it is having a significant impact on succession within family businesses, management buy-outs (MBOs) and arrangements to provide liquidity in shares for employees involving 'close companies'.

In our view, inserting an exclusion for *bona fide* commercial transactions into section 135 TCA 1997 would provide the necessary level of certainty to taxpayers when considering their scaling options. With Brexit looming, Irish businesses need, now more than ever certainty over their tax affairs.

We hope that these matters could be considered in the context of the Committee Stage discussions on the Bill.

Yours truly



Marie Bradley
President

1 Minister Paschal Donohoe, T.D. at the Committee Stage debate on Finance Bill 2017, 8 November 2017

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Appendix 1

1. Recommendations on Key Employee Engagement Programme (KEEP):

We welcome the amendment in Finance Bill 2018 to increase the remuneration limit from 50% to 100% of an employee's annual emoluments, subject to an annual ceiling of €100,000.

However, the KEEP continues to have six significant limitations which considerably impact the feasibility of the scheme. These are:

i. the definition of a 'qualifying individual'
ii. the definition of a 'holding company'
iii. the requirement for new issued shares
iv. share buy backs need to be facilitated to assist with liquidity
v. reorganisations are not specifically catered for within the provisions of KEEP, and
vi. agreed approaches to share valuations and the development of 'safe harbours' are required.

To address these limitations, we recommend the following amendments to the existing legislation:

- The current KEEP provisions envisage that an individual will be an employee of and carry out duties for a single company. However, employees may carry out work for the holding company and one or more subsidiaries or transfer between group companies, as well as devoting their time to the qualifying KEEP company within the group. This will be dictated by business needs. We believe the definition of a 'qualifying individual' should be amended:
    - to allow an employee who transfers to a group company to retain their KEEP options (that qualify for CGT treatment), provided all the other conditions of section 128F TCA 1997 are satisfied, and
    - to allow more practical flexibility (particularly in SMEs), so that employees who spend substantial time in the KEEP company will qualify for the relief even where they carry out some duties for other group companies.
- Holding companies generally do not only own shares (i.e. a holding company can hold money in a bank account to discharge its running expenses or advance a loan to a subsidiary) and are not always the 100% parent company, which is what is required under the existing provisions to qualify for KEEP. We recommend that the definition of a holding company under the scheme should be amended to adopt a similar definition to that contained within Revised Entrepreneur Relief where a holding company *"means a company whose business consists wholly or mainly of the holding of shares of all companies which are its 51 per cent subsidiaries"* and which provides for a qualifying group.
- For commercial reasons, it is common for company share schemes to manage the delivery of shares to eligible employees under a trust arrangement. Furthermore, they will often make available shares for key recruits from a pool of existing shares set aside

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for that purpose. The flexibility to operate these common and accepted practices is not available under KEEP and that is significantly limiting the use of the regime. To address this gap, the regime should enable existing, as well as new shares, to qualify for use. This could be achieved by deleting the reference to 'new' in part (a) of the definition of a qualifying share option under section 128F TCA1997.

- The provisions of the KEEP scheme do not accommodate the buy-back of shares and this can have significant implications for the liquidity of the business. A substantial challenge for SMEs wishing to operate a KEEP scheme will be to provide assured liquidity for their shares, as not all these companies are likely to be sold or listed on a stock exchange. Section 176 TCA 1997 should be amended to reflect that a buyback of shares acquired under KEEP can be expected to meet the conditions for the benefit of the trade test in that section and consequently, subject to CGT treatment.

- The current legislation does not provide for the continuing availability of CGT treatment if the SME undergoes a corporate reorganisation during the period in which the KEEP share option rights are outstanding. Therefore, we recommend the adoption of similar provisions in KEEP to those contained within the Revised Entrepreneur Relief legislation, which secure the entitlement of a qualifying individual and a qualifying company to meeting the scheme requirements when a reorganisation takes place.

- We believe that agreed 'safe harbour' approaches to share valuation for KEEP purposes should be developed, similar to the approach to valuations adopted under accounting standards. This will ensure the scheme is more accessible, easily understood and capable of implementation without undue duplication of effort and cost to SMEs.

2. Recommendations on Revised Entrepreneur Relief:

- Revised Entrepreneur Relief is restricted to owner-managers and locks out much-needed external investors from the possibility of a lower CGT rate. We believe this disparity should be removed.

- The €1 million lifetime threshold for Revised Entrepreneur Relief needs to be increased to a minimum of €10 million to compete effectively with other countries for international capital.

- There are also issues with the current Revised Entrepreneur Relief legislation[2] (as interpreted in Revenue's Operational Manual),[3] which are limiting its use in three significant situations and creating barriers to investment. These are:

    - where a dormant company is present in the group;
    - where the group is party to a joint venture;
    - where the group/company is holding investments and/or leasing trading premises

[2] Section 597AA TCA 1997
[3] Revenue Operational Manual 19.06.02B – Capital Gains Tax Revised Entrepreneur Relief

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We recommend that section 597AA TCA 1997 is amended to remove restrictions to Revised Entrepreneur Relief in situations where a group holds a dormant company or has a shareholding in a joint venture company of less than 51%.

The legislation should also be amended to allow for either an apportionment of relief when a company holds investments or earns rental income or alternatively full relief to be claimed provided such activities fall below a certain level