Tax and Entrepreneurship Review

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1. Executive Summary

The Department of Finance launched a public consultation on 2nd June setting out key questions to inform its review of Tax and Entrepreneurship. The Government, in its Spring Economic Statement, set out its ambition to have 2.155 million people in employment by 2020. Realising this ambition will be best achieved by a policy focused on enterprise and entrepreneurship. The Department of Jobs, Enterprise and Innovation launched the National Statement for Entrepreneurship in 2014 and will shortly publish an overarching enterprise policy to set the framework and ambition for sustainable growth over the next decade.

It is entrepreneurs who take risks, start and grow businesses and create jobs. Government policy can strongly influence our chances of realising our ambition by focusing investments on the productive sector and by redressing barriers to entrepreneurship and business formation. There is a strong interplay between the tax environment and the funding environment, and access to finance is crucial for enterprises across all stages of their growth lifecycle. The tax environment can influence an individual's decision in whether or not to establish a business in the first instance and in what jurisdiction to locate a business. A competitive tax code plays a key role in the attraction of skills and talent for enterprise and in influencing an investor's decisions based on risk/reward factors.

Entrepreneurs today are increasingly mobile. We need to ensure that Ireland continues to provide a competitive environment so that entrepreneurs will choose to establish and grow from here (accepting that considerations relating to end markets, proximity to customers etc., also play a role in business location decisions). In more recent years, entrepreneurs and enterprise stakeholders have highlighted that Ireland's tax regime is no longer competitive vis a vis the UK. We have included a comparison between the two jurisdictions, which has served to inform our submission. Of particular note is the fact that the CGT entrepreneurial relief reduces the SME investment risk across the entrepreneurial ecosystem.

This submission by the Department of Jobs, Enterprise and Investment draws together inputs from Enterprise Ireland, IDA Ireland and is comprehensive. It has been structured to answer the specific questions raised in the consultation document and therefore encompasses a broad range of measures.

The executive summary highlights those aspects that are deemed a priority in the context of Budget 2016, in order to redress barriers and to stimulate greater levels of entrepreneurial activity, job creation and growth. The main areas of focus relate to recommended changes in aspects of Capital Gains Tax and Income Tax regimes with the aim of presenting a comprehensive and connected tax System that: incentivises entrepreneurs to start and grow a business; encourages investment into businesses; helps our businesses to attract and retain talent and that better recognises the risk/reward dynamic that influences individuals' choices.

Our submission also notes that a number of aspects of the existing regime are working well, are supportive of entrepreneurship and should be retained. In some instances there may be a longer time-frame required to deliver to desired outcomes (e.g. where a road-map setting out objectives and time-lines is desirable). Overall, there needs to be ongoing and regular review of measures in the context of Ireland's relative competitiveness with other jurisdictions in the context of a changing external environment, including measures such as R&D Tax Credit, SURE, USC etc.

Priority areas

Capital Gains Tax

Investment and reinvestment of capital are critical to enterprise development. Following increases in recent years, Ireland's CGT rate now stands at a relatively high rate of 33 percent, without any indexation to allow for the effects of inflation. We propose that a review of the CGT rate is required with the view to delivering a significant reduction in the general CGT rate.

In the immediate term, and as a priority, a specific focus is required to redress our loss of competitiveness vis a vis the UK (in particular), and to incentivise greater investment in business formation and growth:

- In terms of Ireland's **CGT Entrepreneur's relief** we recommend that a 10 percent CGT rate be applied on business gains up to a lifetime limit of €15 million. We also recommend that the relief by available on all gains; that the investment window be extended to up between three to five years; and that the working director hours be reduced.
- That investors benefit from a 10 percent CGT rate on gains realised on **Employment and Investment Incentive** (EII) shares. We also recommend that the 40 percent income tax relief available on initial investment be reinstated to enable a wider cohort of SMEs to be attractive to investors.

An SME Share Option scheme to draw talent into SMEs to deliver their potential

We recommend the introduction of a specific share option scheme for SMEs. The objective would be to simplify the mechanism to enable smaller and higher risk growth companies to recruit and retain the qualified key employees they need to achieve their growth potential. The key elements of the scheme would involve no income tax on grant and/or exercise of options, a favourable CGT rate applying on any gain arising on disposal, and that the scheme would incorporate a cap for both the employee and the company.

Incentivising Talent

In the context of the global competition for scarce skills, our desire to attract back the many skilled Irish that have gained valuable experience overseas, as well as the particular challenges facing SMEs, we recommend the introduction of a **Talent for Ireland Scheme**. The objective of the scheme is to assist Irish based SMEs and research centres to attract skilled labour from abroad to come and work in Ireland and/or to attract Irish nationals to return following a defined period overseas. We recommend the introduction of an internationally competitive flat rate of tax of approximately 30 percent (income tax and universal social charge) to position Ireland in the top 4-5 countries and which would be easily communicated. The incentive should be aimed at addressing key skills deficits and tailored to meet the needs of SMEs in particular.

Income tax

A competitive income tax regime is essential in attracting and retaining people to work in Ireland, and more generally to encourage people to remain in, or return to, the labour market. Building on the positive changes in Budget 2015, coupled with the improving economic conditions, we recommend that the entry point to the top marginal income tax rate should be increased and that the maximum personal tax rates (income tax, universal social charge and PRSI) should continue to be lowered to 50 percent.

In addition, we recommend that the tax system be better aligned with the important contribution of entrepreneurial risk takers to job creation and economic growth. A roadmap is required that sets out the route to delivering on parity of treatment between self-employed tax payers and PAYE tax payers through the removal of the additional 3 percent USC on self-employed and other measures to mitigate the disparity of the self-employed not having a PAYE tax credit.

Knowledge Development Box

Delivering on our ‘best in class’ commitment for the **Knowledge Development Box** (KDB) intellectual property (IP) regime to attract substance is as important for entrepreneurs and SMEs as it is for larger enterprises. Smaller Irish owned enterprises in particular face specific challenges in relation to IP and it is important that these are considered as the KDB legislation is introduced and that the process is administratively simple and accessible. Considerations include, for example, the scope of the qualifying definition; considering the interaction of KDB with CGT entrepreneurial and retirement relief; and approach for loss making companies.

Corporation Tax

Finally, maintaining and enhancing our international tax competitiveness Ireland operates in a global environment, and the relative competitiveness of our tax offering needs continuous review and enhancement. Ireland needs to **continue to provide certainty, predictability and clear signals** to enterprise in relation to the taxation of corporate income and in this regard, our commitment to the 12.5 percent corporation tax rate on trading income remains essential.

Conclusion

There are a number of factors that influence business decisions and whether or not to start a business in the first instance. The tax environment is an essential and important element of a favourable business ecosystem and plays a key role in stimulating entrepreneurship and business growth.

We welcome the Department of Finance’s consultation as it is timely to review the full spectrum of Ireland’s offering and to make the amendments necessary to ensure that Ireland remains competitive as a location of choice to start, grow and scale a business.

We are aware that tax and entrepreneurship spans a broad agenda and we have provided commentary on a number of instruments overall, while prioritising those aspects that we consider most pertinent in terms of enhancing our competitive offering in the immediate term.

The interplay between these distinct incentives is also important, ensuring that they operate as a coherent system, influence behaviours and redress market failures. The ongoing work within OECD is informative in this regard, and provides a useful framework to assess the influence of taxation on economic margins faced by SME owners.

2. Background and Introduction

The Department of Finance launched a public consultation on 2nd June setting out key questions to inform its review of Tax and Entrepreneurship. This submission has been structured to answer the specific questions raised and as such some thematic areas (such as CGT) are reflected in different sections of the response. In more recent years, entrepreneurs and enterprise stakeholders have highlighted that Ireland's tax regime is no longer competitive vis a vis the UK (and including Northern Ireland)[1]. We have included a review of the comparisons between the two jurisdictions, which has served to inform our submission.

The Spring Economic Statement has set out a forecast that envisages having 2.155 million people in work by 2020. New businesses are a critical element of any economy's growth. New businesses create jobs. New businesses are the source of new ideas, new technologies, new and disruptive business models and sectors. New businesses drive change, innovation and competitiveness. It is people - entrepreneurs - who create new businesses. A National Policy Statement on Entrepreneurship in Ireland was published in 2014, reinforcing the significance of entrepreneurship as an integral part of Ireland's overall enterprise policy.

Historically, two thirds of new jobs in Ireland have been created by companies in their first five years[2]. Over the recessionary period there was a decline in enterprise births in Ireland (a key indicator of entrepreneurship) from levels of circa 17,000 in 2006 to levels of 12,500 in 2012[3]. Although some of the recovery in more recent years is characterised by high 'necessity driven'[4] entrepreneurship, there is an encouraging upturn in the number of people indicating they want to start a business within the next three years (up over 80 percent). The rate of early stage entrepreneurs[5] increased to 269,000 in 2013 and Ireland is now ranked 11th among the OECD countries, 9th of the EU-28 countries and 2nd of the EU-15 countries.

Finance is the lifeblood of every business. It is needed at every stage of the business development lifecycle from the start-up phase through to growth and expansion. If Irish companies are to grow and compete in international markets, we need to develop a strong equity culture and access to equity as part of a broader mix of financing options overall. The interlinkages between the funding environment and the tax code are key and we need to ensure that Ireland has an internationally competitive tax regime that promotes entrepreneurship, investment in Irish companies and managed risk taking.

[1] DJEI consults on an ongoing basis with enterprise including through a number of industry fora,e.g. The Entrepreneurship Forum, the Advisory Group on Small Business and the Retail Forum

2 Research published by the Central Bank of Ireland in 2013 concludes that 67 percent of new job creation comes from companies within their first five years. Research from the Kaufmann Institute in the United States also indicates that new and young businesses are the primary drivers of net job creation

3 In 2006 enterprise births amounted to 16,969, and were 12,551 in 2012, representing an increase of 6 percent over the previous year. Source Business Demography, 2012, CSO Statbank (latest available data)

4 Necessity entrepreneurship refers to people seeking to start a business because they have reduced alternative employment options

5 Total early stage entrepreneurs include nascent entrepreneurs and new business owners. Nascent entrepreneurs are those actively planning a new venture, Global Entrepreneurship Monitor Report (GEM) for Ireland 2012

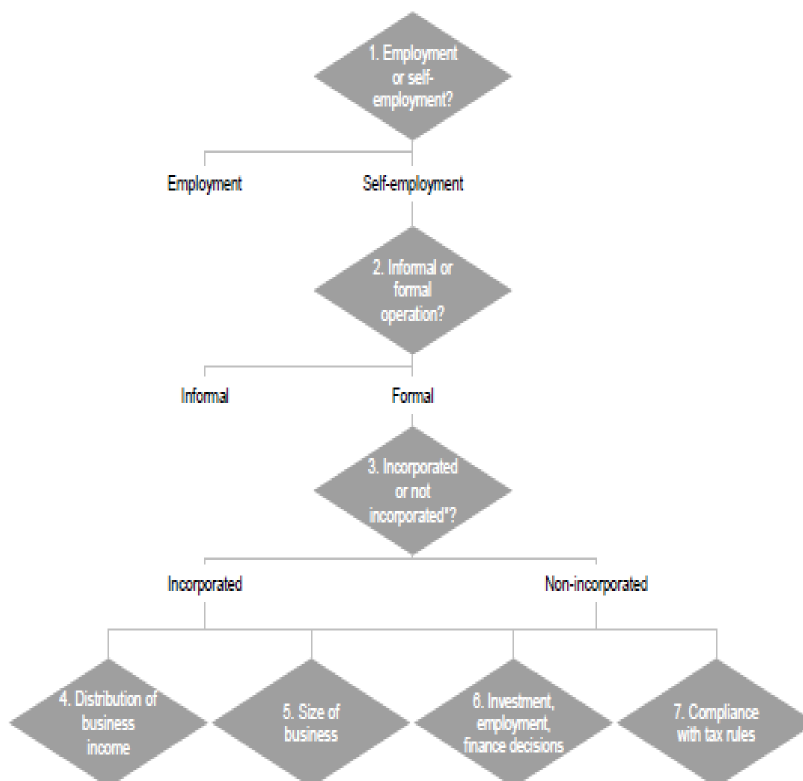
3. International Context

As a small open economy, and given that entrepreneurs are increasingly mobile, it is important that we have regard to the international context and to Ireland's relative competitiveness and attractiveness for entrepreneurs and business investment. This sections sets out an international policy framework and demonstrates the way in which tax instruments can influence decision making and/or influence business decisions. We provide a high level overview of capital gains tax, income tax and corporation tax before looking at specific interventions in sections 4 and 5 of the submission. An analysis was also undertaken to review the UK's entrepreneurial tax environment in comparison to Ireland's offering.

3.1 International tax policy framework

In an ideal world, a tax system should be neutral regarding its impact on business decisions, including the creation, form and growth of SMEs. Having said that, a tax system is important in terms of addressing market failures and/or influencing behaviours of individuals. OECD research[6] finds that tax systems in other countries often provide incentives to incorporate and to distribute income in the form of capital. Certain features of the tax system may also disadvantage SMEs relative to larger enterprise; e.g. asymmetric treatment of profit and losses, a bias towards debt equity and higher fixed costs associated with regulatory and tax compliance. The reality is that tax can, and does play a role in influencing the decisions of business owners as set out in Figure 1.

Figure 1 Summary of influence of taxation on economic margins faced by SME owners



Source: Unpublished OECD (July 2015), 'Taxation of SMEs – Draft OECD Tax policy'

6 OCED (2015), 'Taxation of SMEs: Draft OECD Tax Policy Study' (8th July 2015), page 3.

The decision of whether to opt for self-employment in an unincorporated entity (as distinct from being in employment) can be influenced by the changes in the level of social security contributions, ability to influence labour income, deductibility of expenses and any tax incentives targeting the self-employed.

The decision on whether to incorporate or not can be influenced by a range of factors. For example, the taxation of corporation profits at a low rate, compared to the top personal income tax rate, combined with the ability to defer shareholder taxation of profits, tends to increase the relative attractiveness of incorporation for profitable SMEs. When considering the distribution of income, there is a tax incentive to distribute in the form of capital gains, which is often taxed at considerably lower combined statutory rates, even before SME exemptions and reductions.

The taxation of income is most relevant to the decisions in 1, 3, 4, 5 and 6. We know that today entrepreneurs are mobile and that their location decisions are based on a number of factors, including the income tax regime.

The OECD framework illustrates the entrepreneur's journey and decision making processes (including decision as to whether or not to incorporate) which can in turn, inform the identification and targeting of appropriate measures to particular cohorts.

We recommend:

- Using the OECD methodology to compare the taxation of income, by unincorporated and incorporated business, to inform policy discussion and decision making.

The Department of Finance's public consultation is timely in the context of the ongoing update by the OECD of 'Taxation of SMEs' (2009)[7] expected to be completed before the September 2015 meeting of the G20 Finance Ministers. Active participation by Ireland would be of benefit in terms of international benchmarking and perspectives across our full suite of SME tax policy measures.

We recommend:

- Prioritising the active participation in the OECD update of 'Taxation of SMEs' (2009) by Irish delegates(s), in consultation with enterprise colleagues.

3.2 Capital Gains Tax (CGT) and the influence on business decisions

Tax on gains

The OECD[8] outlined the importance of capital gains tax for entrepreneurship stating: "Capital gains taxes affect the level of profits retained by individuals and enterprises and can influence risk-taking activity by entrepreneurs and investments by small firms. A substantial part of entrepreneurial or self-employed income may be reinvested in the firm and subject to capital gains tax (when the business is sold) rather than personal income tax. High rates of capital gains tax can increase the bias against savings and investment with negative effects on the supply of capital for entrepreneurs and start-ups. Capital gains tax treatment should also be assessed in relation to tax treatment of dividends. Differential rates can lead

7 Working Party No. 2 on Tax Policy Analysis and Tax and the OECD Committee on Fiscal Affairs.

8 OECD (2002), 'Entrepreneurship and Growth: Tax Issues', page 12.

taxpayers to realise earnings in the form (gains vs. dividends) which is taxed more favourably; anti-avoidance rules may be needed where the rates diverge significantly”.

The general conclusion from economic research highlights that capital gains taxation has been found to impede entrepreneurship[9&10]. This happens through a number of mechanisms[11]. Higher rates of capital gains taxes:

- Reduce incentives to invest and attract talent. For cash flow poor businesses, capital gains taxes have an impact negatively upon the ability of entrepreneurs to attract key managers from other sectors by offering potential in the growth of the business rather than salary.
- Reduce innovation and risk taking. The asymmetric taxation of capital gains and losses (in which gains are taxed more heavily than losses) may be an especially important issue for entrepreneurs. The lack of diversification of many entrepreneurs (i.e. fully focused on a single project) means that the capital gains tax may create a form of asymmetric ‘success tax’ in which the State taxes the upside returns to investment but does not share symmetrically in projects that fail.
- Creates an incentive for owners’ of capital to hold on to their current investments, even if more profitable and productive investment opportunities are available (capital locked in)[12.]
- Increase the cost of capital for entrepreneurs. Faced with higher capital gains taxes, shareholders in publicly-traded firms may require a higher hurdle rate of return for investments. This same affect applies to private firms. However, if an entrepreneur relies more heavily on financing sources which are subject to capital gains tax (i.e. equity provided by taxable investors as opposed to debt), then these effects can be relatively more important for entrepreneurial firms than for established firms. It is also more likely to affect services businesses that generally have more difficulty in accessing debt finance.
- Finally, capital gains taxation also affects the demand for venture capital[13].

Ireland has the third highest rate of capital gains tax in the OECD at 33 percent (8th highest rate in 2011), which has increased by over 65 percent in less than 5 years from 20 percent in 2009.

Assessing the capital gains tax treatment in relation to the taxation of dividends, Ireland has a high level of capital gains tax on shares and dividends as at 1 July 2012 when the rate was 25 percent, refer to figure 2. The CGT rate has since increased twice, to 30 per cent finance Act 2012 and to current 33 per cent in Finance Act 2013. The data underpinning this figure relates to the maximum rates, excluding any of the reliefs available.

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9 Poterba, J., 1989, Capital Gains Tax Policy Toward Entrepreneurship, National Tax Journal, 42(3), 375-389.

10 Keuschnigg, C. & S. B. Nielsen, 2002, Tax policy, venture capital, and entrepreneurship, Journal of Public Economics, 87, 175-203. / Keuschnigg, C. & S. B. Nielsen, 2004, Start-ups, venture capitalists, and the capital gains tax, Journal of Public Economics, 88, 1011-1042.

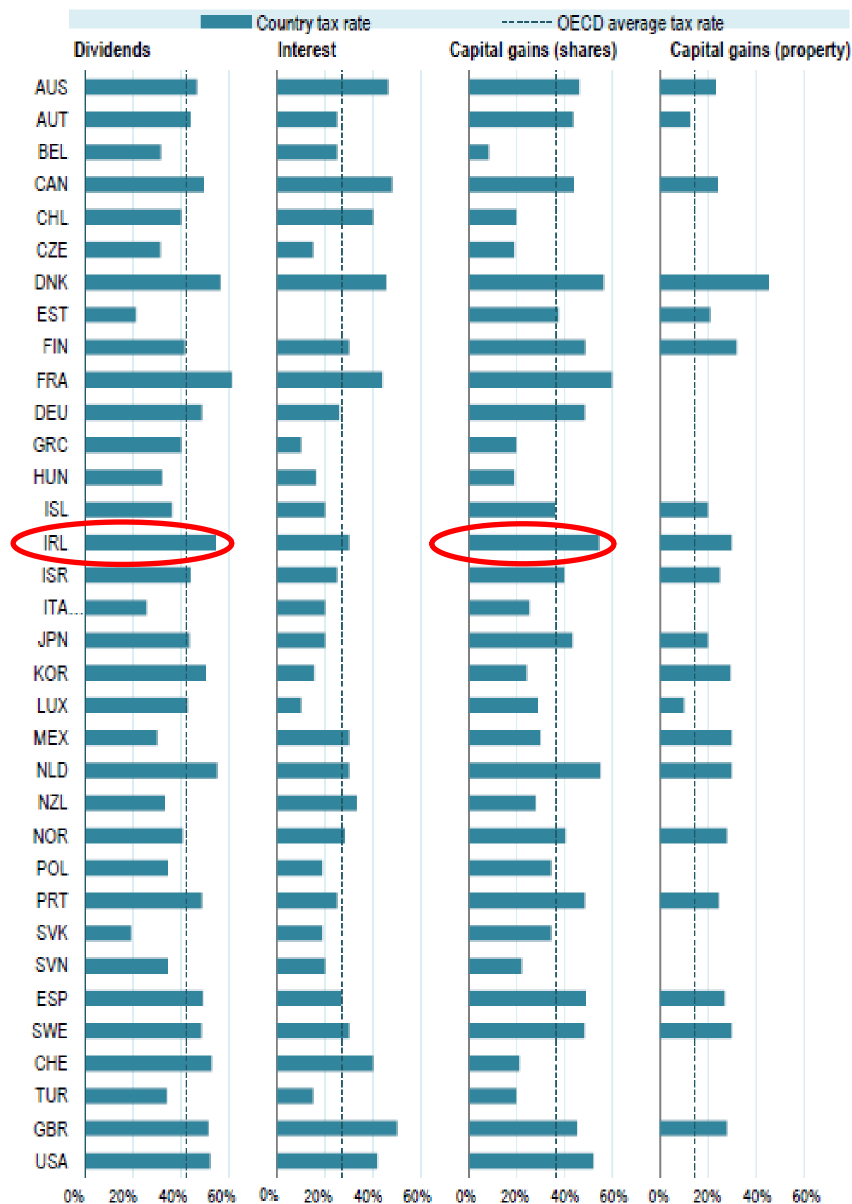
11 Capital Gains Taxation and Entrepreneurship, William M. Gentry, Ph.D., Professor of Economics, Williams College, November 2010, http://www.accf.org/wp-content/uploads/2012/02/capGainsTaxation.pdfl

12 Chari et al argue that entrepreneurs and venture capitalists may hold on to their investments for too long because of the inability to find investments that compensate them for taxes paid. They conclude that potentially more profitable projects go unfunded because entrepreneurs lock-in their capital in current projects. Chari, Golosov, and Tsyvinski also emphasize that some individuals have a comparative advantage in creating new businesses. However, once the business has been established, economic efficiency is enhanced by the entrepreneur selling the firm to professional managers and potentially starting another new business (i.e. it impedes serial entrepreneurship) Chari, V.V., Mikhail Golosov, and AlehTsyvinski. 2005. “Business Start-ups, the Lock-in Effect, and Capital Gains Taxation.” Unpublished manuscript, Harvard University.

13 Gompers P, Lerner J. What drives venture capital fundraising? Brookings Papers on Economic Activity—Microeconomics 1998; 1998:149-192.

The EY G20 Entrepreneurial Barometer Report 2013 highlights that many countries, including Canada, Australia, Japan and the UK, have put in place capital gains tax deductions to ensure that entrepreneurs are not excessively penalised on sale or exit. For example, the UK's CGT Entrepreneur's Relief makes the gains made on the disposal of a business or shares in the company liable at 10 percent, while Australia provides capital gains concessions to small businesses, such as the ability to discount a capital gain by 50 percent. In Canada, the taxable portion of capital gains and the deductible portion of capital losses is 50 percent. In addition, in the United States, capital gains on assets held for more than 12 months are taxed at a maximum rate of 20 percent (compared to the income tax rate of 39.6 percent)[14]. Each of these measures is designed to drive investment into important areas for the economic growth and to ensure that entrepreneurs make more money that can be reinvested or saved.

Figure 2: Combined statutory tax rates on interest, dividends and capital gains (1 July 2012).



Source: OECD (2013),Taxation of Dividend, Interest and Capital Gains Income – Working Papers

14 Irish Venture Capital Association (2014), 'IVCA Pre-Budget Submission 2015'

In Ireland, up until the introduction of the CGT entrepreneur's relief, CGT incentivisation focused on latter stages of the entrepreneurial lifecycle (over 55 years) and on property reliefs[15].

UK GGT Relief - analysis

Given the impact of the UK CGT Entrepreneur's relief on competitiveness, we have considered its take-up and estimated cost. HM Revenue & Customs provided an estimated cost for Entrepreneurs relief of £2,700 million in 2013/14 and £3,000 million in 2014/15. The trend in the estimated cost is illustrated in figure 4, noting that the increase in 2010/2011 was driven by an increase in the standard CGT rate from 18 percent to 28 percent. The level of disposals that have benefited from the relief is illustrated in figure 3. HM Treasury has confirmed that no evaluation on the UK Entrepreneur's Relief has been published.

Figure 3: UK's Entrepreneurs' Relief - take up

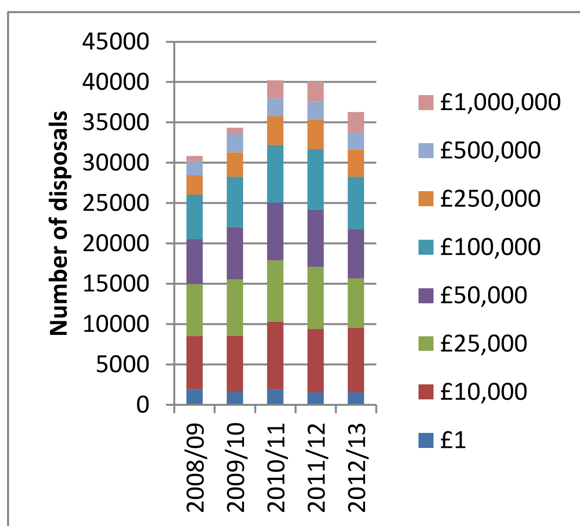
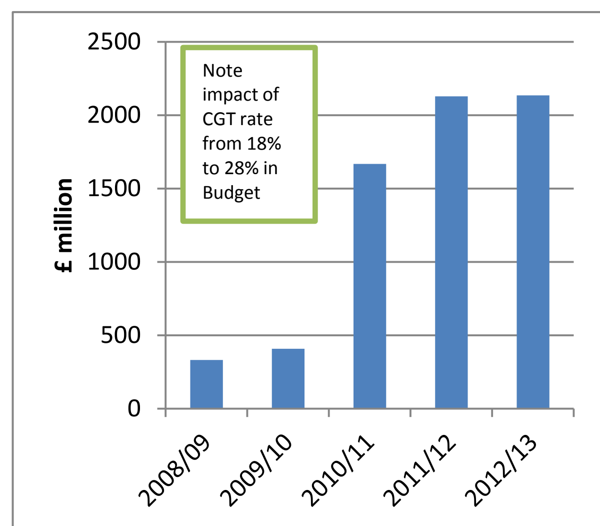


Figure 4: CGT Entrepreneurs' Relief - Cost (£m)



Source: HMRC (2015) published statistics with figure 3 based on DJEI calculations. The information in the figures is an approximation[16] to provide an insight into the trend in the estimated cost and what level of disposal is benefiting from this relief.

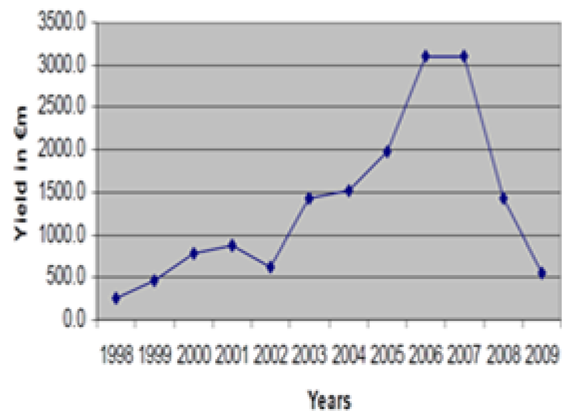
Ireland's CGT yield

Focusing on the potential policy options, there is strong evidence in the Irish experience that the CGT yield to the Exchequer falls when the CGT rates are perceived to be too high. The CGT yield actually fell by €48 million in 2013, despite the increase in the rate from 30 to 33 percent.

15 Ireland's targeting of relief at retirement stage is not unique. Australia has measures targeting this stage of the lifecycle - Australian Government (2015), 'Re:think - Tax discussion paper'.

16 Caveat: HMRC has confirmed that while the method of estimating the cost of ER from the national statistics tables is valid and provides a good estimate for those years, but it doesn't take claimed reliefs into account, therefore is only an approximation.

Figure 5: Irish GCT Yield 1998-2009



Source: Department of Finance (2011), Tax Strategy Group - Capital and Savings Taxation Issues [TSG 10/05], page 3.

The significant rate reduction in 1998 from 40 percent to 20 percent (other than for offshore funds and foreign life policies) resulted in a significant increase in the CGT yield prior to the property boom, refer to figure 5. While the drop in the CGT yield at the onset of the crisis can be attributed to declining asset values and a reduction in the number of property and share transactions. Given the recent recovery in asset values and economic sentiment, the estimates for 2015 CGT yield of €415 million (+4.3 percent year-on-year)[17] may indicate that a significant cut in the rate could increase the volume of transactions to deliver a greater yield to the Exchequer. If economic conditions and behavioural response triggered an increase in revenue of pre-boom levels, this may help to mitigate future budgetary downside risks and expenditure risks driven by aging demographics.

Our preferred policy option is for a significant reduction to the general CGT rate is outlined below. A number of policy options exist, including re-introduction of indexation (inflation) relief, re-introduction of multiple rates based on length or ownership of asset and introduction of a targeted reduced CGT rate for business investment.

We recommend:

- Our preferred option for capital gains tax reform is a significant reduction in the general CGT rate to around 20 percent. While the re-introduction of indexation or a target rate could provide similar benefits, it would be more complex.

3.3 Income tax and international competitiveness

Entrepreneurs make informed decisions based on a number of factors, including the income tax regime. In this context we need to ensure that Ireland's relative competitiveness is benchmarked on the right metric. There is a wide spectrum of business income for entrepreneurs and different entry levels to the top rate of income tax. When comparing Ireland's offering international, the average personal statutory tax rate across income levels is more appropriate as it more accurately reflects the level of taxation that entrepreneurs will face.

Almost all countries entry into the top income tax rate is above the average wage, with Ireland, Czech Republic, Estonia and Hungary the exceptions. Ireland has a high personal tax rate (excluding social security contributions) that is above the OECD average across all income levels, with Ireland 10 percentage points above the OECD average at all income levels from two to five times the average wage.

17 Department of Finance (2014), Budget 2015 - Economic and Fiscal Outlook, page C-19, Table 10.

Table 1 **Average personal tax rates (excl. social security contributions) at different levels of average wage income, 2014.**

	Average Wage (AW) € rounded	AW1	AW2	AW3	AW4	AW5
Ireland	34,000	16	32	37	40	42
UK	44,000	14	25	32	36	37
US	38,000	17	24	28	30	32
Germany	46,000	19	30	35	37	39
France	37,000	15	22	26	30	33
Netherlands	49,000	16	32	38	41	43
Unweighted OECD Mean	33,000	14	21	25	28	30

Source: Unpublished OECD (2015), *'Taxation of SMEs: Draft OECD Tax Policy Study' (8th July 2015)*, Table 4 and 5 on pages 27-30. Calculations based on Taxing Wages (OECD 2014) for a single taxpayer with no children.

Ireland's performance in terms of income taxes is generally competitive. Ireland has one of the highest entry points to the core income tax system. On the other hand, the level at which individuals start paying the higher rate of tax (€33,800 for single individuals) is very low relative to other countries. The higher rate of tax impacts on individuals earning less than the average wage of €36,626 in Q4 2014[18]. This means that marginal rates (i.e. the tax paid on an individual's last euro of income) are in excess of 50 percent for single individuals earning €33,800 per annum.

However, in 2014, the difference between the employers' cost of hiring an individual and the individual's actual take-home pay increased in two thirds of the OECD countries with Ireland having the largest increase due to a higher proportion of earnings being subject to tax[19]. The difference is wider for higher paid workers in Ireland. While positive in terms of progressivity[20], this is of concern as Ireland competes internationally for higher paid mobile talent.

Mirroring the OECD hierarchy of taxation, economic growth would be boosted by lowering the burden of taxation on labour - in particular, marginal tax rates. Over time, this could be achieved by moving the entry point to the top marginal rate up from the average wage and/or from reducing the top marginal tax rate. The Revenue Commissioners estimate that a one percentage point reduction in the 40 per cent

18 CSO Earnings and Labour Costs: Employment, Hours and Earnings by Type of Employee, Statistic, Industry Sector NACE Rev 2 and Quarter

19 OECD (2015), Taxing Wages 2014, executive summary.

20 OECD (2015), Taxing Wages 2014. The Irish income tax system is second most progressive in the OECD, as measured by comparing the ratio of the tax wedge of a single individual at 166 per cent of the average wage with an individual at 66 per cent of the average wage.

income tax rate would cost €226m in a full year[21]. Increasing the tax take from consumption (i.e. VAT) and/or property to offset potential revenue losses arising in line with the OECD hierarchy of taxation would still produce positive economic gains.

We recommend:

- Building on the positive changes in Budget 2015 the entry point to the top marginal rate should be increased and the personal tax rate (income tax, USC and PRSI) should continue to be lowered to 50 percent in Budget 2016 and brought below 50 percent thereafter.

3.4 Corporate tax influencing behaviours

Corporate tax rates can influence the choice of legal structure selected by an entrepreneur. Corporate tax rates which are below top marginal personal income tax rates, together with provisions for deferral of personal taxation through reinvestment of profits, can provide incentives for the self-employed to incorporate their profitable businesses[22].

Ireland offers its 12.5 percent corporate tax rate on trading income to all companies, at all levels of scale. This is a very competitive offering and compares well against the SME specific rates in other countries are considered.

A wide gap between the corporation tax rate and the personal rate can lead to change of behaviour and an increase in incorporation. This is the rationale for certain anti-avoidance and anti-fragmentation legislation, such as the Irish close company provisions.

When the UK had SME corporate rates[23] which resulted in a widening of the gap between income tax and corporation tax[24], there was a significant increase in businesses incorporating for tax reasons. As the corporation tax rate in the UK decreases and the gap with income tax continues to increase, there is speculation that some form of close company provision will be re-introduced in the UK to protect the tax base.

We recommend:

- Continuation of Ireland's commitment to maintaining the current 12.5 percent corporation tax regime for all companies and keeping anti-avoidance legislation under review to ensure no unforeseen consequences.

21Ready Reckoner - Post Budget 2015, Prepared by Statistics & Economic Research Branch, Revenue Commissioners, November 2014.

22 OECD (2000), 'Entrepreneurship and Growth: Tax Issues', pages 8-9.

23 10 percent in 2000/01, nil from 2002/03 – 2004/05.

24 And following the abolition of close company apportionment in 1989.

3.5 UK comparison

As a result of the UK tax reform that aims to make the *"UK to be the best place in Europe to start, finance and grow a business"* it is now perceived as being more 'entrepreneur friendly' than Ireland in terms of its tax system. The UK offers Irish entrepreneurs a 'home from home' with a bigger market close to one of the financial capitals of the world. Entrepreneurs are increasingly mobile and we cannot assume that Irish entrepreneurs will choose to set up and trade from Ireland. It is important that we disentangle perception from reality, so it is timely to review the full spectrum of Ireland's offering and to make any amendments necessary to ensure that Ireland remains relatively competitive and that we do not inadvertently compromise the Irish entrepreneurial ecosystem that has been built up over many years.

A comparison of the UK tax system demonstrates that its impact on the risk/reward levels is significantly more favourable than is the case in Ireland. CGT spans across the entrepreneurial ecosystem in the UK (encompassing the entrepreneur, the investor and the key employee) and there is a range of complementary reliefs to stimulate investment and business formation (refer to Table 2 and Figure 6).

The schemes targeting investors in the UK differ from the Irish scheme as they provide a range of tax incentives, while the Irish Employment and Investment Incentive (EII) provides an income tax incentive only.

The Enterprise Investment Scheme (EIS) is designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

The Seed Enterprise Investment Scheme (SEIS) is designed to help small, early-stage companies raise equity finance by offering tax reliefs to individual investors who purchase new shares in those companies. It complements the existing Enterprise Investment Scheme (EIS) which offers tax reliefs to investors in higher-risk small companies. SEIS is intended to recognise the particular difficulties which very early stage companies face in attracting investment, by offering tax relief at a higher rate.

Table 2 Support for SME investments Irish compared with UK

	Irish EII	UK EIS[25]	UK SEIS[26]
(1) On investment:			
Income tax relief	30 percent + potential 10 percent after 3 years	30 percent	50 percent
Reinvestment relief[27] on previous disposal	N/A	N/A	14 percent on previous gain
Potential support from the tax system	30 percent + potential 10 percent after 3 years	30 percent	~ 64 percent
(2) If investment is unsuccessful			
Share loss relief against income tax.	N/A	31.5 percent	22.5 percent
Potential downside risk is mitigation	30 percent certain + 10 percent likely	61.5 percent	86.5 percent
(3) If the investment is successful the gain is liable to			
CGT	33 percent	0 percent (after 3 year holding period)	0 percent (after 3 year holding period)

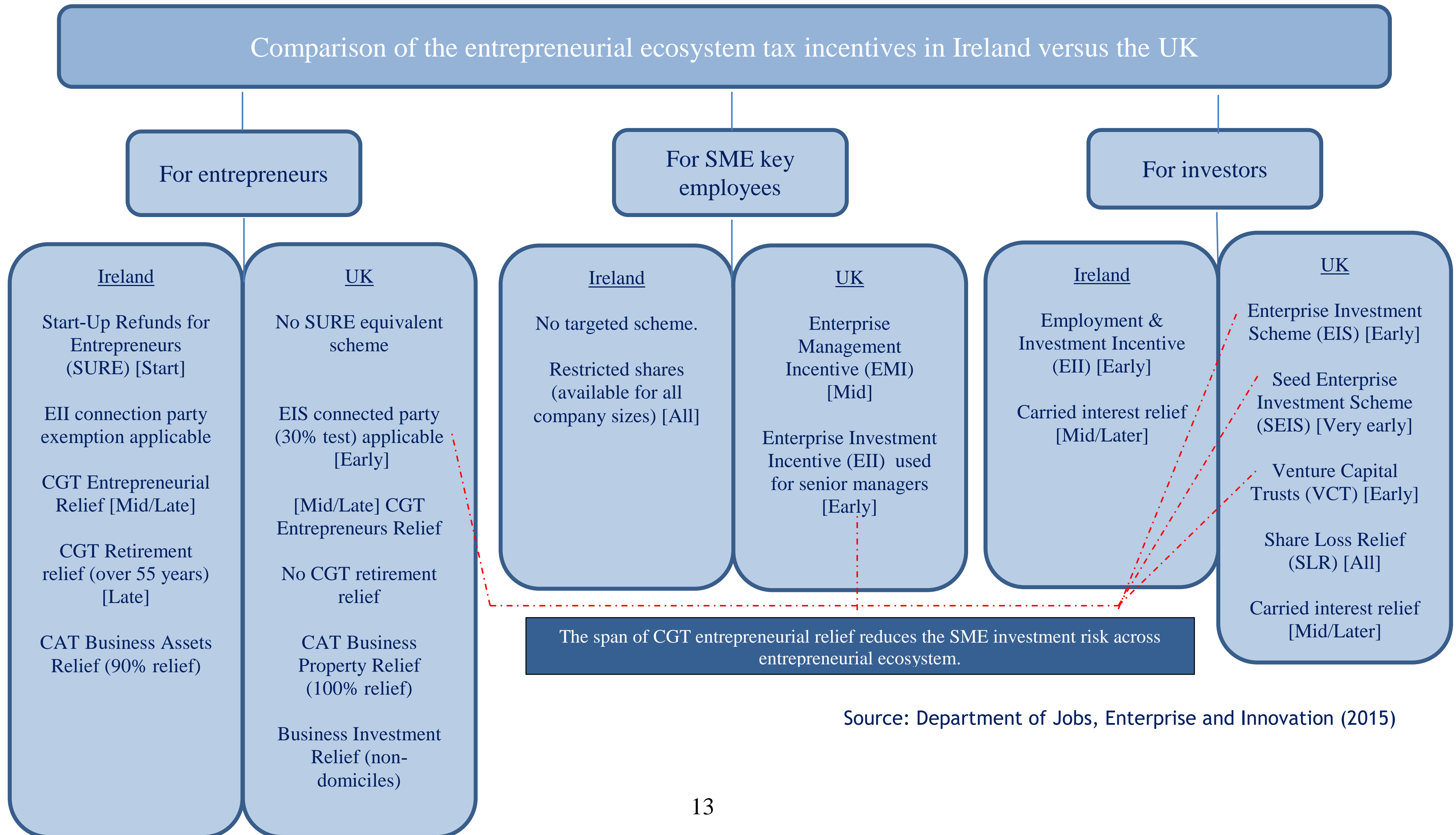
Source: Meeting with London EY partners dealing with entrepreneurs and HMRC guidance.

25 On an initial investment of £100, income tax relief of £30 up front. If the investment was not successful then the unrelieved portion of the investment (£100-£30)=£70 could obtain income tax relief at the highest marginal rate of personal income tax of 45 percent = 31.5 percent. It is possible to defer the CGT liability via rollover relief, but as it is a deferral it is not reflected. Therefore the total risk mitigation is 61.5 percent.

26 On an initial investment of £100, income tax relief of £50 up front. If the investment was not successful then the unrelieved portion of the investment (£100-£50)=£50 could obtain income tax relief at the highest marginal rate of personal income tax of 45 percent =22.5 percent. The initial first year CGT exemption was replaced with half the CGT rate applicable, assuming CGT rate 28 percent = 14 percent. Therefore total risk mitigation is 86.5 percent

27 i.e. CGT reduction on previous sale when reinvested

Figure 6 **Comparison of the entrepreneurial ecosystem tax incentives in Ireland versus the UK**



Source: Department of Jobs, Enterprise and Innovation (2015)

Differences between Irish and UK tax offerings

Following the entrepreneurial lifecycle, the key differences between Irish and UK tax offerings are highlighted [Ireland's relative position is more: positive +, negative – or ± unclear]. Refer also to more detailed analysis in appendix 1.

+ Ireland's Startup Refunds for Entrepreneurs (SURE) which provides an income tax refund for those setting up their own start-up company, does not have a UK equivalent.

– Connected directors eligibility criteria under UK Enterprise Investment Scheme (EIS) appear to be better than equivalent Irish Enterprise Investment Incentive (EII).

– UK CGT Entrepreneurial Relief is significantly more competitive by targeting first time disposals, a lower 10 percent CGT rate and simplicity. EIS investors and employees with Enterprise Management Incentive (EMI) shares can also qualify.

– SEIS and EIS investors are exempt from CGT if the shares are held for three years.

+ Irish CGT retirement relief, for which there is no UK equivalent, targets a point in the lifecycle of the traditional family business and there are capital acquisition tax reliefs for beneficiaries receiving a gift of the family business to avoid its disposal to pay tax liabilities.

– There is no tax advantaged share option incentive targeting SME employees in Ireland, similar to the UK EMI.

The Irish EII differs from the equivalent UK EIS scheme in a number of critical aspects:

– Annual individual investment limit is low (€150k) compared to the UK (£1 million).

– Removal from the high income earner restriction only temporary until 31 December 2016, compared to permanent in the UK. Positive increase in take-up was not available for the D/Finance review.

– Points above undermine the ability to raise investment for the company lifetime limits which have been increased.

– EII appears more restrictive in relation to director eligibility, above EII exemption threshold

– EII only provides income tax relief; it has no capital gains or capital acquisition tax (CAT) dimension to the scheme. UK EIS shares qualify for the Business Property Relief inheritance relief.

– EII additional income tax relief after 3 year holding period, if employment and R&D criteria of the EII are met.

– EIS company 12 month rolling limit of £5 million limit versus EII €15 million lifetime cap.

– As per previous DJEI recommendations, EII activities may need to be revised in light of the increased use for wind farms and the UK experience which has resulted in the exclusion of low risk renewable energy projects.

– UK EIS take-up may be impacted by other factors including; (i) non-domicile business investment relief and (ii) EIS investments may qualify for obtaining a Tier 1 visa.

We recommend:

To address inherent market failures for SME risk capital investment:

(1) Reform CGT measures to enhance competitiveness and particularly targeting the risk capital market failure. Specifically:

- Deliver a significant cut the general CGT rate to approximately 20 percent (refer to section 3.2).
- Reform Irish CGT entrepreneurial relief to be competitive with the UK offering (refer to question 6 and 7).
- Any EII gains on disposal should be liable to a low rate of CGT, to be competitive against the CGT exemption on UK EIS and SEIS gains (refer to question 3 – EII).
- Any EII losses on disposal and any future SME employee incentive share option scheme should be allowable losses for CGT purposes.

(2) Introduce a tax advantaged SME employee share option scheme, similar to the UK (refer to question 4).

(3) Enhance the EII scheme to ensure its competitiveness (refer to question 3).

4. Tax Policy & entrepreneurship – the context

The following sections are structured to respond to the specific questions posed in the Department of Finance consultation document.

Q1: What role, if any, should the tax system play in encouraging entrepreneurship?

4.1 Tax Policy and entrepreneurship

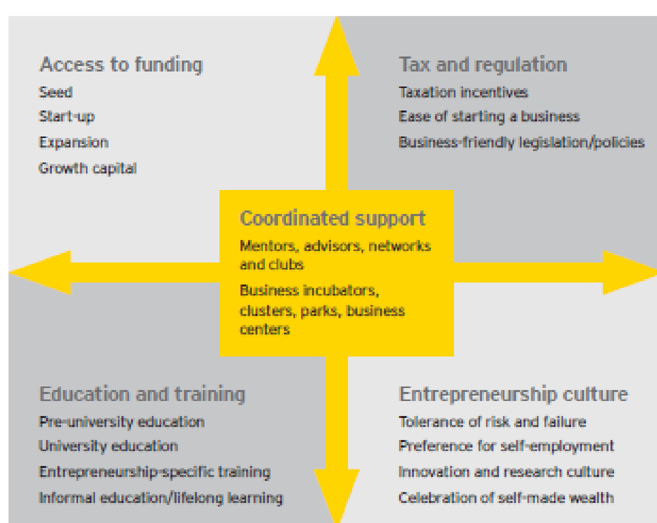
The Commission on Taxation was clear about the role of the tax system in encouraging entrepreneurship,

> *"A tax code that facilitates enterprise is a key component in supporting economic activity[28]".*

Various international tax policy reviews have also considered this issue. The Mirrlees Review (UK)[29] core message is that "small business taxation is inherently complex, involving the boundaries between personal and corporate taxes and between the taxation of labour income and capital income". It concluded that it could be appropriate to seek to increase the share of small businesses in overall economic activity, if there were positive externalities or spillover benefits.

The Re:think (Australia)[30] also considers small business separately. It inherently recognises the role of taxation in the framing of its questions; i.e. how effective the current range of tax concessions are at supporting small business, the extent that the benefits outweigh the compliance, complexity and revenue costs they introduce and what other mechanisms could assist small business. The Canadian system has not been reviewed since the Carter Commission in 1962 and stakeholders are currently highlighting that the complexity is driving compliance costs which negatively impact SMEs and others.

Figure 7: Entrepreneurial development framework: Five pillars that foster entrepreneurship



Source: EY G20 Entrepreneurship Barometer (2013), 'The Power of Three'.

Tax and regulation is one of the five pillars that foster entrepreneurship, as highlighted in the G20/EY research which compares the entrepreneurial ecosystems in the G20 countries.

Over the period since 2008 (at the onset of the economic crisis), Ireland's tax environment for entrepreneurs has become less attractive as CGT rates were increased, and investment incentives become more restrictive and/or costly (see Table 3).

28 Commission on Taxation (2009), The Commission on Taxation Report 2009, page 9.

29 Institute of Fiscal Studies (2011), 'Tax by Design', chapter 19 Small Business page 451-468.

30 Australian Government (2015), 'Re:think – Tax Discussion paper', pages 105-120.

Table 3: Key entrepreneurial changes in the Irish tax system in recent years

	2008	2013	2015
CGT rate	20 %	33 %	As per 2013.
CAT rate	20 %	33 %	As per 2013.
Marginal tax rate for entrepreneurs; *i.e. non-PAYE income >€100,000.*	46.5 %	55 %	As per 2013 as income tax decrease and USC increased by 1%.
Highest USC rate for entrepreneurs; *i.e. non-PAYE income >€100,000 no reduction in overall marginal rate post Budget 2015.*	N/A	10 %	11 %
CGT retirement relief	Relief available for anyone transferring a business over 55 years	Age cap reduces the incentive to pass on assets after 66 years (due to no CGT on death) while incentivising before 66 year deadline.	As per 2013.
Value of transfer from parent to child tax free	€521,028	€225,000	As per 2013, despite increases in asset valuations.
Employment Investment Incentive (EII) / Business Expansion Scheme (BES)	5 year minimum share holding period.	3 year minimum share holding period.	4 year minimum share holding period.
Share options used to reward employees	No PRSI applied.	4 % PRSI applied since 2011.	As per 2013.
Interest relief for loans used by individuals to invest in trading companies.	Income tax relief at the investor's marginal rate of tax.	N/A - abolished for loans made after 2010.	As per 2013.

Source: DJEI (2015), adapting/updating Irish Taxation Institute (2013).

Guiding principles

Entrepreneurship is a wide umbrella encompassing a broad spectrum which involves people with different needs and motivations. It includes necessity entrepreneurs, lifestyle entrepreneurs, high growth businesses, companies of one employee up to 250 employees etc. Clearly a one-size-fits-all tax design approach is not appropriate. Targeted tax policies can be informed by a clear understanding of the specific barriers at various stages of the entrepreneurial life-cycle, and/or to influence behaviours to ensure that Ireland benefits from a strong entrepreneurial community and greater number of businesses starting up, creating jobs and delivering economic impact.

The following guiding principles have helped to frame our submission:

- Tax neutrality – tax should not create a bias; i.e. decisions should be made for economic reasons, not on their tax merits;
- Certainty – the amount of tax to be paid should be certain, clear and not arbitrary;
- Simplicity - tax rules should be known and tax liability clear;
- Equity/Fairness - similar taxpayers should be taxed similarly;
- Pragmatism – the tight timeframe of the public consultation and the wide scope of entrepreneurship, necessitated that the focus was on tax reform rather than tax design;
- 'Think Small First' - design mindful that the tax administrative/compliance burden falls disproportionately on smaller business; and
- Economic growth - tax policy decisions should raise revenue in line with the OECD hierarchy of taxation for growth.

Carefully designed and controlled tax incentives have a role in delivering the desired behavioural change to correct market failure, to attract mobile investment and to offset shortcomings in other areas of public policy. Temporary tax incentives, which are often sectoral in nature, can instigate the desired behavioural change due in part to their time-bound nature. Once the predefined objective has been achieved, any extension to stated sun set clauses should be based on a clear rationale and evidence.

We recommend:

- A tax code that aligns with clear guiding principles and that supports economic activity, job creation and a positive entrepreneurial ecosystem.

Q2: What barriers to establishing enterprises exist in supporting small businesses and encouraging entrepreneurs?

Establishing an environment to stimulate entrepreneurship requires concerted effort to continuously assess and reassess what is working and what is not, and to take the necessary actions in a timely manner to redress barriers. It is important to note, too, that entrepreneurs and businesses are mobile at the early stages of business formation or lifecycle. There are two dimensions to this that are of importance from Ireland's policy perspective. Firstly - our ability to attract mobile entrepreneurs (which is a stated ambition in the Action Plan for Jobs), and secondly and increasingly, our ability to influence our Irish entrepreneurs to establish their businesses here.

There are a number of aspects that influence an individual's decision to set up a business in the first instance (or barriers that might prevent them from doing so) and/or to decide on where best to establish a business. We need to ensure that our incentives are best placed to redress barriers, to stimulate increased entrepreneurship. We need also to ensure that we do not inadvertently disadvantage Ireland in terms of competitiveness vis a vis other jurisdictions in aspects such as personal taxation, capital gains tax and share based remuneration. Some specific barriers include:

- **Access to Finance/Capital**. Since 2011, Government policy has focused on supporting SMEs (including start-ups) in accessing an appropriate supply of financing from both bank and non-bank sources. A number of policy initiatives have been deployed (including the establishment of the Strategic Banking Corporation of Ireland (SBCI), that establishment of the Ireland Strategic

Investment Fund (ISIF), Microfinance Fund Ireland etc. From the perspective of entrepreneurship, early stage funding is critical to assist a business through its formative years. The tax system plays a key role in stimulating such investment including through initiatives such as the EII and SURE.

- Cash flow (or the lack of it) is a real threat to the survival of some small enterprises and smaller enterprises tend to be more negatively impacted by administrative cost burdens.
- For individuals starting their own enterprise and for investors, an **attractive risk/reward initiative** plays a key role in incentivising the behaviours we want – to stimulate a greater number of start-ups and to enhance survival rates. In this context aspects such as tax relief on the initial investment, as well as CGT rates can influence decisions.
- Fear of Failure – is largely a cultural dimension and successful entrepreneurs can play a role in demonstrating what is possible and in engendering ambition amongst students to start a business. We need also to ensure that our tax regime does not inadvertently penalise managed risk taking.
- **Talent attraction and skills** Start-ups and SMEs cite a challenge in attracting the appropriate skills compounded by the fact that they 'compete' against established Irish based MNCs. Talent is increasingly mobile, and the war for talent is global. The ability to offer an attractive package plays a key role in this regard and aspects such as share option schemes and/or incentives to attract (or attract back) mobile talent are directly relevant.
- **Growing to scale** As enterprises grow their operations the challenges facing them are multifaceted – and involve, for example, leadership capabilities and ambition, risk appetite, succession planning (including in the case of family owned businesses), competences in sourcing funding options (including, for example equity and quasi-equity), tax implications as well as personal circumstances and they present in different ways depending on the company's strategy, organisational structure, market focus and business model.

5. Existing tax measures to support small businesses and encourage entrepreneurs

Q3: What existing tax measures are effective in supporting small businesses and encouraging entrepreneurs?

We have considered Ireland's existing tax measures in the context of the barriers to entrepreneurship identified under Q2 above and have listed the tax measures in order of the importance of the tax measure to our overall tax offering for entrepreneurs. We consider the measures that we have included here (and set out in appendix 2) as being broadly effective in supporting small businesses and encouraging entrepreneurs, although with scope for improvement in some instances. Enhancements to the EII, SURE, R&D Tax Credit and KDB are regarded as a priority to stimulate investment and innovation and to enhance their competitiveness international and including UK offering. In the main, the other initiatives listed should remain in place and/or be subject to regular review.

We have considered each measure separately, however, it is noteworthy that the need to improve our CGT offering has emerged as a key recommendation across a number of priority headings, which has been highlighted in the executive summary.

Included in this section are the following measures:

- Employment and investment incentive scheme (EII);
- Startup Refunds for Entrepreneurs (SURE);
- R&D Tax Credit;
- Knowledge Development Box (KDB);

Ireland's corporation tax rate and transparency is internationally competitive and an important aspect of Ireland's overall tax offering. This has been included in section 3.

Start-up company relief (and including Start Your Own Business) is responded to in Q8.

Employment and Investment Inventive Scheme

The Employment and Investment Inventive (EII) provides an income tax incentive to private investors in companies. The scheme encourages equity investment in SMEs to create and retain jobs – firms that would otherwise find it difficult to raise funds. The EII targets recognised market failures in the risk capital environment which have been exacerbated by the recent economic and financial crisis.

Notwithstanding the positive impact of the scheme[31], usage of the scheme and the associated cost has fallen significantly in recent years. While the increase in investment in 2013 is welcome, we believe that a number of scheme design features are limiting take-up.

We welcome a number of positive changes in the past year including securing EU approval to extend the EII (and SURE) until December 2020 and the exclusion of the scheme from the higher earner restriction for three years up to 31st December 2016. EU efforts towards setting up a simpler, more flexible and

31 A Department of Finance review (2011) of the scheme found that 'since its inception, the BES (now EII) has proved successful in helping SMEs gain access to capital investments, with a view to supporting job retention and creation in the State'.

enhanced state aid framework for the provision of risk finance to SMEs and mid-caps are also very welcome. Budget 2015 enhancements reflected the new state aid environment, with the welcome abolition of the distinction between assisted and non-assisted areas so that all medium sized companies can qualify and increasing the lifetime threshold to €15 million per SME.

Given the likely growth in demand for funding as the economy recovers and the need for alternative non-bank sources of funding, we believe that it is essential that consideration is given to the following improvements to enable the EII to fulfil its potential.

We recommend:

- Examining and addressing the overall level of risk mitigation for SME capital investors, in terms of relative competitiveness of the EII (refer to comparison with the UK in section 3.5).
- That the removal of the EII (i.e. the up-front income tax relief of 30 percent) from the high income earner restriction, currently due to cease on 31st December 2016, is extended indefinitely based on positive take-up impact and signalled in Budget 2016 speech.
- Reinstate the 40 percent income tax relief upfront to enable a wider cohort of SMEs to be able to attractive to investors and funds (refer to section 3.5).
- Increase the annual individual investment limit from €150k to better align with UK EIS limit of £1 million (refer to section 3.5).
- Increasing the minimum holding period to five years, with an exemption where capital replacement is combined with the injection of new fresh capital into the company.
- That the legislation reflects the positive expansion of the EU revised General Block Exemption Regulation as announced in Budget 2015 and the removal of annual investment limits in a company, while ensuring that the existing scope of the scheme is not restricted.
- Address the apparent more restrictive EII director eligibility compared to the UK EIS and SEIS scheme.
- In light of UK EIS policy change in 2014 (further detail in appendix 1), assess whether the broadening of the sectors eligible under the scheme to include asset backed investment options (e.g. hotels, green energy), has displaced investment from the productive higher risk and/or early stage internationally trading businesses, which was not the original policy intent.
- Review whether the policy intention of the delayed income tax relief for investors (i.e. employment and R&D criteria) is having its desired impact given the negative impact on investors return on investment calculation. This should be undertaken when sufficient data is available and with a sample comparison of companies that received BES investment.
- That an anomaly which has arisen in relation to internationally traded financial services companies is addressed in clear guidance and/or legislation.
- That further research is conducted into proposals to broaden the EII/SURE beyond equity financing and the merits of providing additional early stage investment capital interventions, noting the level of risk mitigation in the UK (refer to section 3.5).
- Any restructuring of the EII should reflect that for legitimate business reasons, companies winning international business may need to set up international subsidiaries, and it is important that the EII criteria do not disadvantage investors thereby putting the company expansion and job creation at risk.

SURE

Startup Refunds for Entrepreneurs (SURE) allows an individual leaving employment to set-up their own business to reclaim income tax on the capital invested in the new business. The capital must be invested as shares in the company. The income tax refund can be claimed in respect of up to €600,000 of income in the previous six years, subject to an annual income cap of €100,000 in each of the six years.

The SURE has the potential to play a key role in assisting entrepreneurs to raise the capital required to set-up their new business. The SURE addresses a recognised market failure - many of the entrepreneurs will not otherwise be in a position to raise the capital required for the set-up of their new business. The SURE remains important as a source of equity investment and as a trigger to fund early stage entrepreneurship.

The Department of Finance (DoF) review[32] undertaken last year shows that approximately 60 companies per annum availed of the scheme over the previous 10 years at an average cost to the exchequer of approximately €20,000 per company. The review points out that 15,506 new companies were incorporated in 2013[33], and states that:

"While most of these companies will have been set up by individuals who would not qualify … it is still reasonable to assume that the level of take-up of the scheme is very low."

In accordance with one of the findings the DoF review[34], an inter-departmental group (with representatives from DoF, DJEI, Revenue, and Enterprise Ireland) was set-up to rebrand and market the scheme. The scheme was rebranded as the SURE (from SCS -Seed Capital Scheme), an online calculator provided and guidance documents made more user friendly:

This rebranding, in conjunction with the marketing campaign, has increased awareness of the scheme and aims to promote an increase in take-up and entrepreneurial activity.

There is merit in crafting a clearer, more concise and more broadly available offering which may involve altering some of the design features – similar to the approach taken with the JobsPlus. For example, replace the current complex formulae for calculating the refund with an income tax credit model that provides the entrepreneur with a refund of 50 percent of the capital invested, subject to the entrepreneur having paid that amount of income tax in the previous six years. Consideration could also be given to providing a three-year window for businesses to qualify, thus facilitating the entrepreneurial journey from employment, to self employed to incorporation.

We recommend:

- In light of the recent rebranding and marketing campaign, it is recommended that the level of take-up of SURE be reviewed in early 2016, and if the level of take-up remains unsatisfactory, alternative options to incentivise entrepreneurs investing their own capital in their business should be considered.

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32 Department of Finance (2014), "Review of the Employment and Investment Incentive and Seed Capital Scheme" – page 20.

33 Companies Registration Office Annual Report for 2013

34 Department of Finance (2014), "Review of the Employment and Investment Incentive and Seed Capital Scheme" – page 59.

R&D Tax Credit

The R&D tax credit was recently reviewed by DoF[35] and was found to be an effective policy instrument. The design of the R&D tax credit efficiently and effectively encourages entrepreneurs to undertake R&D. Ireland's R&D tax credit is important in terms of stimulating business investment in RD&I to deliver national objectives.

The administrative requirements, including record keeping requirements, imposed on businesses claiming the R&D tax credit has a significant impact on the attractiveness of the R&D tax credit. It is also critical that business is provided with certainty regarding what activities qualify for the R&D tax credit.

Compliance with administrative requirements is more burdensome for entrepreneurs and start-ups at early stages in the business cycle. A specialist R&D unit within Revenue could improve the attractiveness of the R&D tax credit for entrepreneurs and the wider enterprise cohort.

We recommend:

- In light of the critical importance of innovation to firms' growth, competitiveness and job creation potential, creating a centralised and expanded innovation tax unit within Revenue to provide all the guidance, opinions and monitoring of tax incentives (including the KDB) related to innovation for companies of all sizes would enhance the certainty and consistency of tax administration.

Knowledge Development Box (KDB)

Smaller indigenous enterprise faces some specific challenges in relation to intellectual property (IP), most notably confidentiality and the costs of defending IP rights. The Knowledge Development Box, announced in Budget 2015 will provide an effective tax rate for IP income that is below the standard trading corporation tax rate. It is important that the Knowledge Development Box legislation to be introduced in this year's Finance can be used by SMEs to support their innovation.

We recommend:

- Including short-term patents in the qualifying definition of intellectual property.
- Examining the potential to simplify the scheme for smaller companies.
- Considering how the KDB will interact with capital gains tax entrepreneurial relief and retirement relief.
- Considering how the scheme can deal with loss making companies.

35 D/Finance, Review of Ireland's Research and Development (R&D) tax credit 2013

Q4: What existing tax measures are ineffective in supporting small businesses and encouraging entrepreneurs? How could such measures be improved or should they be abolished?

There are a number of measures that are ineffective in addressing barriers to setting up and/or growing a company. As set out earlier, the ability for small and medium enterprises to attract funding and skilled personnel is key to realising their growth potential.

Capital Gains Tax (CGT) is particularly important and we have set out our proposals for amendments in sections 3.3 (CGT general rate) and in response to the more specific question 7 relating to Entrepreneur CGT Relief.

This section, therefore, focuses on skills attraction and retention in the context of intense international competition for talent, and more locally based competition between SMEs and larger scale foreign owned entities. We have considered the existing Share based employee remuneration and have also put forward a proposal for a new incentive to Bring Talent Home – to help address the persistent skills gaps in the enterprise base, ensuring its applicability to smaller enterprises.

- SME Share Option Scheme (new)
- Talent for Ireland scheme (new)

SME Share Option Scheme

This section covers the broad area of share based employee remuneration by entrepreneurs, and includes reference to the tax measures specifically referred to in the consultation document for restricted shares and Employer PRSI exemption from share-based remuneration.

Ireland's existing Revenue-approved share schemes are not suited to the circumstances of an entrepreneur or innovative early stage companies when looked at in terms of their practical application or through the lens of national competitiveness. Entrepreneurs need to have the option to provide share based remuneration to key employees. Share based employee remuneration links employee interests with the long-term interests of employers and thereby encourages employees to work in a manner that is aligned with the long term strategy and best interests of their employers. Share based employee remuneration has the potential to support the attraction and retention of talent, reduce fixed labour costs and capital requirements, thereby providing significant cash-flow benefits – particularly to high potential start-ups and scaling companies.

The following impediments arise:

- **Timing of tax liabilities:** If an entrepreneur provides share options to a number of key employees, personal tax liabilities of 52 per cent are typically triggered at a time when there is no market for the shares. This tax liability must be paid by the employee as a payroll deduction under the PAYE system. This timing issue alone makes it impractical for an Irish-based entrepreneur to provide key employees with share options. This timing issue does not arise to the same extent in the case of listed companies where there is a readily available market to sell a proportion of shares to discharge tax liabilities.
- **Inability to target key employees**: The existing schemes must be provided to all employees and therefore lack the flexibility required by entrepreneurs to target the incentive towards key employees.
- **Costs and Administrative Burdens:** The existing share based schemes in Ireland are not suited to SMEs due to the high costs and significant administrative burdens are imposed by the need for Revenue approval, trust mechanism (where applicable) and an external administrator.

Restricted Shares

Shares acquired by employees on the exercise of option rights and under other employee share offer schemes may be subject to a restriction whereby the disposal is prohibited for a number of years. The amount otherwise liable to income tax, PRSI and USC can be reduced by up to 60 percent, with the 60 percent reduction being available where the restriction exceeds five years. While the use of restricted shares is a positive step in the right direction towards reducing relevant tax liabilities on share-based remuneration, the practical issue of having to discharge personal tax liabilities, typically at 52 percent - from net-take home pay - remains a serious impediment to the use of share-based remuneration for employees.

Employer PRSI exemption from share-based remuneration

Ireland's existing share based remuneration schemes contain an employer PRSI exemption. This exemption acts as a significant encouragement for employers to offer share-based remuneration and the exemption should remain in place. The employer PRSI exemption also overcomes potential practical problems associated with tax liability calculations, thereby avoiding significant administrative problems for enterprise.

However, an employer PRSI exemption alone is not a sufficiently strong incentive to drive share-based employee remuneration for entrepreneurs. As outlined above, the requirement to discharge personal tax liabilities of up to 52 percent from net take-home acts as an impediment to the use of share-based employee remuneration for entrepreneurs.

Entrepreneurs compared with PLCs

The current share based schemes in Ireland are more suited to PLCs than to private companies. This places entrepreneurs and High-Potential-Start-Ups at a competitive disadvantage versus listed companies when competing for staff. Due to the inability to offer effective share-based remuneration, entrepreneurs have greater difficulty than listed companies when seeking to attract suitability skilled staff from within the global talent pool.

UK Share-Option scheme

The UK's Enterprise Management Initiative (EMI) offers tax-advantaged share options to help small, higher risk independent trading companies recruit and retain the high calibre employees they need to grow and succeed. To qualify for the EMI, companies must have less than Stg£30 million in assets and less than 250 employees. The EMI provides a deferral of tax liabilities and therefore the practical problem of paying personal tax from take-home pay does not arise. When shares received via the EMI are eventually sold, they can qualify for the UK's 10 per cent CGT Entrepreneur Relief. Companies have the flexibility to target the incentive at key employees. Property development, hotels and professional service companies are excluded.

In practice, the existence of a suitable scheme in the UK that enables entrepreneurs to utilise share-based employee remuneration and the absence of a similar scheme in Ireland, is a significant differential in the tax offering of the UK for entrepreneurs when compared to Ireland.

We recommend:

- Introducing an SME tax advantaged share options scheme designed to enable smaller and higher risk and fast growth companies to recruit and retain the qualified key employees they need to achieve their growth potential.

The key scheme design features should include:

- No income tax on the grant and/or exercise of options;
- CGT at a favourable rate applied on disposal;

- Flexibility for the company in terms of selecting employees to offer the scheme to; and
- Be straightforward and with lower costs and administrative burdens than existing schemes.

Consideration needs to be given to other issues such as the timing of tax liabilities that would compare competitively with other countries.

Talent for Ireland (TFI) scheme

It is vitally important that Irish based SMEs are able to attract the right people, who have the skills to deliver business strategies and who can enable them to win business on an international level, on a competitive cost basis, to propel SME growth. Work from the Expert Group on Future Skills Needs has shown, for example, that employers face difficulties in filling positions within a range of niche high skills areas and in particular significant challenges have emerged with regard to high level IT skills (honours and master degrees) [36]. In order for Irish based businesses to compete for global expertise on an international stage, Ireland needs to keep pace with mobile workers' expectations by having appropriate policies for inbound workers which address issues including barriers to relocation (e.g. work permits for non-EEA nationals) and, in particular, taxation.

The current marginal tax rate (including the USC and PRSI), combined with the low entry point to the top rate, is often a deterrent not only for foreign nationals looking at opportunities in Ireland but also for Irish nationals who have spent considerable time working abroad and are considering the possibility of returning home.

The OECD has noted that as highly skilled mobile workers can add significant value to an economy, 'there may be merit, in certain cases, in introducing tax concessions targeted at mobile high-skilled workers[37]'. It is notable that many countries have implemented measures focused on attracting skilled workers. For example, favorable tax schemes have been used to attract skilled migrants in the Netherlands, Belgium, Denmark, Finland, Norway, Sweden and Switzerland. It is notable that while

Figure 8: How to Target a Proposed Scheme

Under the Employment Permits (Amendment) Act 2014, Ireland's skills needs are being reviewed and adapted on a biannual basis to reflect the changing enterprise environment. This review is predicated on a formalised and evidence-based process which obtains and considers advice from the Expert Group on Future Skills Needs and the Skills and Labour Market Research Unit (SLMRU - SOLAS). They, inter alia, stipulate two types of occupation for the purposes of the employment permits system:

- The Highly Skilled Eligible Occupations List (HSEOL) sets out the lists of eligible occupations deemed to be critically important to growing Ireland's economy, are highly demanded and highly skilled, and are in significant shortage of supply in our labour market. This list is an integral part of the Critical Skills Employment Permit which is designed to attract highly skilled people into the labour market with the aim of encouraging them to take up permanent residence in the State;
- The Ineligible Categories of Employment List includes those occupations for which there is a clear surplus of adequately skilled Irish and EEA nationals in the wider labour force. It is primarily focused on elementary occupations.

While this list is currently used for work permit considerations, it could also be used or adapted for the purposes of this proposed relief where it would apply to relevant EEA and non-EEA taxpayers.

36 Expert Group on Future Skills Needs, Vacancy Overview 2014

37 OECD (2011), 'Taxation and Employment', Tax Policy Studies No. 21, OECD Publishing.

Ireland ranks 10th overall in INSEAD's Global Talent Competitiveness Index 2014, we rank 55th in terms of the extent and effect of taxation on attracting talent[38].

Mirroring schemes in other EU countries, there is a clear need for the Government to assess the potential for a dedicated system to allow Irish based businesses to hire key skills from abroad on an internationally competitive basis. Such a system would only be appropriate where there is a key skills shortage and very limited risk of displacement.

The proposed scheme aims to place Ireland in a more internationally-competitive position in attracting key talent from abroad and key elements of its design have been benchmarked against similar tax-based schemes currently in place in other jurisdictions (e.g. Sweden, Denmark, the Netherlands, Italy, France and Spain). To mirror offerings in competitor countries such a scheme could:

- Apply a flat rate of tax of approximately 30 per cent to the taxable remuneration of employees who are coming into Ireland to work. This percentage includes USC with the remainder being income tax[39]. In the design phase it will be important to ensure that the typical SME income levels will benefit sufficiently to increase their international rankings to rank Ireland 4th/5th from 10 countries benchmarked[40]across a range of salary points[41]. The most competitive effective rates at the various salary levels were in Sweden at €50k, €75k and €200k, France at €100k and Spain at €400k[42].
- This rate would apply to individuals that have not been tax-resident in Ireland for the 5 tax years immediately prior to arriving in the State to take up employment. Those qualifying would include both Irish and foreign nationals that worked in Ireland prior to the aforementioned 'previous 5 tax years'. Spain applies a 10 year period; France five years, Sweden five years, and Denmark three years.
- To minimise the risk of displacement, the offering would only be available to employees earning over €60,000 per year[43], though there may be certain exceptions for recognised skills deficits with remuneration between €30,000 and €59,999 to consider drawing from the Highly Skilled Eligible Occupations List (refer to figure 3). The Netherlands applied a threshold of €50,000 and Denmark applies a threshold of circa €100,000.
- Also in the Netherlands, the key condition for qualification is that the expatriate has special skills or knowledge not readily available on the Dutch labour market (termed 'the specialists test').

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38 INSEAD (2015), 'The Global Talent Competitiveness Index 2014'.

39 The flat-rate would not include PRSI on the basis that (i) foreign workers coming to Ireland may apply for an exemption from PRSI and remain in their home country scheme or (ii) Irish workers returning to the State will be liable to PRSI in the same way as other Irish citizens.

40 Countries benchmarked were Sweden, the Netherlands, France, Australia, the UK, Spain, Ireland, Denmark USA and Germany, as at May 2014.

41 Calculations undertaken illustrate that at lower income levels a tiered approach has a more positive effect on the international rankings; e.g. a tiered approach of 28 percent up to €125,000 and 34 percent thereafter would rank Ireland 4th/5th from 10 countries benchmarked across a range of salary points of €50,000, €75,000, €100,000, €200,000 and €400,000.

42 Assumption that no expatriate plan is provided by company.

43 All sectors are eligible for Green Card Employment Permit with a remuneration of €60,000 or higher. There is a highly skilled occupations list for which applications may be made with remuneration between €30,000 and €59,999. This may be of relevance during the design process http://www.djei.ie/labour/workpermits/highlyskilledoccupationslist.htm

- The special tax rate could last for a maximum of five years - a period which reflects the general average of time limits imposed in similar plans abroad. Thereafter the individual would return to normal tax rates.

DoF analysis of the Dutch '30 percent rule' scheme[44] indicates that 13,581 individuals availed of the scheme in 2012. The population of the Netherlands in 2012 was 16.8 million. This is approximately 3.5 times the Irish population (4.6 million) in 2012. Using this ratio as a guide, approximately 4,000 individuals would avail of such a scheme in Ireland at a cost to the Exchequer of approximately €140 million over 10 years. Under our proposal, it would be intended that entry would be more restrictive.

Mirroring the enterprise findings, the current personal taxation environment is not attractive to research leaders when compared to that in competitor countries. Combined with salary caps in public research organisations, Ireland is not well placed from a personal incentives perspective to encourage outstanding research talent to come here. Given an increasing shift towards the importance of substance, the importance of developing Ireland's research base is likely to grow.

Attracting outstanding research talent to Ireland is one of the principal ambitions of Science Foundation Ireland. The recruitment of specialist scientists and engineers will build the national research base and enhance Ireland's reputation as a centre of excellence for research. It also helps win additional international funding (e.g. from EU Horizon 2020) and the development of stronger and deeper research teams in Ireland.

A range of EU countries, which have such schemes to attract mobile talent, offer particularly favourable terms to attract researchers:

- The Netherlands: There is no minimum required salary for scientific researchers who are employed by a university and/or a research institution that is subsidised by the government. PhD and masters graduates who are hired within a year of completing their studies also benefit from a relaxation of rules under the scheme:
- Sweden: Three categories of personnel are eligible for the tax relief including scientists (where the scientist must bring new knowledge to Sweden). The scientist may be employed in industry or by a research institute.

Targeting researchers would help Ireland to achieve our Business Expenditure on Research and Development (BERD) targets and win substantial R&D projects to underpin substantive activities. It could help relieve potential resource constraints which could increase costs and negatively impact on cost competitiveness.

We recommend:

- Introducing of a scheme that would assist Irish based SMEs in attracting skilled labour (both foreign nationals and Irish nationals who have been out of Ireland for a specified period) from abroad to come and work in Ireland.
- The scheme would set an internationally competitive flat rate of tax of approximately 30 percent (income tax and USC) to be applied to all payments, except employer pension contributions, to the qualifying employee for a designated period of time.
- To target the scheme, it would be only available to positions paying relatively high salaries and could be required to address already defined skills deficits.
- Potential exists to focus on specific research needs by building on the Highly Skilled Eligible Occupations List (HSEOL).

44 Department of Finance (2014), 'Review of Special Assignees Relief Programme', page 19 and 37.

6 Specific questions

Q5: Given the difference in the treatment of the self-assessed and PAYE taxpayers in terms of pay & file, tax credits and allowable expenses, is there scope for greater alignment?

The structure of the tax and social welfare system should not discourage entrepreneurship. There are a number of significant differences (outlined below) between the levels of tax paid by those in employment when compared to those in self-employment. There are also significant differences in social insurance payments and benefits for employees and the self-employed. Accepting that this is a complex area, involving a 'balance' between payments and benefits, we contend that where the tax and/or social insurance systems is (or is perceived to be) less favourable towards the self-employed, this sends a negative signal to current and potential entrepreneurs regarding the value that Ireland places on entrepreneurship and small business.

Universal Social Charge

An additional three percent Universal Social Charge (USC) applies to self-employment income and almost all forms of non-PAYE income in excess of €100,000. The DoF provisionally estimate the cost of abolishing the Universal Social Charge surcharge (of three percent on self-employed income in excess of €100,000) in the first and full year at €54 million and €125 million respectively.

PAYE Tax Credit

The self-employed do not qualify for the PAYE tax credit (€1,650 p.a.). This means that a single employee can earn a minimum of €16,500 before paying 20 per cent income tax[45], while a single self-employed individual can earn €8,250 before paying 20 per cent income tax[46]. Introducing a new tax credit (similar to the PAYE tax credit) would benefit all self-employed people - particularly those on lower incomes.

The Revenue Commissioners estimate that the number of income earners who are self-employed or proprietary directors and are not in receipt of the PAYE tax credit is 220,000 and 83,200 respectively[47]. As the differential is greatest for the self-employed on low incomes[48], these measures do not support risk takers in setting up their own businesses. We believe that the historic rationale for these differences is no longer justified (e.g. high inflation, differences in payment dates[49]).

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45 €16,500 @ 20 percent = €3,300, less €1,650 (personal tax credit) and less €1,650 (PAYE tax credit) = €0.

46 €8,250 @ 20 percent = €1,650, less €1,650 (personal tax credit) = €0.

47 The number given for the self-employed relates to income earners whose main source of income is from non-PAYE sources.

48 Niall Conroy and Donal de Buitléir (2014), 'Low Income Self-Employed Are Unfairly Treated by the Tax System', Public Policy. A self-employed single person on an income of €15,000 now pays almost 8 times more tax and PRSI than an employee on the same income and has a lower entitlement to social welfare benefits.

49 The historic rationale for this measure was the self-employed paid personal tax in the October following the tax year and that in an era of high inflation this amounted to a significant advantage over PAYE employees; however this former cash-flow benefit to the self-employed has largely been removed via the current obligation on the self-employed to pay preliminary tax on current year profits.

The DoF provisionally estimate the cost of[50] extending the PAYE credit to the self-employed and proprietary directors at €470 million in a full year. When setting out the costs of any change in this area in Budget 2016 and generally in the short-to-medium term, it would be important to ensure that sufficient leeway remains to also facilitate the introduction of the pro-entrepreneur priority measures set out in the Executive Summary.

Social Insurance - payments and benefits

The self-employed do not have access to the same level of social insurance benefits as employees. PRSI payments on both self-employment and employment income contribute towards qualification for the State Contributory Pension. The self-employed generally pay less into the PRSI fund, as no employer contribution is made[51].

There are significant differences in the rates and structure of PRSI payments for employees and the self-employed at various earning levels. For example, the self-employed Class S PRSI liability is far higher at lower earnings levels than the employee element of PRSI in employment situations - the key differentiating structural difference is that the exemption limit for self-employed Class S PRSI is €5,000 p.a., while the exemption limit for employee PRSI is €18,304[52].

The Third Report of the Advisory Group on Tax and Social Welfare (the Group) examined the question of extending social insurance supports to the self-employed. The Group considered the following three principal benefits that the self-employed might access if social insurance cover was extended:

(i) Jobseeker's Benefit

The Group was not convinced there was a case for extending social insurance cover for the self-employed to include Jobseeker's Benefit and highlighted the availability of means-tested Jobseeker's Allowance. The Group also identified a range of practical challenges in providing Jobseeker's Benefit on an equal basis to employees. Referring to the most recent Actuarial Review of the Social Insurance fund[53], they estimated that extending Jobseeker's Benefit cover to the self-employed on a revenue neutral basis would require approximately a 1 percent increase in self-employed PRSI. This equates to a cost for 2016 of €76 million based on a 12 month entitlement. This costing was based on a Jobseeker's Benefit duration of 12 months which has subsequently been reduced to 9 months, which now suggests that the cost of extending Jobseeker's Benefit to the self-employed would require approximately a 0.75 percent increase in self-employed PRSI [54].

(ii) Invalidity Pension (including Partial Capacity Benefit)

The Group was of the view that social insurance for the self-employed should be extended to provide cover in terms of contingencies related to long-term sickness or illness. The Group was cognisant that significant control issues would arise, e.g. some self-employed people could continue to obtain an income while suffering an illness whereas an employee, while experiencing a similar illness, might not.

50 See PQ [10646/15]

51 See PQ [11722/15]

52 €352 per week times 52 weeks = €18,304 p.a.

53 Department of Social Protection (2010), 'Actuarial Review of the Social Insurance Fund 2010', Table 10.8 – page 89

54 1 percent times 12 months, divided by 9 months = 0.75 percent

The Report of the Group estimated that extending Invalidity Pension cover to the self-employed on a revenue neutral basis would require approximately a 1.5 percent increase in self-employed PRSI. This equates to a cost for 2016 of €93 million[55].

(iii) Illness Benefit

Given the control difficulties that might arise with a self-employed person self-certifying their non-participation in their business, the Group considered that it would not be appropriate to extend social insurance to the self-employed for short-term illness income supports, such as Illness Benefit or Occupational Injuries Benefit. The extension should therefore be limited to longer term illness and disability supports, such as Invalidity Pension and the Partial Capacity Benefit. Stakeholder consultations by DJEI following the publication of the Report, clarified that stakeholders were not in favour of an increase in PRSI rates to fund the extension of Jobseeker's Benefit (sought on an optional basis). In addition, a minority of submissions to the Group sought an extension of the Invalidity Pension and the vast majority were focused on Jobseeker's Benefit so it is difficult at this juncture to be definitive.

Personal Tax Rates

Considerations regarding the rate of self-employed PRSI should be considered in the context of behavioural impacts, in particular the incentive to engage in entrepreneurial activity. If changes are being considered to self-employed PRSI rates, they also need to be made in consideration of maximum personal tax rates (i.e. including Income Tax, PRSI and USC). Ireland's maximum personal tax rates for the self-employed, at 51 percent/52 percent/55 percent are too high, and the entry level to the higher-rate income tax band is extremely low by international standards. Therefore, changes to income tax, PRSI and USC rates for the self-employed need to be considered in the context of overall maximum personal tax rates (i.e. including Income Tax, PRSI and USC).

The high-level options in this area include:

- Increasing PRSI rates for the self-employed to fund increased benefits; and/or,
- Providing additional PRSI related benefits without an increase in PRSI rates.

However, in consideration of the other priorities identified in this submission in the area of maximum personal tax rates, we view reducing maximum personal tax rates for both employees and the self-employed to 50 percent as the greater immediate enterprise priority, i.e. over the extension of additional categories of PRSI related cover to the self-employed.

We recommend:

- Commence in Budget 2016 the implementation of a roadmap to deliver parity of treatment between self-employed tax payers and PAYE tax payer, through removal of the additional 3 percent USC levy on the self-employed.
- If changes are being considered to self-employed PRSI rates, such changes should be considered from the perspective of the entrepreneur and through the lens of competitiveness in the context of maximum personal tax rates (i.e. including Income Tax, PRSI and USC rates).
- The recommendations of the Advisory Group on Tax and Social Welfare regarding social insurance payments and benefits for the self-employed require ongoing consideration, as it is important that the social insurance system is not perceived as discouraging entrepreneurship.

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55 Department of Social Protection (2010), 'Actuarial Review of the Social Insurance Fund 2010', Table 10.7 – page 89.

Q6/Q7: CGT entrepreneur relief

Q6 Given the targeted nature of CGT entrepreneur relief under Section 597A of the Taxes Consolidation Act 1997 and the requirement to satisfy EU State aid rules, what changes could be made to the relief in that context to make it more effective in supporting small business and entrepreneurs?

Q7: What specific aims and rationale would underpin such changes to the relief?

Entrepreneurial relief was initially announced in Budget 2014 subject to state-aids approval and was subsequently amended in Finance Bill 2015 to ensure compliance with the "Group Block Release Exemption", thereby allowing the relief to be introduced without a requirement for state-aids approval. The relief was introduced for a five-year period from the 1st of January 2014 to the 31st December 2018 and was estimated to cost €20 million by 2018[56].

In order to qualify for the relief an individual must firstly, have disposed of an asset on or after 1st of January 2010, secondly, have paid CGT on that disposal, and thirdly, have reinvested the sales proceeds as initial risk capital in a new business in which they are a full-time working director. Full-rate CGT at 33 percent is payable on 'first' disposal, while the CGT reduction is provided on the 'second' sale. The CGT reduction is capped at the lower of the CGT paid on the 'first' disposal, or 50 percent of the CGT otherwise payable on the 'second' sale.

The introduction of this relief is a step in the right direction towards a lower differential CGT rate for entrepreneurial activity; however, the qualification criteria restrict the scheme to a small minority of the body of entrepreneurs that Ireland needs to encourage and support.

The requirement to have disposed of an asset denies access to the relief to entrepreneurs who have not sold an asset since the 1st of January 2010. The additional requirement to have paid CGT on that sale further restricts the scope of the relief, as many entrepreneurially inclined individuals that disposed of assets since 1st of January 2010 would not have paid CGT on those disposals as capital losses would have arisen on the sale. In situations where a capital gain is triggered on the sale of one asset, many individuals with investment portfolios would have the option to select and sell another asset in order to crystallise a capital loss, which can then be offset against the capital gain, leaving no CGT liability and thereby no eligibility for entrepreneur relief.

The amount of CGT reduction is not competitive and is quite complex to market and explain. The timing of the benefit is very remote from the timing of the decision to set-up a business. The level of relief is a maximum of 50 percent of the CGT otherwise payable on the 'second' disposal, which provides a maximum average CGT rate reduction of 8.25 percent across both disposals. The actual CGT reduction is also capped at the amount of CGT paid on the 'first' disposal, introducing a range of potential effective CGT rates.

Both the amount of CGT reduction and the extent to which the relief can be easily explained to potential entrepreneurs compares unfavourably with the 10 percent CGT rate on lifetime gains of Stg£10 million available to UK based entrepreneurs.

The requirement for the investor to be a full-time working director from the outset limits the scope of the relief, as most businesses are formed in the early stages by people working in a part-time capacity who over time migrate to full employment. The restriction requiring qualifying investments to be within the first six-months also very significantly restricts the scope of the capital investments that qualify for

56 Budget 2014 cost estimate.

the relief. The combined result of these rules is to severely limit the availability of the relief, particularly when practical factors such as the following are considered:

- Businesses being initially incorporated to secure company names; and
- Businesses being built-up gradually in the initial months on a part-time basis.

We recommend:

To enhance the CGT entrepreneurial relief available to entrepreneurs who both invest and work in their own business, at a minimum the following is required:

- All disposals qualify; i.e. a complete removal of the requirement to have sold a 'first' asset and have paid CGT on that disposal.
- CGT 10 per cent rate on all qualifying investments up to a life time amount of €15 million.
- Extend the initial six-month investment window as close as possible to the three-to-five-year period typically regarded as the early-stage risk capital investment period.
- Replace the requirement for the entrepreneur to work full-time as a director with a requirement for the entrepreneur to work on average 20 hours per week as a director.

Q8: Start-up Company Relief (including Start Your Own Business)

The review contains the following specific questions regarding Start-Up Company Relief:

- Has the relief led to an increase in employment and economic activity?
- How many jobs have been supported by this relief?
- What types of companies are using the relief?
- What has been the impact of the carry-forward provisions introduced in Finance Act 2013?
- What role does the relief play in decisions by start-up businesses on whether or not to incorporate?
- Are there specific elements of s486C that should be considered as part of the review?

Background

Start-Up Company relief provides relief from corporation tax in respect of the profits of a new business conducted through a company for the first three years. Full relief from corporation tax is potentially available where the total corporation tax payable on annual profits does not exceed €40,000, with marginal relief available where total corporation tax payable is between €40,000 and €60,000. No relief is available where corporation tax liabilities exceed €60,000. The amount of Start-Up Company Relief in any period is limited to the amount of employer's PRSI paid, subject to a maximum of €5,000 per employee and an overall limit of €40,000.

Following changes introduced in Finance Act 2013, loss-making companies can 'bank' the employer PRSI paid during the first three years, for offset against future corporation tax liabilities. This relief is

categorised as “de-minimis” from a State-Aid perspective and is therefore subject to the overall total limit of €200,000 of “de-minimis” aid per enterprise in any three-year period.

Has the relief led to an increase in employment and economic activity?

The relief has the potential to both reduce employment costs and the amount of capital required to set-up a business, and thereby has strong potential to encourage entrepreneurial activity and job creation. These benefits can be factored into business plans and bank loan applications.

Where a company’s business plan projects the required level of corporation tax liabilities that would enable the available relief to be offset against corporation tax liabilities in each of the first three years, this reduction in employments costs and the amount of capital required to set-up a business is a clear benefit. This benefit will be taken into account in decisions by entrepreneurs regarding whether to set-up a business and take on employees etc. However, in the case of loss-making companies, the available relief is ‘banked’ for offset against future corporation tax liabilities. For loss-making companies, the timing of the receipt of the benefit is further removed from the decision to set-up a business and create employment during the first three years; therefore there is not as strong a basis for the benefit of the relief to positively influence the ‘loss-making’ entrepreneur towards setting up a business and/or creating employment for others.

How many jobs have been supported by this relief?

The cost of the relief, in terms of offsets against corporation tax liabilities each year is outlined in the following table:

Table 4 Cost of the relief

Tax Year	Number of claims	Estimated Tax Cost (€)
2011	1,284	6.8m
2012	1,270	5.4m
2013	1,038	4.7m

Source: Revenue (2015)

This costing does not include relief ‘banked’ by loss-making companies that will be available for offset if corporation tax liabilities are generated in the future.

The table shows that 1,038 claimants were benefitting from the relief in 2013. While it is not entirely clear from the above data how many jobs were supported, at a minimum 1,038 jobs were supported in 2013. In addition, as entrepreneurs pay Class S PRSI which does not include an employer element, the relief has supported up to 1,038 entrepreneurs that have set-up a business, generated employment and generated a profit. We cannot be certain that the 1,038 claims represent 1,038 individual entrepreneurs; however, the number of entrepreneurs setting up multiple companies, each of which creates employment and generates a profit is likely to be minimal.

Furthermore, the loss-making companies that have not made a claim, but have ‘banked’ the relief for offset against future corporation tax liabilities, represent additional jobs supported by the relief.

What types of companies are using the relief?

There is a decreasing trend in the number of claims made between the years 2011-2013, going from 1,284 in 2011 to 1,038 in 2013, a fall of 20 percent. This is mirrored in the decreasing trend in the cost from €6.77 million in 2011 to €4.72 in 2013, a fall of 30 percent.

Between 2011 and 2013 the three sectors with the largest number of claims and money paid out were, in order: (i) Wholesale and retail trade, (ii) professional, scientific and technical activities, and (iii) construction. Between 2011 and 2013 (inclusive) these three sectors accounted for 54 percent of claims and 56 percent of the amount paid out.

What has been the impact the carry-forward provisions (Finance Act 2014)?

Prior to the Finance Act 2013 changes, a company that generated a loss in each of the first three years, received no benefit from the relief. Following the Finance Act 2013 changes, the available relief can be 'banked' for offset against future corporation tax liabilities. This was a welcome development in that businesses that generate losses during the first three years can benefit from a reduction in the overall tax burden.

However, as the timing of the receipt of the benefit is further removed from the decision to set-up a business and create employment during the first three years, there is not as strong a basis for the benefit of the relief to positively influence the 'loss-making' entrepreneur towards setting up a business and/or creating employment for others. By the time that a company has generated sufficient profits to initially offset earlier losses and then generate a corporation tax liability against which 'banked' employer PRSI can be offset, the company will be much less in need of financial assistance than during the early loss-making years.

We have identified the following improvements to the relief that would accelerate the receipt of the benefit in the case of loss-making companies:

- Providing an employer PRSI exemption/refund; or
- Introducing a refundable corporation tax credit of say 12.5 percent of labour costs.

While there are some risks that these improvements, by effectively reducing labour costs, will extend the economic life of non-viable businesses; the exchequer will receive better value-for-money on the basis that providing the incentive during the first three years provides a far stronger basis for positively influencing decisions by entrepreneurs regarding whether to set-up a business and to create employment.

What role does the relief play in decisions by start-up businesses on whether or not to incorporate?

Entrepreneurs set-up businesses with the intention that each business will ultimately generate a profit. Start-Up Company relief provides that a company can generate a maximum of €960,000 in profits without paying corporation tax, and/or 'bank' up to €5,000 per employee per annum in employee PRSI for offset against future profits. The maximum cash equivalent benefit of this relief is €120,000[57].

The availability of this relief if an entrepreneur incorporates is likely to have encouraged many entrepreneurs to set-up companies that otherwise would not have incorporated. Where micro-businesses incorporate to avail of company specific tax incentives such as Start-Up Company Relief or SURE/Employment and Investment Incentive, this increases both the costs and administrative burdens associated with setting-up, running and, where necessary, closing down a business. In practice, in the absence of company specific tax incentives, accountants would advise many entrepreneurs (where limited liability was not a priority) to initially trade as a sole trader and, depending on the success or otherwise of the business, to later consider incorporation.

57 €40,000 p.a. over 3 years = €120,000

Interaction with SYOB

[The SYOB is separately examined in the second part of this section.]

There will be cases where the SYOB will provide a greater tax advantage than Startup Company Relief, and there will be other cases (typically where projected profits are in hundreds of thousands) where the Startup Company Relief will provide the greater tax advantage. If an entrepreneur initially trades as a sole trader and avails of the SYOB, the entrepreneur cannot later incorporate the business and avail of Start-Up Company Relief, as the business must be a new business in order to qualify for Start-Up Company Relief. In practice profitability and employment levels are difficult to project, so many entrepreneurs will initially incorporate on the basis that Start-Up Company Relief is potentially the more attractive tax incentive.

The tax system could avoid changing behaviours and increasing the costs and administrative burdens on entrepreneurs, if the entrepreneur had the option of initially trading as a sole trader and later incorporating and availing of Start-Up Company Relief. The costs and administrative burdens associated with setting-up a business for the long-term unemployed could be minimised by allowing an entrepreneur to initially claim SYOB and later incorporate and avail of Start-Up Company Relief.

Are there specific elements of s486C that should be considered as part of the review?

Maximum corporation-tax free earnings: Full relief from corporation tax is potentially available on annual profits of up to €960,000[58]. The relief would be easier to market if the relief could be provided on annual profits of up to €1 million.

Employee PRSI cap: While the employment related PRSI cap rightly targets scarce resources towards companies that generate employment, the design of the cap could be improved to send a more positive message to entrepreneurs that create jobs. The relief is limited to €5,000 in employer PRSI per employee per annum; therefore the relief is limited to the first €46,512[59] in gross wages. This penalises companies that create jobs in high-wage sectors. The average wage of agency assisted clients during 2013/2014 was €58,000. If the employee related cap was removed, this relief would be subject to an overall employer PRSI cap of €40,000. This would support job creation at all wage levels.

Practical implication of owner-drawings: The relief is not available on profits withdrawn as salaries from companies by owner-directors, as director salaries are treated as an expense when computing profits for corporation tax purposes. This has the advantage of targeting the relief towards profits retained within the business for the future development of the business. This has the disadvantage that no tax reduction is available on profits withdrawn by the entrepreneur to cover living expenses.

Limit on company profits: Full relief from corporation tax is potentially available on profits of up to €320,000 per annum. Tapered marginal relief is available on profits between €320,000 and €480,000. The design of the relief generally rewards success by entrepreneurs; however, if the entrepreneur is very successful and generates company profits of over €480,000, no relief is available. In some respects, this penalises success by entrepreneurs. This could be avoided if the relief was provided to all companies in full on the first €320,000 in taxable corporation tax profits, although this would increase the cost of the scheme and broaden the cohort benefitting from the relief; the implications on the State-aids framework within which the relief operations would also have to be considered.

58 €40,000 per annum * 3 years = €120,000. €120,000 / 12.5 percent = €960,000.

59 €5,000 / 10.75 percent = €46,512.

We recommend:

- Extend the new and improved relief for a further period of five years (beyond its current 31 December 2015 expiry date);
- Remove the €5,000 employer PRSI cap per employee;
- Increase the maximum potential amount of profits on which full relief from corporation tax will be available from €960,000 to €1 million, and provide this relief to all companies on the first €1 million in profits;
- Accelerate the provision of the cash-flow benefit of the relief for loss-making companies by (i) providing an employer PRSI exemption/refund, or (ii) introducing a refundable corporation tax credit of say 12.5 percent of labour costs; and
- Allow entrepreneurs to initially trade as a sole trader for up to three years and later incorporate and avail of Start-Up Company Relief. Allow the long-term unemployed to initially claim Start Your Own Business Relief and later avail of Start-Up Company Relief.

Start Your Own Business Relief (SYOB)

Start Your Own Business Relief (SYOB) provides relief from income tax in the first two years for the long-term unemployed who set-up a non-incorporated business. The business must be a new business. Under SYOB, profits of up to €40,000 in each of the first two years are not subject to income tax (but are subject to USC and PRSI). The relief was originally introduced from 25 October 2013 and the legislation currently provides for an expiry date of 31 December 2016.

This income tax incentive encourages the long-term unemployed to engage in entrepreneurial activity and is a welcome addition to the suite of tax incentives supporting entrepreneurship. This incentive supports the labour market activation of the long-term unemployed.

The tax cost to the State of providing the incentive is limited to the first two years, and is therefore targeted towards the critical start-up period, although our experience is that the Start-up period extends to the initial three-to-five years. The relief rewards the entrepreneur for creating a job; this is a clear advantage over the design of the Start-up Company Relief, which does not directly reward the creation of the entrepreneur's job. However, the SYOB does not reward the creation of jobs by the entrepreneur, a key advantage of Start-up Company Relief.

The maximum tax advantage under SYOB is €32,000[60] based on the assumption that individuals would have paid tax at 40 percent income tax on the relevant income. However, in practice many individuals will have tax credits and standard rate bands that will reduce the tax otherwise payable, to give a tax advantage considerably lower than €32,000 and an effective tax relief rate far lower than 40 percent.

A comparison of Start-up Company Relief with SYOB is technically complex given that the former is provided via the corporation tax system, while the latter is provided via personal taxation and owner-director salaries move profits from the scope of corporation tax to personal tax. However, given that (as outlined in part Q8(i)(e) above) the maximum potential tax reduction from Start-up Company Relief is €120,000, almost four times the potential tax reduction under SYOB, this suggests that the existence of SYOB will only sometimes offset the tax advantage of incorporating and availing of Start-Up Company Relief.

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60 €40,000 @ 40 percent = €16,000 p.a. over two years = €32,000.

We recommend that consideration is given to the following:

- Extend the relief beyond the current expiry date of 31 December 2016;
- Increase the period of the relief from two years to three years to provide greater alignment with the generally accepted start-up period;
- Extend the scope of the relief, by removing the requirement to have been unemployed for 12 months and generally position the relief as an alternative for all entrepreneurs to Start-up Company Relief;
- Significantly increase the benefit of the relief to avoid incentivising sole traders to incorporate solely to avail of Start-up Company Relief;
- Explore providing the relief as a personal tax credit in order to make the relief easier to market and explain to potential entrepreneurs. Consider rebranding the existing relief, e.g. Entrepreneurs or Start-up Tax Credit;
- Consider providing an additional personal tax incentive for the entrepreneur where the entrepreneur creates jobs; and
- Allow entrepreneurs to initially claim Start Your Own Business Relief and later avail of Start-Up Company Relief.

Appendix 1 Supporting comparison of the Irish and UK tax incentives

Table 5 Detailed comparison of relevant UK versus Irish tax incentives [prior to UK Summer Budget 8th July 2015]

UK (including Northern Ireland)	Ireland
For entrepreneurs CGT Entrepreneur's Relief - Targets entrepreneur and investors to start a business. - Reduced rate of 10 percent (versus the normal 18 percent or 28 percent) on the first successful investment. - Lifetime limit of £10 million for each individual (increased from £1 million since its introduction); *i.e. up to £1.8 million in a lifetime*. - Qualifying criteria apply throughout a one year qualifying period to date of disposal or cessation. - Relief can be claimed on a disposal of qualifying business assets or shares in your personal company (i.e. you hold at least 5 percent of the ordinary share capital and 5 percent of the voting rights, known as IR35). - Requirement that from the date of issue of shares, the company must be UK resident or have a permanent establishment in the UK.	**For entrepreneurs** CGT Entrepreneurial Relief *'Provides a tax relief from a future CGT liability for entrepreneurs who, on or after 1 January 2014 and on or before 31 December 2018, invest the proceeds of an earlier disposal in respect of which CGT was paid in new business ventures which are subsequently sold*[61]*'*. - Targets successful serial investor or entrepreneur to invest gains in a new business venture (incorporation not required). - Relief on a future successful investment. - Roll over relief. - Minimum holding period of the second investment is 3 years. - Relief is the lower of CGT paid on earlier disposal (as a proportion of the reinvestment amount and 50 percent of the CGT on the second disposal. - Assets must have cost a minimum of €10k and assets held as passive investments are excluded. - Requires companies to have been trading for less than 7 years. - Must be full time working director if a qualifying company.

61 Minister for Finance (2015), Written answer to parliamentary question [19266/15] on 19th May 2015.

- Estimated cost: HMRC's estimated cost for this relief in 2013/14 is £2,700 million and 2014/15 is £3,000 million - Impact: Refer to figure 3 & 4 in section 3.2	- Estimated cost. Discrepancy: Budget 2014 material states estimated to be €20 million in total by 2018[62], but recent PQ states €20 million in a full year). - Impact: Revenue have confirmed that as the Irish CGT Entrepreneurial Relief is in respect of investments from 1/1/2014 and holding period of 3 years (i.e. 2017), there is no data on take-up as no claims are eligible until 2017. Anecdotally, there has been little take-up.
No CGT retirement relief. This was phased out in the UK between 2008 and 2003.	CGT Retirement Relief - Retirement relief has been available since the introduction of CGT in 1975. - It is available where an individual aged 55 or over is disposing of business or agricultural assets. - In order to qualify for the relief, those assets must have been owned and used for business or farming purposes for a period of 10 years prior to the disposal. - In the case of disposals outside the family, no CGT is payable where the consideration for the disposal is €750,000 or less; *i.e. up to €247,500 saving*. The threshold is reduced to €500,000 where the person disposing of qualifying assets is aged 66 or over and the disposal takes place on or after 1 January 2014 *i.e. up to €165,000 saving*. Marginal relief applies where the consideration slightly exceeds the relevant thresholds. - Where the disposal is within the family, for example, a disposal by a parent to a son or daughter, there is no upper limit on the relief except where the person who is disposing of the qualifying

62 Department of Finance (2013), Summary of 2014 Budget Measures Policy Changes, page A.6.

Enterprise Investment Scheme (EIS): - A paid director is eligible, despite being a connected party, if in receipt of 'permitted payments'; i.e. no high payments directly or indirectly to connected parties.	assets is aged 66 or over and the disposal takes place on or after 1 January 2014. In such a case, the relief is capped at €3m; *i.e. no cap on the relief prior to 66 years*. - Where the disposal is of shares, the individual must have been a working director of the company for not less than 10 years and full time working director for not less than 5 years. - There is related capital acquisition tax reliefs for business assets and agricultural assets for beneficiaries to avoid disposal of the business/farm to pay tax liability. Start-Up Refund for Entrepreneurs (SURE): - Excludes serial entrepreneurs who not have PAYE before the tax year prior to the investment. Employment Investment and Incentive (EII): - Where an investor can qualify where he is investing in his own company once the amounts subscribed for the issues share capital and the loan capital do not, in aggregate, exceed €500,000.

For employees	**For employees**
Enterprise Management Incentive - Targets the employees of SMEs. - Granting of options does not trigger a liability to tax or PRSI equivalent. - Employee can receive up to £250k market value of share options. - Company may award up to £3 million market value of share value. - On disposal can qualify for the reduced 10 percent capital gains tax rate under the Entrepreneurial Relief. Employee shareholder Employee shareholder status introduced which will result in employees having differing employee rights and shares worth a minimum of £2k in their employer company. Gains of up to £50k of shares acquired by employee shareholders will be exempt from capital gains tax. Employers are required to pay for independent legal advice for prospective employee investors. [Negative media reaction to this measure].	No scheme targeting SME employees. Unrestricted shares D/Finance has been suggested that unrestricted share may be relevant to policy considerations. They are available to all companies. The upfront cash impediment remains, albeit reduce income tax by up a maximum of 60 percent dependent on the holding period duration. Initial soundings taken are that take-up is low and no separate data is captured on Revenue forms.

For investors

Enterprise Investment Scheme (EIS)
subject to the EU state aid and de minimis rule

- Designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new full-risk shares in those companies.

- Individual:
- Income tax relief of 30 percent (20 percent before 6th April 2011) on investments up to individual annual cap of £1 million per tax year, a significant increase on prior years [previous maximum amounts were £500k from 2008/09, £400k for 2006/7 and 2007/8, £200k for 2004/5 and 2005/6 and £150k up to and including 2003/4]
- There is a 'carry-back' facility which allows all or part of the cost of shares acquired in one tax year to be treated as though the shares had been acquired in the preceding tax year.
- Investors can either invest directly in the qualifying companies or through an approved investment fund [UK EIS Association estimate approx. 50:50 split].
- Specifically excluded from the scope of the UK's limit on income tax relief since its introduction on 6th April 2013.
- Minimum holding period for shares is 3 years.
- A paid director is eligible, despite being a connected party, if in receipt of 'permitted payments'; i.e. no high payments directly or indirectly to connected parties.
- Individual on disposal:
- Gains are free from capital gains tax after three year holding period.
- Loss minus the income tax relief can be offset against income tax payable in that year.
- Unlimited 'roll-over relief' where a CGT payment can be deferred if the gain is invested in the shares of a qualifying EIS company within the period one year before or three years after the gain arose.

For investors

Employment and Investment Incentive Scheme (EII)
subject to the EU state aid and de minimis rule

- Designed to help SMEs raise finance. Formerly the Business Expansion Scheme, in 2011 it was revamped with employment and R&D criteria added and relief availability extended.

- Individual:
  - Targets individuals and funds under the same scheme.
  - Provide income tax relief of 30 percent upfront on investments up to individual annual cap of €150,000 per tax year, with potential 11 percent income tax relief on the investment if certain employment or R&D criteria are met by the company.
  - There is a 'carry-back' facility which allows all or part of the cost of shares acquired in one tax year to be treated as though the shares had been acquired in the preceding tax year.
  - Investors can either invest directly in the qualifying companies or through an approved investment fund.
  - *Temporarily* removed from the high income earner restriction from 16 October 2013 to 31 December 2016.
  - Funds can invest in the scheme.
  - Minimum holding period for shares is 4 years.
  - Connected parties are not eligible, except where an investor is investing in his/her own company where the amounts subscribed for the issues share capital and the loan capital do not in aggregate exceed €500,000.
  - Any losses on disposal are not allowable losses for capital gains tax.

- Company:
  - Company lifetime cap of €15 million of EII investment, increased from €10 million in Budget 2015.

- If shares held for three years prior to disposal then no CGT applies.
- EIS investments may qualify for business property relief meaning that they are exempt from inheritance tax if held for two years[63].

- Company:
- Require a company to be less than 12 years old when first EIS/VCT investment is made, except where it leads to a substantial change in the company activity.
- Companies can obtain up to maximum of £5 million per rolling 12 month period [£2 million up to 6th April 2012].
- Companies must have fewer than 250 full time employees and gross assets of less than £15 million and four months of actual activity prior to the share issue.

- Administration:
- EIS investment never receive explicit approval, only 'advance assurance' where the EIS status is granted subject to the scheme operating as proposed to HMRC.

- Estimated cost: Provisional data for 2012-2013 is that 19,925 investors invested £881 million of funds. *Therefore, estimated cost for the income tax relief would be £264 million.*

- Impact:

- When considering the statistics below, renewable energy companies that were in receipt of public subsidies (thus reducing the inherent

- Certain activities are not eligible due to EU state aid.

▪ Other:
- Advance approval required from Revenue.
- Targets individuals and funds under the same scheme.

▪ Estimated cost[67].

EII	No. of companies	No. of investors	Amt. invested €	Est. tax cost €
2014				
2013	Not provided	1,011	41.5	12.4
2012	Not provided	352	13.4	4
2011	Commenced 25th November 2011 not separately recognised until 2012.			

BES	No. of companies	No. of investors	Amt. invested €	Est. tax cost €
2012	Not provided	984	Not provided	31.5
2011	Not	927	Not	41

63 PWC (20

67 Department of Finance (2014), 'Review of the Employment and Investment Incentive and Seed Capital Scheme', page 19 and 20.

risk) received large amounts of investment in 2011-12 and 2012-13 are no longer eligible. In 2012-13, 20 percent of the EIS funds raised were for 5 percent of all EIS companies were involved in the Energy & Water Supply industry.

- Provisional data for 2012-2013 is that 2,395 companies raised £1,015 million of funds, similar to 2011-12 with 2,675 companies raising £1,032 million of funds. Since its launch in 1993-94, over 21,000 companies have received investment and over £10.7 billion has been raised.
- In 2012-13 companies from the Hi-tech, Entergy & Water Supply and Business services sector made up 55 percent of all EIS investments. Interestingly a large proportion of companies 43 percent (1,020 companies) receive investments of below £100,000, while there was a concentration of investment funds in investments above £2 million (40 percent) and indeed between £4-£5 million (23 percent).
- Concentration of 60 percent of the investment in companies based in London and South East.
- Since the launch of EIS, 59 percent of the investment was for companies raising EIS for the first time.
- Positive impact of the coordinated increase in the investor and company annual investment amount is noteworthy. 15 percent of the total EIS investment raised on which claims were made was within the range £500k to £1 million and 40 percent of the investment raised (£414 million) was between £2 million and £5 million.
- The number of investors remained stable in 2012-13, following a 77 percent increase in the previous year. Investments of less than £50,000 represented 79 percent of the claims for tax relief, while investors claiming for less than £500 doubled to 1,150.

	provided		provided	
2010	Not provided	1,467	Not provided	58.3
2009	Not provided	1,642	Not provided	62.3
2008 [68]	Not provided	3,200	Not provided	135.7
2007	Not provided	1,913	Not provided	42

- Impact: From a sample (percent of total unknown) the following sectors were the top 3 beneficiaries; e.g. Information and communications; Manufacturing and Professions, Scientific and Technical Activities.

Differences identified ROI versus UK:

- EIS/EII Company annual versus lifetime cap.
- EIS/EII individual annual investment limit ratio to company investment level.
- EII has no CGT or CAT dimension to the scheme.
- EII has no increased income tax relief for earlier

68 BES figures do not represent the investment in the year, but the year of input into Revenue system. Previous Forfás research with Revenue confirmed investment in 2008 was less than 2007.

Factor that may influence take-up in the UK:

- EIS qualifying conditions are similar to those for investments qualifying for the Business Investment Relief under the rules applicable to non-domiciled individuals making remittances to the UK.
- Some EIS qualifying companies may also meet the conditions to be qualifying investments for the purpose of obtaining a Tier 1 visa.

Seed Enterprise Investment Scheme (SEIS)

subject to EU state aid and the de minimis rule

- Designed to help small early stage UK companies raise finance up to £150,000, for investments on or after 6th April 2012. Complements EIS by offering tax relief at a higher rate in recognition of the particular challenges for very early stage companies in attracting investment.
- Individual:
- Provides income tax relief of 50 percent on investments up to individual annual cap of £100,000 per tax year.
- There is a 'carry-back' facility which allows all or part of the cost of shares acquired in one tax year to be treated as though the shares had been acquired in the preceding tax year.
- Minimum holding period for shares is 3 years.
- Loss minus the income tax relief can be offset against income tax payable in that year.
- To kick-start the scheme the Government offered a Capital Gains Tax exemption to investors on any gains realised in the year 2012-13 that are invested through SEIS in the same year and extended to 2013 to 2014 at half the rate.
- If shares held for three years prior to disposal then no CGT applies.

stage investment.

- EII appears more restrictive in relation to director eligibility, above EII exemption threshold.
- EII only has a temporary exclusion from Irish high income earner restriction.
- EII complexities of employment & R&D criteria need to be re-examined.
- As per previous DJEI recommendations, EII activities may need to be revised in light of the increased use for wind farms and the UK experience which has resulted in the exclusion of low risk renewable energy projects.
- There are other factors in the UK which may be influencing take-up; e.g. non-domicile business investment relief and EIS investments may qualify for obtaining a Tier 1 visa.
- Tax administration – central coordination of approval with company's district office and investor claims are handled by their own office.

Carried interest relief

Gains are taxed at a lower CGT rate on investment, specifically 12.5 percent on investments via a company and 15 percent through partnerships versus the higher income tax rate.

- Company:
- Targets exclusively small, start-up companies whose trades are no more than 2 years old, with fewer than 25 full time (35 hours) employees and assets of up to £200,000 or those seeking to start a new business in eligible activity that do not have a main stock exchange listing.
- The amount of all SEIS investment, together with any other de minimis State aid received by the company in the 3 years to the date of the latest SEIS investment, must not exceed £150,000.

- Other:
- Advance assurance facility is available to check the eligibility of company for SEIS before a full application.
- SEIS is administered by two specialist offices in Cardiff and Maidstone, the Small Companies Enterprise Centre (SCEC). Investor claims are handled by their own tax office.

- Estimated cost: In 2012-2013 a total investment of £117 million was made by 5,000 investors in SEIS[64]. *Therefore, estimated cost for the income tax relief would be £58.5 million*.

- Impact: Profile of *early* participants in the first few months of 2012[65]. Of the 95 agents involved they were mainly small to medium sized accountancy practices in London, South-East or in Manchester (i.e. urban centres). The 64 SEIS companies were reasonably innovative having undertaken R&D and introduced products and processes in previous 12 months. Very few had registered IP or patents. Main

64 Financial Times (20th February 2015), 'How to invest in enterprise investment schemes'.

65 PACEC (2013), 'The Seed Enterprise Investment Scheme (SEIS)…', HMRC Research Report 279.

sectors were online services for retailing, creative industries or software development. The 259 investors were mainly self-employed or retired and had made relatively few investments in business (in contrast to business angels who usually make several investments). Motivation for companies was to obtain investment finance, specifically equity funds which would not have to be repaid or serviced. Generally the investors knew the directors of the businesses prior to investing and were attracted to the business ideas.

HMRC[66] state that over 1,100 companies received investment through the scheme with over £80 million funds raised, with an average of £75,000 per company. Over 55 percent of all SEIS investment benefited companies in Hi-tech (32 percent), Business services and Distribution, restaurants and catering. Investments of over £50,000 represented 86 percent of SEIS investment raised. London and South East based companies benefited from 62 percent of the investment.

Venture Capital Trust (VCT)

subject to the EU state aid and de minimis rule

- VCT is a company, broadly similar to an investment trust, which has been approved by HMRC and which subscribes for shares in, or lends money to, small unquoted companies. Designed to encourage investment in small unquoted companies (except AIM market and equivalent). Individuals invest by holding shares in a VCT. The VCT invests in a spread of small unquoted companies, enabling investors to spread their risk, just as they do by holding shares in an ordinary investment trust company. VCTs shares are listed and tend to offer regular dividends.

▪ Individual investors receive:

- 'front-end' income tax relief of 30 percent only to those that subscribe

66 HMRC (2014 December), 'Enterprise Investment Scheme and Seed Enterprise Investment Scheme'

for the shares of up to £200,000 [€100,000 up to 2004/5] but clawed back if conditions not met over the 5 year holding period.

- exemption from income tax on dividends in respect of ordinary shares acquired (new or from a prior owner) within the 'permitted maximum' of £200,000
- CGT exemption on the disposal of ordinary shares acquired (new or from a prior owner), through via individual subscribing or purchase from a previous shareholder, within the 'permitted maximum' of £200,000. No minimum holding period.
- Prior to 6th April 2004, CGT deferral relief was available for new subscriptions.
- Minimum holding period for subscriptions qualifying for income tax relief has reverted to 5 years. It was 3 years between 6th April 2000 and 5th April 2006.

▪ Trust and its investments:

- At least 70 percent of the VCTs underlying investments must be invested in small unquoted companies and there are caps on cash held.
- Companies which qualify for VCT investment are limited to companies carrying on a qualifying trade with fewer than 250 full time equivalent employees at the time shares are issued, and gross assets of no more than £15 million before investment and £16m immediately after investment.
- No single investment can account for more than 15 percent of total value of the VCTs investments.
- The VCT is itself exempt from CT on chargeable gains (and losses for chargeable gains purposes are not allowable losses). Therefore reinvest of the gross gains is possible.

VCT Budget 2015 amendments, subject to EU approval are:

- Require that companies must be less than 12 years old when

receiving their first VCT investment, except where the investment will lead to a substantial change in the company's activity.

- Introduce a cap on total investment received under tax-advantaged venture capital schemes of £15 million, increasing to £20 million for knowledge-intensive companies.
- Increase the employee limit for knowledge-intensive companies to 499 employees, from the current limit of 249 employees.

- Estimated cost: The amount raised by VCTs has been relatively stable also, gradually increasing from £340 million in 2009-10 to £440 million in 2013-14. *Therefore, estimated cost for the income tax relief only in 2013-14 would be £132 million*.

- Impact:

- The number of VCTs raising funds has been relatively stable since 2009-10, with 66 VCTs raising funds in 2013-14.

Interaction of the schemes above:
UK Budget 2015 recognised company lifecycle and investment raising time lags in removing the requirement that 70 percent of the funds raised under SEIS be spent before EIS or VCT funding can be raised. Note a company cannot issue shares under SEIS if it already had investment from a VCT or issued shares under EIS.

Share Loss Relief (SLR)
- Purpose of Share Loss Relief is to encourage entrepreneurs to invest in

unquoted trading companies, as relief against income may be more valuable to the investor than relief against capital gains. - Share Loss Relief allows capital losses which arise in respect of shares to be set against a person's income providing certain conditions are met. Otherwise allowable losses could only be relieved by setting them against chargeable gains on other assets. - Available to individuals (who pay income tax) and to companies (which generally pay corporation tax), although only investment companies are eligible to claim it. - Shares bought from a previous owner will not generally qualify for SLR, unless the EIS relief is attributable to them and the claimant is an individual. - Included in the UK's limitation of income tax relief. Corporate Venturing Scheme (CVS) [ceased 1st April 2010] - Designed to provide reliefs to companies that make investments in small unquoted companies. It provided a range of tax reliefs for companies that subscribe for shares in other companies, which are unquoted at the time the shares are issued, carry on or are preparing to carry on certain types of trading activities, and satisfy certain requirements. Many of the conditions that they have to meet are identical with the conditions to be met under the EIS. Carried interest relief Gains are taxed at the maximum CGT rate of 28 percent versus the higher income tax rate.	

Source: DJEI (2015) compiled from a variety of sources, including UK HMRC and Irish Revenue material.

Appendix 2

Q 3 What existing tax measures are effective in supporting small businesses and encouraging entrepreneurs? … cont'd

The top four existing measures that we deem broadly effective have been included in Section five above. The remaining measures that we deem broadly effective have been included here, again in order of importance. As outlined in section five above, while the measures are broadly effective, there is scope for improvement in some instances. In the main, the other initiatives listed here (5-17) should remain in place and/or be subject to regular review.

1. Employment and investment incentive scheme (EII);
2. Startup Refunds for Entrepreneurs (SURE);
3. R&D Tax Credit;
4. Knowledge Development Box (KDB);
5. Foreign Earnings Deduction (FED);
6. CGT Retirement Relief;
7. Capital Acquisitions Tax - Business Relief and Personal Exemption Thresholds;
8. VAT Cash Receipts Basis Threshold;
9. Nine percent VAT Rate;
10. Levy on private pension funds;
11. Exemption for transfers of ISE ESM transfers;
12. Venture capital 'carried-interest' - lower CGT rate;
13. Home Renovation Incentive (HRI);
14. Micro-brewery excise duty relief;
15. Rate of employer social contributions;
16. Close Company Surcharges – de-minimis exclusion; and
17. VAT Cash Receipts Basis Threshold.

5 Foreign Earnings Deduction (FED)

The Foreign Earnings Deduction (FED) supports efforts by indigenous firms and multinationals to expand their exports into growth markets. It incentivises employees to undertake trips to overseas markets with a view to increasing Irish exports to the large populations of those qualifying countries.

The FED enables employees based in Ireland and working abroad for more than 40 days a year in qualifying countries to claim an income tax deduction on the element of their income earned while working there. The maximum income tax deduction is €35,000; i.e. a maximum annual benefit of €14,000. The FED was introduced in Budget 2012 and originally ran for three years until the 31st December 2014; however, this was extended in Budget 2015 until the 31st December 2017.

Countries that qualified initially were: Brazil, Russia, India, China and South Africa (i.e. the BRICS). The following countries were added in Finance Act 2013: Algeria, Congo, Egypt, Ghana, Kenya, Nigeria, Senegal and Tanzania. The following countries were added in Finance Act 2014: Japan, Singapore, South

Korea, Saudi Arabia, United Arab Emirates, Qatar, Bahrain, Indonesia, Vietnam, Thailand, Chile, Oman, Kuwait, Mexico and Malaysia.

Table 6 Foreign Earnings Deduction Cost[69]

Country	Estimated Tax Cost €		Number of Claims	
	2012	2013	2012	2013
Brazil	45,436	70,198	7	10
China	186,104	216,141	29	32
India	77,873	104,901	11	12
Russia	120,889	57,588	13	8
South Africa	156,899	159,152	19	19
Other Countries* and Claimants that visited and claimed for more than one country in 2013	54,157	313,777	10	38
TOTAL	641,358	921,757	89	119

We welcome the extension of the FED to the 31st of December 2017 and the extension of countries. We also note the need to continue to align the list of countries with Ireland's Trade, Tourism and Investment Strategies and the client lead priorisation of markets by the enterprise development agencies.

We welcome the following changes to the design of the tax relief in Budget 2015:

- The number of qualifying days abroad reduced from 60 to 40;
- The minimum stay in a country is reduced to 3 days; and
- Travelling time included as time spent abroad.

We note that a number of the recommendations that we made as part of our submission to the DoF Review in 2014[70] remain to be considered further during the next review.

We recommend:

- Retention of the Foreign Earnings Deduction.
- Review on a regular basis to:
- Align the list of countries with Ireland's evolving Trade, Tourism and Investment Strategies and the client lead priorisation of markets by the enterprise development agencies; and
- Ensure that the detailed technical aspects of the design of the relief support the policy objective of the relief.

69 PQ18175/15

70 D/Finance (2014) 'Review of the Foreign Earnings Deduction' http://budget.gov.ie/Budgets/2015/Documents/FED_Report_Oct14_final.pdf

6 CGT Retirement Relief

The combination of CGT Retirement Relief and Capital Acquisitions Tax Business Relief/Personal Exemption Threshold is an important mechanism to encourage entrepreneurship and effective succession planning within the family context. As no CGT is liable on assets transferring on death, the CGT retirement relief and related capital acquisition tax reliefs recognise the wider societal benefits of early succession planning and early transfer of businesses.

Full relief from Capital Gains Tax is available where a family business is being transferred from one generation to the next by an individual aged between 55 and 65 inclusive who have held the business asset for 10 years. The relief is limited to €3 million once the transferor is aged 66.

CGT Retirement Relief facilitates the timely transfer of family businesses from one generation to the next. In the absence of CGT Retirement Relief, substantial parts of the business may have to be sold to discharge tax liabilities, possibly resulting in the remaining business being unviable. The step-effect of the €3 million cap at age 66 encourages the transfer of assets at retirement age.

Full relief from CGT is also available on disposals to non-family members on disposal proceeds of up to a lifetime limit of €750,000 for individuals aged between 55 and 65 inclusive, while the lifetime limit is lowered to €500,000 once the transferor is aged 66 or over. CGT Retirement relief for transfers to non-family members generally facilitates the transfer of businesses from one entrepreneur to another where the transferring entrepreneur is approaching retirement age.

CGT Retirement relief suits the traditional family business within the domestic economy. Serial entrepreneurs aged under 55 developing high-growth companies do not qualify and therefore, other CGT reliefs, such as CGT Entrepreneurial Relief are required for this cohort.

Note that serial entrepreneurs aged under 55 developing high-growth companies do not qualify and therefore, other CGT reliefs, such as CGT Entrepreneurial Relief are directly relevant (and required) for this cohort.

We recommend:

- Retain CGT Retirement relief as it encourages the timely transfer of businesses from one generation to the next and from one entrepreneur to the next, when the transferor is approaching retirement age.

7 Capital Acquisitions Tax - Business Relief and Personal Exemption Thresholds

Business Relief reduces the value of business assets transferred from parent to child for Capital Acquisitions Tax calculation purposes by 90 percent. When considered in conjunction with the relevant CAT personal exemption threshold (from parent to child) of €225,000, this allows up to €2.25 million in business assets to be transferred from parent to child without triggering a Capital Acquisitions Tax liability. To the extent that business assets exceed €2.25 million, an effective CAT rate of 3.3 percent[71] applies where Business Relief is claimed.

In the case of gifts, CGT Retirement Relief may be also available against the transferor's CGT liability. (CGT does not apply on a death.) CGT arising on a transaction can be offset against CAT arising on the same transaction.

71 CAT rate of 33 percent reduced by 90 percent = 3.3 percent.

Business Relief from CAT facilitates the timely transfer of business assets from one generation to the next where the transferor is over 55 and eligible to avail of CGT Retirement Relief. CGT Retirement relief would not work effectively if the transferee was subject to 33 percent Capital Acquisitions Tax on gifts. In the case of gifts, it is typically the combination of CGT Retirement Relief and Business Relief from CAT (combined with Personal Exemption Thresholds) that minimise the potential capital tax liabilities. Business Relief also reduces CAT liabilities arising on the inheritance of the family business by a child on the death of a parent.

We recommend:

- Retain CAT Business Relief and the CAT Personal Tax Exemption Thresholds (as in conjunction with CGT Retirement Relief in the case of gifts), they ensure that family businesses can be transferred from one generation to the next, without the need to sell substantial parts of the business to fund tax liabilities, thereby possibly leaving the remaining business unviable.

8 VAT Cash Receipts Basis Threshold

In general, businesses file VAT returns every two months. The VAT on all sales invoiced during each of the six two-month VAT periods is payable on or before the 19th of the month following each two-month VAT period. Where a business has not received payment in respect of a sales invoice by the 19th of the month following the two-month VAT period, the business must make the sales VAT payment despite having not received payment from the customer.

The cash-receipts basis allows businesses with a turnover of up to €2 million to calculate sales VAT on the 'cash-receipts' basis, i.e. sales VAT is due on cash-received from customers during each period. The threshold was increased from €1 million to €1.25 million via Budget 2013 as a pro-small business measure and further increased from €1.25 million to €2 million in Budget 2014. The cash-receipts basis constitutes a significant cash-flow benefit for entrepreneurs and also reduces the financial risks associated with late payments from customers and generally assists entrepreneurs with cash-flow management.

We recommend:

- This tax measure provides significant cash-flow benefits to entrepreneurs at a relatively very low cost to the exchequer and it should remain in place.

9 Nine percent VAT Rate

As a 2011 Jobs Initiative measure, a lower 9 percent VAT rate was introduced in respect of certain labour intensive activities with a tourism and hospitality sector focus, previously the 13.5 percent rate applied. The lower VAT rate was initially applicable from the 1st of July 2011 to the 31st of December 2013. The lower VAT rate has the potential to reduce the cost of labour intensive activities and thereby provide an incentive for an increase in demand for such services.

- The measure has the potential to reduce the costs of holidaying in Ireland and thereby encourage domestic and international tourists to holiday in Ireland.
- In order for the potential economic benefit to materialise, the lower VAT-rate must be passed on to consumers.

The lower nine percent VAT rate has been extended indefinitely. However, the costs of the measure are relatively high and its funding with the levy on private pension funds (refer to section below).

We are now experiencing a return to growth following a period of deep recession tax expenditures, particularly those intended to be of a temporary nature, should be subject to ongoing review.

We recommend:

- Tax expenditures, particularly those originally intended to be of a temporary nature, would be subject to ongoing review.

10 Levy on private pension funds

The levy on private pension funds impacts of those saving for their pensions, including entrepreneurs and their employees. The charge had delivered over €2 billion by October 2014 and is expected to raise €135 million in 2015. The Minister for Finance has stated that "without the pension levy, there would have been no VAT reduction [to 9 percent on tourism services]".

From a policy perspective, it is important that individuals provide for their retirement and that they can be confident that their fund will be there when they need it.

We recommend:

- Cessation of the Pension Levy at the end of 2015 in line with the Budget 2015 commitment.

11 Exemption for transfers of ISE ESM transfers

Launched in 2005, the Irish Stock Exchange's Enterprise Securities Market (ESM) is a market for growth companies at the earlier stages in their development where Irish companies can access both euro and sterling pools of capital through dual ESM and AIM (the London Stock Exchange's international market for smaller growing companies) admission.

In Budget 2014, a policy decision was made to abolish stamp duty on share transfers within the ESM at a cost of €5 million per annum. Previously, transfers of shares in all Irish registered companies were subject to stamp duty of 1 percent, regardless of which market the trade took place. As the UK Government has abolished stamp duty for AIM listed companies, this left Ireland out of line in relation to stamp duty vis-à-vis European and US norms. The abolition of stamp duty for share transfers on the ESM supports stronger non-bank funding channels.

The legislation introduced in Finance Act 2014 to give effect to the policy decision, was subject to commencement order to facilitate engagement with the EU Commission from a State-Aids perspective. The legislation has yet to be commenced.

We recommend:

- The policy decision to introduce a stamp duty exemption on the transfer of shares listed on the Irish Stock Exchange's Enterprise Securities Market should remain in place.
- The legislation giving effect to the policy decision should be commenced as soon as possible, subject to State-Aids considerations.

12 Venture capital 'carried-interest'

The Venture Capital industry norm is that VC companies receive 20 percent of the increase in the value of the shares in which the VC company has invested as an investment bonus, with the remaining 80 percent being returned to investors that contributed capital to the VC company. Specific provisions, in place since the 1st of January 2009, provide for a lower CGT rate on investment, specifically 12.5 percent on investments via a company and 15 percent through investment partnerships. In the absence of these specific provisions, standard rate CGT (currently 33 percent) would apply. The benefits of this relief include the following:

- Increasing investment by existing VC existing companies in Ireland;
- Ireland becoming a more attractive location for international VC companies;
- Providing additional capital required to grow high-risk enterprises that would generally not qualify for bank financing;
- Funding start-ups;
- Attracting high-value economic activity to Ireland.

We recommend:

- Retention of the venture capital carried interest tax measures.

13 Home Renovation Incentive (HRI)

Finance (No 2) Act 2013 and Finance Act 2014 provided for a Home Renovation Incentive (HRI) Scheme, which will run to the 31st of December 2015 for Homeowners and Landlords. The Incentive provides for tax relief by way of an Income Tax credit at 13.5 percent of qualifying expenditure on repair, renovation or improvement works carried out on a main home or rental property by qualifying Contractors subject to certain conditions.

The HRI was a welcome time-bound incentive introduced at a particular point in the economic cycle that provided for approximately a 12 percent[72] cost reduction in respect of qualifying expenditure aimed at job creation, entrepreneurship and economic activity within the residential construction sector. The HRI was also designed to encourage greater compliance within the construction sector.

We recommend:

- As a time-bound economic incentive, introduced at a particular point in the economic cycle, the incentive should be subject to regular review. Specifically, given the current 31 December 2015 expiry date, the incentive should be reviewed in advance of Budget 2016.

14 Micro-brewery excise duty relief

The half-rate excise duty for micro-breweries producing up to 30,000 hectolitres per annum supports the development of the micro-breweries sector.

72 13.5 percent / 113.5 percent = 11.89 percent, rounded to 12 percent

We recommend:

- The current position should be maintained but kept under review on an ongoing basis to see how the sector develops. This is a growing sector of the economy.

15 Rate of employer social contributions

The rate of employer social contributions has been included on the basis that it is listed in the Appendix to the Tax and Expenditure Review consultation document. While Ireland has a low rate of employer social contributions based on international standards, a more informative international comparator is the tax wedge that captures the difference between the cost to the entrepreneur of hiring staff when compared to net 'take-home' pay. The tax wedge takes Employer PRSI, Income Tax, Employee PRSI and USC into consideration. It is important when making international comparisons that the entire social insurance fund model is considered, e.g. in other countries the benefits include the provision of childcare.

The tax wedge impacts on the cost to the entrepreneur of hiring staff and including internationally mobile highly skilled employees. While the level of employer PRSI in Ireland constitutes a smaller component of the tax wedge than in other countries, Ireland's tax wedge is generally not low by international standards. More specifically, Ireland's tax wedge is low at earnings levels below the average industrial wage, particularly below the minimum wage, but is high by international standards on earnings above the level of the average industrial wage.

- Any increase in Employer PRSI will have a direct negative impact on Ireland's labour cost competitiveness and is not recommended
- Any increase in Employer PRSI will make Ireland's tax system more prone to reductions in exchequer revenue as the population ages.

We recommend:

- If employer social contribution is being considered that the impact on the tax wedge and overall competitiveness needs to be taken into account.

16 Close Company Surcharges – de-minimis exclusion

Ireland's 12.5 percent corporation tax rate applies to trading income. Other company income is subject to a 25 percent corporation tax rate.

Special surcharges apply in the case of "investment and rental income" earned within "close-companies", i.e. owner-managed businesses. The surcharge is quite technical in nature and applies an additional effective 15 percent corporation tax to investment and rental income not withdrawn from a company within 18 months of the year-end (via a dividend payment to the owner-managers).

The investment and rental income surcharge was introduced in 1976 to act as a disincentive towards profits being retained within a business to avoid triggering high personal tax liabilities, i.e. by owner-managers keeping profits within companies in order to avail of the lower 25 percent corporation tax rate on future investment and rental income earned within a company.

In the majority of cases, funds placed on deposit are required for use within the business as part of the trading cycle, for general working capital requirements or for the future development of a business. Therefore, there will be cases when interest is earned on funds placed on deposit for genuine business reasons, and that interest triggers a potential additional 15 percent corporation tax liability. Although this is typically avoided in practice via the payment of a dividend to the owner-manager, the payment of

a dividend, including withholding tax, creates an administrative burden for the owner-manager and adds an unnecessary layer of complexity to the owner-manager's personal tax return. It is an enterprise priority that administrative burdens on business are minimised. In addition, as a matter of principle, an owner manager should not fall foul of anti-tax-planning provisions when placing funds required for trading purposes on deposit with a financial institution.

The Commission on Taxation (2009) considered the issue, and were "not convinced by the argument that the passive income surcharge inhibits the growth of Irish business". In Budget 2013, the de-minimis amount of undistributed investment and rental income which may be retained by a close company without giving rise to a surcharge on such income was increased from €635 to €2,000. This was a cash-flow measure to increase the amount of income which a company can retain for use as working capital without giving rise to the surcharge. The relative impact of the de-minimis exclusion will decrease if deposit interest rates increase.

We recommend:

- In order to reduce the administrative burden on small businesses, retain the €2,000 per annum de-minimis exclusion from the close company investment and rental income surcharge.
- Keep the limit under review, particularly if deposit interest rates rise.

17 VAT Registration Thresholds

The following businesses have the option to register for VAT but are not obliged to register for VAT:

- Business supplying services of less than €37,500 per annum: and
- Businesses supplying goods of less than €75,000 per annum.

The option not to register for VAT allows micro-businesses to reduce the administrative burden associated with preparing VAT returns. The Budget 2015 Tax Strategy Group papers identified that it would be possible to increase the thresholds broadly in line with inflation to €40,000/€80,000 at a cost of €26 million in a full year. The papers also identified that such an increase would remove around 2,200 businesses from the VAT net.

Ireland's VAT registration exemption is already high (and competitive) relative to other EU countries and it is not entirely clear that the benefits of increasing the thresholds would exceed the costs of doing so. In this context, we do not see a justification for increasing the threshold. In addition, such a measure would reduce indirect tax revenues and would be counter the general recommendation to follow the OECD hierarchy by increasing indirect taxes in preference to corporation tax and income taxes in order to minimise any negative impact of the tax system on economic growth.

We recommend:

- The VAT registration thresholds reduce the administrative burden on micro-businesses and should remain in place.