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Mr Barry Cowen
Cathaoirleach
Select Committee on Budgetary Oversight
Leinster House
Dublin 2

By email: budgetscrutiny@oireachtas.ie

1 September 2023

Re: Pre-Budget 2024 Submission

Dear Cathaoirleach

Thank you for the invitation to share our recommendations for Budget 2024 and our views on the Government's strategy as outlined in the Summer Economic Statement (SES).

Summer Economic Statement

The Institute broadly agrees with the judicious balance the Government has struck between investing in public services and the imperative of keeping public finances on a sustainable footing in the current inflationary environment. While the 6.1% increase in core spending set out in the SES is a departure from the Government's medium-term public expenditure rules, the Statement does envisage a return to a more sustainable growth rate of 5% over the next two years, as inflationary pressure ease.

We welcome the decision to allocate an additional €2¼ billion from booming corporation tax receipts to boost the delivery of critical capital infrastructure projects over 2024 - 2026. Gaps in the country's public infrastructure negatively impact the Irish economy and its people and various indices of international competitiveness have consistently laid bare Ireland's poor performance in this important factor in attracting inward investment.

We also welcome the €1.1 billion tax package set out in the SES and the Government's stated intention to adjust income tax bands and credits so that pay increases awarded to workers are not eroded by higher income tax brackets. A commitment to protect the salary increases of income earners would strengthen the country's competitiveness and make Ireland an attractive proposition for international investors.

Institute Recommendations

The overarching theme of the Institute's recommendations for Budget 2024 is competitiveness. At a time of heightened uncertainty and a darkening global outlook, the Government must do all it can to strengthen competitiveness to protect and build on the progress that has been made in the Irish economy.

Over-reliance on the multinational sector is a top risk to the resilience of the Irish economy. The most sustainable strategy for mitigating that risk is to build an innovative, productive, and competitive indigenous sector. Tax has a central role to play in this endeavour.

SME Supports

The Institute believes that, despite some welcome amendments in recent years to the Employment Investment Incentive Scheme (EIIS), the Key Employee Engagement Programme (KEEP), the R&D Tax Credit and CGT Entrepreneurial Relief, these vital supports for Irish businesses are still not working as intended.

In our Pre-Finance Bill Submission to the Minster for Finance, we have set out in detail the legislative and administrative changes that we believe need to be made to each scheme. But there are three underlying issues common to all the measures that hamper their effectiveness in boosting productivity and innovation in the indigenous sector.

1. Administrative Complexity

   The administrative burden involved in the EIIS and the R&D Tax Credit is onerous and time consuming for small and micro businesses which should be the main beneficiaries of these supports. A streamlined application process would greatly increase the take up in this target sector.

   In the case of the R&D Tax Credit, the 'one size fits all approach', irrespective of the claimants' size, is a significant barrier for small business and startups. At a time when Ireland is falling behind in innovation, it makes no sense to make the accounting test under this critical tax credit so difficult. We believe simplified documentation requirements that would not be such a drain on resources would improve the uptake of the R&D Tax Credit and help to build badly needed innovative capacity in the Irish small and micro business sector.

2. Barriers to Development

   Each of the incentives is overly restrictive to a greater or lesser extent.

- Start-Up Relief for Entrepreneurs (SURE)is restricted to former PAYE workers. It is difficult to fathom why new business founders who were previously self-employed should not be able to benefit from this refund.

- The EIIS does not allow the offset of capital losses and only allows investors to exit by way of a share redemption or a trade sale. Despite amendments in last year's Finance Act, the connected party rules continue to curtail investment by non-executive board members and key employees who can play an important part in the development of early-stage companies.

- Under the R&D Tax Credit, rent qualifies as an allowable expenditure only in the case of specialised premises such as a laboratory or clean room. The idea that R&D work can be carried out at a desk in an office is not countenanced, suggesting a narrow understanding of the nature of R&D undertaken in a technology-driven world.

- The requirement under CGT Entrepreneur Relief that an investor must spend at least 50% of their time over 3 years working for the company in which they invest, effectively rules out angel or venture capital investors for SMEs at a time when startups are crying out for funding.

- In the current spate of redundancies in the multinational tech sector, it is unfortunate that the limitations of the KEEP acts as a barrier, rather than an enabler for small companies, seeking to recruit talented workers who might have an appetite to join the indigenous tech sector.

3. <u>Out of Step with the Start-up Economy</u>

Requirements relating to company structures loom large in the difficulties experienced by companies seeking to avail of the SME reliefs. The problem is that the measures are out of step with how enterprises evolve and develop in a modern start-up economy. Founder holding companies are common in start-ups and can evolve out of a variety of commercial arrangements such as partnerships or joint ventures arising from incubator programmes. In some cases, the structure can be a legacy from a previous failed venture.

While this commercial reality is recognised and accepted by Enterprise Ireland and other arms of Government that provide funding to SMEs and start-ups, holding companies are excluded from availing of the EIIS, whose express purpose is to help start-ups and small businesses to raise investment. At the very least, there needs to be a joined-up approach across Government on eligibility criteria for funding and tax measures for the SME sector.

In this context, the Institute strongly agrees with the recommendation of the Commission on Taxation and Welfare that Revenue, the Department of Enterprise, Trade and Employment and Enterprise Ireland should develop a mechanism which provides an assurance to small enterprises that they are eligible for tax incentives like the EIIS, KEEP and the R&D Tax Credit.

Foreign Direct Investment

Building productivity and innovation in the indigenous sector is critical to the resilience of the Irish economy. But attracting investment from abroad will remain a key objective of Ireland's strategy as an advanced small economy.

Over the last 20 years, Ireland's low corporation tax rate has been a unique selling point. Now that is to be replaced from 1 January 2024, by the 15% global effective minimum rate for the large multinational sector, the competitiveness of other parts of the tax code will fall under the spotlight of prospective investors.

The Government's immediate priority must be to retain the multinational businesses that are well embedded in the economy. That requires, at a minimum, that the corporation tax code is aligned with other EU Member States and in one significant respect, it is very much out of step.

A Territorial System of Taxation

Ireland is now the only EU member state that does not have a territorial system of taxation which allows a participation exemption for foreign dividends. This means that the foreign earnings of multinational companies based in the State must be assessed by Revenue for tax purposes. While the tax yield from this exercise is negligible due to the availability of foreign tax credits, the rules are complex and administratively burdensome for the affected companies.

The Institute is aware that competitor countries are drawing attention to this gap in the country's corporation tax offering as they seek to woo large multinational businesses. To ensure Ireland remains a compelling location for these businesses, it is essential that at the very minimum, the Government introduces a participation exemption for foreign dividends in tandem with the implementation of the Pillar Two Minimum Tax Directive in the forthcoming Finance Bill.

We have outlined in detail in our Pre-Finance Bill Submission, the key elements of a participation exemption which we believe are necessary to safeguard Ireland's reputation as a good location for business.

Tax Simplification

Over the last decade, the proliferation of anti-avoidance measures arising from the OECD BEPS Project and the EU Anti-Tax Avoidance Directives have added complexity to tax systems and increased the administrative burden for business across the EU. Achim Pross, Deputy Director of the OECD's Centre for Tax Policy and Administration has recently acknowledged the duplication that has occurred as tax rules have evolved and suggested that countries could do a "spring clean" of anti-avoidance rules to "declutter" their regimes.

The Institute heartily agrees and in our Pre-Finance Bill Submission, we have set out in detail how we believe the current interest deductibility regime, one of the most onerous in the EU, could be reformed to bring it into line with what is on offer to taxpayers in other European countries.

Complex and burdensome rules can hinder trade and investment and breed distrust among taxpayers. A strong focus on tax simplification and reducing compliance complexity would greatly enhance Ireland's ability to offer tax certainty and consistency to both domestic and multinational businesses, thereby boosting its competitiveness. Appropriate resources should be allocated to the Revenue Commissioners to undertake this simplification project.

Incentivising Sustainability

The imperatives of climate action have moved sustainability to the top of the agenda for multinational companies while, new rules requiring Irish SMEs to account for their environmental and social impact come into effect next year. Robust climate action policies, including supports for green initiatives, have become key considerations for investors. Many jurisdictions are using tax incentives to support businesses in reducing their carbon emissions and to attract investment in green enterprises.

In the Institute's view, Ireland's current offering needs to be more competitive.
The changes we recommend are listed in our Pre-Finance Bill Submission. They include broadening the scope of the existing Accelerated Capital Allowance for Energy Efficient Equipment to cover new product categories and whole buildings with accreditation for overall energy performance and amending enterprise tax measures such as the EIIS to support green energy projects.

Reform of PRSI

The extraordinarily complicated PRSI system is in urgent need of reform. In our view, the PRSI base should be aligned over a phased period and ultimately merged with the USC as a social charge.

Consideration should be given to capping the level of earnings to which PRSI would be applied in the overall determination of a merged rate. In the meantime, any move by Government to increase PRSI must factor in the overall impact on the marginal tax rate and on the cost for employers of employing people in Ireland.

Fairness and Equity

The Commission on Taxation and Welfare has said in its report that the 3% USC surcharge, which applies to self-employed income over €100,000, does not comply with the principle of horizontal equity and should be removed.

Conclusion

Tax policy is only one measure of competitiveness, but it is an important one. Few business decisions are taken without regard to their tax implications, and, unlike many other factors affecting the Irish economy, the Government has the power to change it. A clear, simple and competitive system of tax will go a long way to protect and grow the success of the modern Irish economy.

Yours sincerely

Colm Browne
Institute President