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Consultation on a White Paper on Enterprise Policy

Dear Tánaiste

The Irish Tax Institute welcomes the opportunity to participate in your Department's consultation on the future direction of Ireland's enterprise policy which will inform the White Paper to be published at the end of the year.

Previous reviews of Ireland's industrial policy - the Telesis Report in 1980 and the Culliton Report a decade later – were undertaken at times of high unemployment and economic stagnation. The backdrop to your re-appraisal is unprecedented levels of employment, record beating export growth, and tax returns beyond all expectations.

Nonetheless, as you stated when you launched the White Paper, Ireland faces significant challenges in an increasingly difficult global trading environment. In this context, a reappraisal of enterprise policy is timely.

Ireland's extraordinary post-pandemic recovery was driven by the multinational sector. The super-productive global tech and pharma companies that have made Ireland their home, powered through the pandemic as demand for their goods and services ballooned. Immune from the impact of the public health crisis, they effectively insulated the economy and enabled its rapid bounce back.

And therein lies the inherent weakness of the Irish economy which the White Paper must address: the productivity gap between a remarkably resilient and profitable MNE sector and a comparatively underperforming domestic sector.

An Effective Tax Regime for SMEs

Over recent months, successive economic forecasters have identified Ireland's over-dependence on its multinational companies for corporation tax and employment taxes, as a top risk to its economic fortunes.

The most sustainable strategy for mitigating this risk is to broaden the economic base by nurturing innovation, productivity, and competitiveness in the indigenous SME sector. Effective tax measures have a significant role to play in this endeavour.

While welcome changes have been made to some existing measures over recent budgets, they still fall short. Below, we summarise our recommendations for change to three tax measures which are particularly important to SMEs.

R&D Tax Credit

In its report on SME and Entrepreneurship policy in Ireland, the OECD referred to the need to make the R&D Tax Credit more accessible to SMEs. In the Institute's response to the recent consultation by the Department of Finance on the credit, we set out detailed recommendations that would make it more effective in supporting SMEs. Chief among them is a call for legislative clarification to ensure that rent, a substantial expense for most SMEs, is a qualifying cost under the terms of the credit. A change in Revenue's guidance in July 2020 significantly narrowed the circumstances in which rent may qualify, making the credit significantly less attractive for SMEs.

We also recommended condensing the current 3-year R&D Tax Credit refund to one year for all businesses or at the very least for SMEs. Accelerating the refund would provide valuable assistance to smaller companies that tend to be cash constrained.

To benefit small and micro businesses, the Institute believes a pre-approval process should be introduced for first time R&D Tax Credit claims. SME friendly guidance would also help to take the uncertainty out of the process for this sector.

Key Employee Engagement Programme (KEEP)

In the current tight labour market, the KEEP should be inundated by small businesses seeking to improve their terms to help them retain key staff. In reality, a very limited number of companies avail of the scheme. As you said during your presentation to the IIEA in May, the scheme is not working.

In our response to the Department of Finance consultation on the KEEP last month, we recommended six key reforms which would enable the scheme to achieve its policy objective.

These are:

- Develop an agreed 'safe harbour' approach to share valuation and impose an appropriate sanction where there is an undervalue.
- Further amend the definition of a "qualifying holding company" to permit the group as a whole to be considered, rather than simply considering the holding company in isolation.
- Create liquidity in KEEP shares by allowing a company to buy-back KEEP shares.
- Simplify the qualifying share option limits for the KEEP by removing the annual emoluments cap.
- Allow continuity of relief should the SME undergo a corporate reorganisation during the period in which the KEEP share option rights are outstanding.
- Provide for 'roll over relief' of KEEP share options in certain situations.

Employment Investment Incentive Scheme (EIIS)

Some welcome changes have been made to this scheme in recent Finance Acts but, like the R&D Tax Credit, it is complex and administratively burdensome for small companies. We have recommended further improvements to the EIIS, including:

- A carve-out from the connected party rule linked with a control test.
- A streamlined EIIS administrative process for small and micro companies.
- Removing the exclusion of holding company structures.
- Recognising additional exit strategies for EIIS investors.
- Committing appropriate and adequate resourcing to the administration of EIIS applications.
- Applying more proportionate monetary sanctions for administrative errors or the late filing of a return.
- Providing a 4-year holding period for all EIIS investments.
- Allowing the offset of capital losses.
- Broadening the scope of instruments through which start-up companies can raise funds using the EIIS by amending the definition of eligible shares so that it blends the characteristics of equity and loans.

CGT Rate

The tax that matters most to investors is Capital Gains Tax and our headline rate, at 33% is one of the highest in Europe.

Given the low level of CGT receipts in recent years – 2% of total Exchequer receipts in 2021 – it is reasonable to conclude that the current high rate is dampening transactions and growth in the SME sector. In our view, it is now time to re-examine this rate and our recommendation is that a rate of 25% should apply for active business assets.

Attracting Inward Investment

Ireland's rapid economic progress over the last three decades is largely due to its success in getting some of the world's largest and most productive companies to locate here. As a small open economy, inward investment will continue to be critical to the country.

But with the scope for tax competition set to narrow under new international tax rules on a global minimum effective rate, the Government must find other ways to make our tax system more attractive to foreign investment.

In that context, it is essential the R&D Tax Credit is considered a "qualified refundable tax credit" for the purposes of the OECD Pillar Two Model Rules.

Given the mobility of R&D investment, this credit should be continually benchmarked against key competitor jurisdictions. Other countries are enhancing their R&D offerings, Ireland needs to follow suit.

Simplifying Corporation Tax

Over recent years, the corporate tax code has become overly complex as a plethora of requirements have been bolted on to existing legislation to comply with EU Anti-Avoidance Directives and the OECD BEPS project.

A project to simplify the code would send a clear signal to outside investors that Ireland is a good place for business. The Institute set out detailed proposals for simplification in our Submission to the Commission on Taxation and Welfare.

Personal Tax

With the imminent introduction of a global minimum corporate tax rate, personal tax regimes and the cost of employment will become increasingly important factors in the investment decisions of international businesses.

This year, Irish taxpayers are paying personal tax at marginal rates of 48.5% on salaries above €36,800 and 52% on salaries above €70,044. Self-employed taxpayers are paying marginal rates of 55% on income above €100,000.

Amid increasing suggestions that PRSI rates may be increased, the Institute has warned in its Pre-Budget 2023 Submission that any such proposal must take account of the overall impact on the marginal tax rate and the cost for employers of employing people in Ireland.

The long-held position of the Institute is that all income earners should contribute to the Exchequer according to their means. We also believe that a broader mix of taxes would mitigate the current over reliance on economically regressive labour taxes and would make the system more robust in the event of economic shocks.

Conclusion

There are some excellent long standing Irish global companies, particularly in the food and drinks, and construction sectors. In recent years, significant strides have also been made in the med-tech, pharma and digital sectors with record levels of exports by Enterprise Ireland assisted companies in 2021.

Yet the productivity and innovation gap between multinational companies and indigenous SMEs remains an issue that has bedevilled Irish industrial policy for 40 years.

In 2021, more than 25,000 new businesses were registered in Ireland. The role of Government is to harness this entrepreneurial energy by creating a supportive environment that enables entrepreneurs to build strong businesses and create good jobs.

To achieve that, the Institute believes a shift to a more supportive mindset is required across all of Government at official and political level, that enables decision-makers to engage positively with business and to understand that risk is an integral part of any enterprise and that those who take it must be rewarded.

We would welcome the opportunity to discuss the matters raised in this submission with you or your officials.

Yours sincerely

Karen Frawley

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Institute President