Pre-Budget 2016 Submission

Executive Summary

The Irish economy grew by 4.8% in 2014 – the fastest rate of any economy in Europe. GDP growth of 3 to 4% is forecast for 2015 and 2016. In addition to this economic growth, positive Exchequer tax data means that it is likely that the Government will succeed in bringing the deficit to below 3% in 2015. As a result of this strong performance, the Government indicated in its *Spring Economic Statement* that fiscal space of between €1.2 and €1.5 billion will be available for taxation and expenditure measures in Budget 2016. The funds will be divided equally between expenditure and tax measures.

However, Ireland is still addressing a very high level of public debt – gross national debt stood at €199.78bn at the end of May 2015. Dublin Chamber fully supports a prudent, counter-cyclical approach to spending to ensure that the mistakes of the past are not repeated.

Therefore, Budget 2016 must be selective in adopting those measures that maximise the chances of increased prosperity for more citizens. Business is the main force for providing the goods and services, and creating and sustaining the jobs that will enhance and spread this prosperity.

Improving the overall quality of life in Ireland is dependent upon companies' success. This implies supporting indigenous and multinational companies through all stages of their life cycle, from startups and microenterprises, to growing and maturing businesses.

Dublin Chamber's Budget Submission is divided into two broad themes:

- Supporting all stages of the business life cycle; and
- Bottlenecks to growth.

These themes reflect the internal day-to-day challenges facing companies and the external business environment. Internally, a business requires support through three distinct phases in its life cycle. Externally, Government must counter the critical shortage of housing, office space and hotels in Dublin, and invest in a strained transport system in order to maintain competitiveness.

Dublin Chamber's top 4 recommendations:

1. Introduce an entrepreneur CGT relief similar to the UK Entrepreneurs' Relief.
2. Introduce an employer PRSI tax credit for new hires from 3 to 10 staff.
3. Implement a two year waiver on development levies to address the housing and space crisis.
4. Ensure appropriate investment in Dublin's transport network.

In developing this submission, Dublin Chamber consulted with its membership of over 1,300 businesses, which cover firms of all sizes in a wide variety of sectors. The recommendations were elaborated through a series of surveys, workshops, briefings, one-on-one meetings, and sessions of our Budget Taskforce. This submission has been approved by the Chamber's governing Council.

Summary of recommendations

I. Supporting all stages of the business life cycle

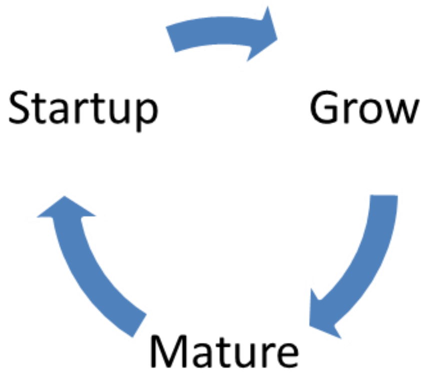
1. Introduce an entrepreneur Capital Gains Tax relief (10% rate) similar to the UK Entrepreneurs' Relief.
2. Replace the Employment and Investment Incentive scheme second tranche of income tax relief with an exemption from Capital Gains Tax on sales of shares acquired under the EII regime.
3. Introduce a three year tax credit on employer PRSI for growing micro businesses on each net new member of staff.
4. Introduce a PAYE allowance for sole traders and Proprietary Directors.
5. Improve the relief for key employees engaged in R&D Activities.
6. Equalise the tax rate on dividends to entrepreneurs and Capital Gains Tax.
7. Amend rollover relief from Capital Gains Tax to encourage uptake from entrepreneurs.

II. Addressing bottlenecks to growth

1. Reduce the marginal rate of tax.
2. Improve tax relief for share-based remuneration.
3. Implement a two year waiver on development levies to address the housing and space crisis.
4. Retain and extend the 9% rate of VAT.
5. Ensure that legislation on vacant sites addresses true barriers to development.
6. Allow for greater flexibility in the planning system.
7. Develop a long term, appropriately-funded plan for investing in Dublin's transport network.

I. Supporting all stages of the business life cycle

1. INTRODUCTION



In recent years, Government has introduced a number of highly-targeted measures designed to support growth and employment. These measures have helped to provide the necessary infrastructure and access to finance for new businesses and businesses with high growth potential.

This package of measures must be simplified, extended and improved to ensure that the tax regime for individual entrepreneurs is sufficiently competitive to attract and retain individual entrepreneurial effort in Ireland.

Ireland's taxation policy actively discourages domestic entrepreneurs from retaining long term ownership of their companies. It does not create an environment conducive for entrepreneurs to grow their business in the domestic market, with the ultimate ambition of growing to become leaders in the global market.

In this section, Dublin Chamber outlines its recommendations for supporting companies throughout the business life cycle, encouraging entrepreneurs to start up, grow and mature their businesses in Ireland.

1.1. The tax environment for entrepreneurs: Ireland vs the UK

Ireland is competitive on many fronts. Despite the pressures of the recession, it has succeeded in retaining an attractive business tax regime which is built upon the foundation stone of the 12.5% rate of corporation tax.

However, it is incorrect to assume that only multinational corporate investment is mobile. Entrepreneurs, both domestic and foreign, can and do move location based on the taxation environment. The nature of the service industry and technology means that sectors that were once domestic and non-exporting are now able to establish anywhere internationally, making the relative taxation regime even more important. Irish entrepreneurs considering where to locate their business may look to Northern Ireland or mainland UK, with their relatively lower cost base.

The UK is widely considered by investors as more attractive than Ireland on non-taxation matters. If it is more attractive on many taxation matters as well, this could be extremely damaging to Ireland's industrial development, to the economy and for the management of the budget deficit.

Dublin Chamber has noted an increase in the number of businesses seeking to relocate to the UK. While this trend does not automatically imply job losses for Ireland, it does carry a heavy opportunity cost as businesses that might otherwise have started or grown in Ireland are now doing so in the UK. For those looking to exit or re-invest in a new entrepreneurial project, their cash is tied up in the UK. Therefore, it is worth assessing the differences in the two countries' tax systems as they affect startups, small businesses and the people that invest in them.

The table below illustrates the tax reasons why an individual might prefer to establish a new business in the UK or Northern Ireland rather than in Ireland.

	Ireland	**UK & NI**
Income tax		
Salary at which rate changes to 40% (€1.39 per £)	€33,800	€59,905
Effective total tax rate on dividends	55%	38.1%
Capital Gains Tax		
CGT rate on exit after 5 years	33%	28%
CGT rate first ~€14m on exit after 5 years	33%	10%
CGT exemption for EIIS / EIS & SEIS	No	Yes
CGT Rollover relief for future investments	No	Yes
Corporate tax issues		
Patent box income	12.50%	10%
Corporate Tax rate	12.50%	20%
VAT	23%	20%
Treaty Network – number of countries	~70	~130

Many of the above advantages have been implemented within the last five years, as the UK has delivered on its express commitment to "roll out the red carpet" for foreign entrepreneurs (quotation from David Cameron, June 2012). The UK's policy aspiration has become a reality. Several of the UK's competitive advantages over Ireland in the table above have only arisen in the past five years. The UK Government's Budget 2015 set a policy objective of reducing corporation tax to 18% by 2020.

The nature of the service industry and technology means sectors that were once domestic non-traded providers are able to establish anywhere internationally, which makes the relative taxation regime even more important for attracting investment. Irish entrepreneurs considering where to locate their business may look to Northern Ireland with its low relative cost base, or mainland UK with its above mentioned attractions. Ireland's relatively disadvantageous tax regime for entrepreneurs is a fundamental issue.

2. STARTING UP A BUSINESS

The Irish tax regime does not encourage entrepreneurs to grow their businesses in Ireland to a scale where they have the potential to become world leaders. The Chamber believes that Government can support entrepreneurs looking to start a business by ensuring that investment proposals are attractive to those that might fund them and by creating equality in their income tax treatment compared to PAYE workers.

Dublin Chamber's recommendations in relation to starting up a business are set out below.

"*As a business owner, the financial pressure of starting up is huge and could easily lead to a change of heart and collapse of the idea. Any ease in that pressure would really help a start up to get past year one.*"

2.1. CGT treatment of entrepreneurs

There are mixed views as to whether businesses starting up are concerned about Capital Gains Tax – as it's a problem of success. Yet all believe that high CGT rates are impacting on their ability to raise capital which is vital to starting up businesses. In its TSG 12/17 paper, the Department of Finance's Tax Strategy Group found that "a CGT rate of 30% is not a penal rate, particularly in the current environment."

This assessment appears to ignore the fact that Ireland's Capital Gains Tax (CGT) rate competes with other jurisdictions, especially when it comes to investors and entrepreneurs at the exit stage.

The Chamber is aware of several cases from the Dublin startup community where businesses that would have established in Dublin, chose to relocate to the UK in order to make use of the Seed Enterprise Investment Scheme, a modified version of the EIS that targets startups.

International context

The UK offers entrepreneurs more attractive schemes to extract money from their business. Entrepreneurs' Relief applies to individuals and operates so that the first £10m of qualifying capital gains are charged to capital gains tax at an effective rate of 10%. This rate of tax represents a considerable reduction on the 28% rate of tax otherwise applying to capital gains, giving a maximum potential tax saving to an entrepreneur of £1.8m on a £10m gain. Qualifying capital gains for each individual are subject to a lifetime limit of £10m (for disposals on or after 6 April 2011). The relief can be claimed on a disposal of qualifying business assets or shares in a "personal company" (i.e. the individual holds at least 5% of the ordinary share capital and 5% of the voting rights).

In addition, the UK rules provide for an exemption from CGT for an investor in a company which qualifies for the UK Enterprise Investment Scheme (EIS), provided the investor is not connected to the EIS qualifying company. The relief is also available for a capital loss realised on disposal of an EIS investment (net of any EIS income tax relief claimed).

The USA operates a system whereby the longer an asset is held, the lower the rate of CGT applied. Assets held for a short period are taxable at income tax rates, whereas assets held for longer periods are taxed at a reduced rate. A similar system was in place in Ireland up to 1992. Consideration could be given to re-introducing a multiple-rate system to encourage longer term investment. Such a system could influence the timing of disposals over the short to medium term. For example, the first €50,000 of gains could be taxed at a "standard" rate with the balance of any gain taxed at a higher rate.

The CGT environment for entrepreneurs in Ireland could be improved through the adoption of two recommendations, which are set out below.

Recommendation: Introduce an entrepreneur CGT relief (10% rate) similar to the UK Entrepreneurs' Relief

Dublin Chamber proposes that the first €15m of qualifying capital gains be subject to CGT at an effective rate of 10%. This should be a lifetime limit such that excess gains over €15m remain taxable at the standard rate. For a period of at least one year before disposal, the individual making the disposal must own at least 5% of the ordinary share capital, 5% of the voting rights and be an officer or employee (full or part time) of the company. The company must be either a trading company or a holding company of a trading company or companies. Dublin Chamber suggests that the relief is confined to unlisted companies which are SMEs (e.g. as defined in Companies Act 2014).

The cost of implementation is largely dependent on figures that are not available. However, the current revenue from CGT on the sale of a business, when netted against businesses that are investing abroad and reposition for a future sale outside of Ireland, would indicate that a cut in the CGT rate will create a rise in total revenue. When the CGT rate was reduced by 20% in 1999 (similar to the recommendation here), more transactions were encouraged in Ireland and the revenue from CGT increased by 84%. These findings are consistent with a US Treasury and Joint Committee on Tax report (2013), which concluded that reductions from the US 40% rate down to 20% on capital gains caused gain realisation resulting in an overall increase in tax revenue.

Recommendation: Replace EII second tranche relief with an exemption from CGT on sales of shares acquired under the EII regime

Dublin Chamber recommends that the second tranche tax relief currently in place for the EII scheme be replaced by an exemption from CGT on the disposal of EII shares.

At present, EII is simply presented as a 30% relief to individual investors given the complexity and risk that the qualifying conditions may not be achieved.

Dublin Chamber appreciates that this proposal was previously considered part of a review of the EII relief in 2014. At that time, the proposal was rejected on the grounds that both income tax relief and a capital gains exemption would remove most of the risk from the investment. Dublin Chamber does not consider that this is the correct way to approach the issue.
In these investments, investors carry the risk of losing some or all of their money. EII provides some relief from that risk. The Capital Gains Tax exemption is only beneficial to the investor if a gain is realised. The relief essentially operates to reward an investor for having taken the investment risk. The investor would be better off in after-tax terms from a capital gains exemption, only getting the benefit of that exemption if they get their money back and also make a gain.

The cost of this recommendation is offset by the reduction in the second tranche relief of 10%.

An alternative approach would be to create a new initiative to particularly address competition faced by the UK's Seed Enterprise Investment Scheme. The details of this proposal are outlined in the Dublin Startup Leaders Group's pre-Budget Submission.

2.2. Tax credits for entrepreneurs and self-employed versus PAYE

Sole traders and Proprietary Directors cannot currently avail of the PAYE tax credit of €1,650. This taxation policy is discriminatory against entrepreneurs and acts as a disincentive to entrepreneurship.

A self-employed single person on an income of €15,000 pays nearly eight times more in tax and PRSI than a PAYE worker on the same income, according to the publicpolicy.ie think tank.

Recommendation: Introduce a PAYE allowance for sole traders and Proprietary Directors

The Government can help to recognise the role of entrepreneurs in job creation by levelling the playing field. Budget 2016 must apply a universal tax credit for all workers, whether PAYE or self-employed.

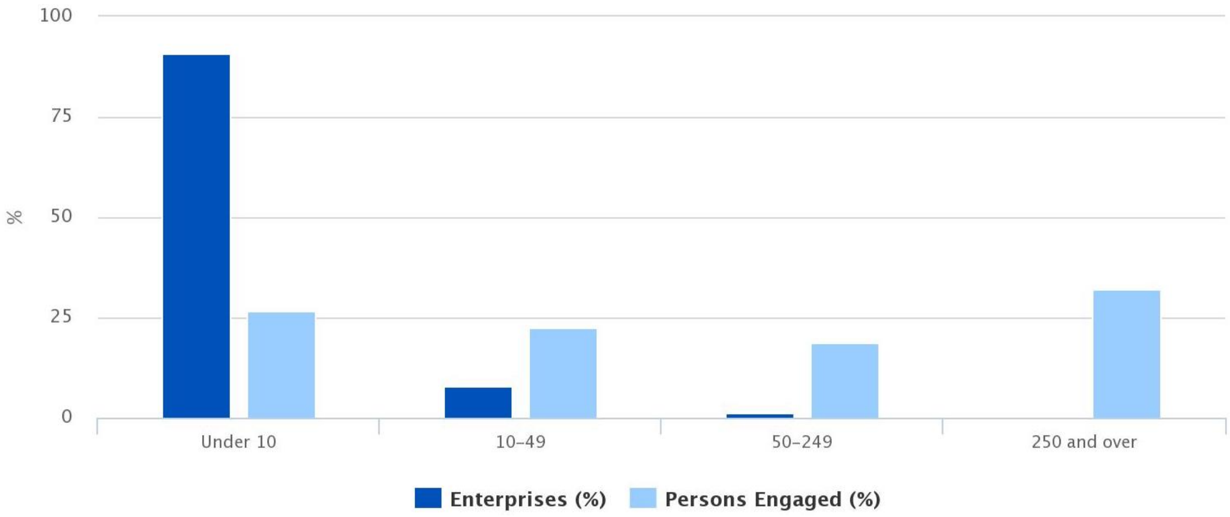
The cost of implementing this proposal has been previously estimated at €450m. This represents a 16% increase on the current total cost of the PAYE tax credit to Government.

3. GROWING A MICRO BUSINESS

This Government has sought to encourage individuals to start up their own businesses through a range of supports and tax policies. Enterprise Ireland's corporate strategy document to 2016 indicates that EI will "actively encourage more Irish owned companies to consider the benefits of staying in longer and to consider IPO as an option". However, achieving this worthy goal will be impossible if the proper supports are not in place for growing Irish companies.

As illustrated by the table below, there are many microenterprises (companies with less than 10 staff) in Ireland which operate on a modest but profitable basis. Many microenterprises have only one or two staff.

Percentage of Enterprises and Persons Engaged by Size (CSO 2012)



Dublin Chamber believes small, indigenous Irish businesses should be encouraged to transition from micro (less than 10) to small (10-49 staff). This can be achieved by removing the cash flow barriers that face micro businesses.

Scaling a business beyond 2 employees into a larger operation is, for many, a far bigger step than the initial decision to start up. A period of poor operations can easily be the difference between the entrepreneur taking a meagre salary, or even paying themselves no salary for a given month. As staff numbers grow, so too do the risks for the owner/manager, and the task of balancing the revenue and payroll become more onerous.

Conversely, large companies benefit from efficiencies and economies of scale, so that the cost of hiring, paying and managing staff is significantly lower per head than for small companies. Potential hires may also be drawn to larger firms due to better brand recognition and a perception that such companies are more likely to survive in the long run.

Dublin Chamber recommends that Government facilitate the creation of jobs in Irish businesses by implementing the below proposals. The Chamber's proposals are consistent with the 'three-year' approach of many existing Government incentives which support startups and microenterprises (e.g. EII, corporation tax holiday for the first 3 years of trading).

3.1. Employer PRSI credit

The Government is correct to focus on encouraging entrepreneurship but this means supporting entrepreneurs through all stages of the business cycle, including growth and scaling. The cost base to enable these businesses to recruit key staff must be reduced.

Employer's PRSI is the same regardless of the size of the business. This creates a significant barrier to hiring for smaller businesses, and inhibits their capacity to create jobs and scale.

> "*My business is small but our sales are growing. Despite this, it's difficult for me to be sure it's safe for my business to take on a new person. If this employer PRSI credit was in place, I could hire someone tomorrow.*"

Recommendation: Introduce a rebate on employer PRSI for growing micro businesses

To assist micro businesses to expand, the Chamber recommends that the Government offer a PRSI tax credit for the first three years of each new hire in firms with between 2 and 9 current employees.

The credit would be non-transferable in terms of the staff number it is associated with. For example, if a new hire within such a company left before the credit is fully used up, the remaining credit could only be used if another person was hired in their place.

The number of active enterprises in Ireland with 1 to 4 staff was 65,810 and with 5 to 9 staff was 16,364 in 2012 (last available data), according to CSO business demography figures. If each of these companies took on only 1 additional staff member that would increase employment by 80,000 and would bring the current unemployment rate down to 6%.

A model exists for this in the Government's Employer Job (PRSI) Incentive Scheme, which is aimed at all businesses hiring employees off the live register. The cost benefit for the state would be roughly €17,000 based on the employers' PRSI cost vs the reduced cost on unemployment benefits.

3.2. R&D tax credit and key employees

Businesses can receive a tax credit on R&D activities of 25% for allowable expenditure. Under the legislation this credit can be transferred to key employees, which means that the main R&D cost for business – payroll cost – can be eased. This policy has been successful in bringing the innovation economy to many large firms, but has left many Irish SMEs behind by design.

The relief in its current form is flawed and is significantly under-used – it simply does not work for those in the SME sector that need it most. A modest number of companies have claimed the relief for their key R&D employees. The relief is perceived generally by companies as being difficult to apply, overly restrictive and high-risk (given that costs fall to the employer company in the event of an over-claim).

The current legislation (Section 766(2A) of the Taxes Consolidation Act 1997) puts in place unnecessary barriers to the use of a tax credit transfer between the business and staff. These include minimum effective income tax levels, preclusions on a director of the company (current, past, or of an associate company) and the requirement to have never held more than 5% of the value of the company in the form of shares.

The provisions require that the eligible employee has a minimum effective income tax rate of 23%. This does not take into account Universal Social Charge (USC) and Pay Related Social Insurance (PRSI). The minimum effective tax rate requirement means that the income tax credit for key R&D employees would not have any benefit for a single person earning about €59,000 or a married with one income household earning about €79,500. In practice, the relief does not give any incentive to Irish businesses to hire young Irish scientists, as the standard pay ranges commanded by such staff are insufficient to exceed the minimum effective tax rate threshold. The relief would be more effective in generating jobs and in aligning with the wider objectives of the Knowledge Development Box scheme if it could also operate to support the employment in Ireland of new science graduates and post graduates.

Finally, the relief requires that the claimant company is paying corporation tax. This precludes startups or those companies just emerging from the startup phase which still have not generated sufficient taxable profits to recover losses carried forward. These companies are often at the greatest risk of loss of R&D personnel as they tend to have the least resources and capacity to pay that 'something extra' to retain their research personnel. If the R&D tax credit is capable of being encashed through refunds of payroll tax liabilities, there is no reason why it should not also be eligible for use by the employer to surrender to fund an employment tax credit for an eligible employee.

Recommendation: Reform the relief for key employees engaged in R&D Activities

Dublin Chamber recommends that removing the requirement that the eligible employee cannot be a director of the company or an associated company, so as to allow scope for the boards of directors of companies to include key R&D personnel. In addition, the requirement for a minimum effective tax rate for the employee should also be removed as the relief is already inherently self-funding and neutral from a tax revenues perspective.

The nature of this relief, which transfers corporate tax credits to individual income tax credits, means that the proposal is tax revenue neutrality.

4. SUPPORTING BUSINESSES TO MATURE OR REINVEST IN IRELAND

Enterprise Ireland has recognised the challenge that exists in supporting the development and growth of small indigenous business in Ireland once the business reaches a certain size. A range of factors make it more attractive for the founders of the business to sell and realise their investment in the business by means of a capital gain. Once a founder has sold (often to international investors), the links with Ireland are reduced as the business matures – especially in the case of mobile businesses rich in IP.

Dublin Chamber's recommendations focus on two objectives during this phase to either support entrepreneurs to stay in their businesses or, if they do exit, to make it attractive for them to re-invest in another entrepreneur in Ireland.

Ireland's Capital Gains Tax rate of 33% is among the highest in Europe and significantly higher than the effective rates of nearly all of our competitors for investment. Moreover, Ireland's CGT rate has increased by a full 65% over the past four years. Despite the rising rate, the tax receipts from CGT have dropped over the past four years. In 2013, €369m was collected compared to €542m in 2009.

These high rates of CGT on equity gains damage Ireland's ability to generate domestic direct investment, or 'DDI'. An entrepreneur with an investment plan will consider the attractions of simply moving their business to Northern Ireland or Great Britain to avail of the significant economic advantages.

In the UK, there are three CGT rates 10%, 18% and 28% depending on the nature and the individual's total taxable income. The 10% rate applies to qualifying entrepreneurial gains. To qualify individuals may invest in a business provided they own at least 5% of that business and have worked there for at least one year. If the investment meets these criteria, investors can earn up to £10m in gains at a special lower rate of 10%.

In contrast, the entrepreneurial relief in Ireland introduced in Budget 2014 is relatively narrow and complex in its application, largely benefitting investors who achieve gains from at least two successful prior investments. There has been a reported increase in the number of moves overseas prior to exit and the number of business establishment decisions have come down to these factors in the past 2 years.

4.1. Dividends to entrepreneurs

Dublin Chamber believes that the first objective of Government in relation to policies for this business cycle phase must be to support the retention of those who are entrepreneurs for the longer term in the business they have founded.

Once their business has matured, many entrepreneurs seek to extract money from their company after years of re-investing their salary back into the company. At present, the nature of incorporated businesses and the income tax system in Ireland is such that a business exit (possibly in another jurisdiction) rather than a dividend payment is the most efficient method for an entrepreneur to extract cash from their business.

Of course, Ireland is not alone in trying to develop an entrepreneurial eco-system. In the US, capital gains on assets held for more than 12 months are taxed at 23.8% compared to the income tax rate of 43.4%. "Qualified" dividends are also taxed at 23.8%. In doing so they have provided tax equality for the business decision to stay or exit.

An additional aspect of the US system is that, for individuals who hold stock in a "qualified small business", some or all of the gain may be subject to an exclusion of 50% or higher. To qualify as a small business, the seller must have acquired the stock of a US corporation at its original issue in exchange for money property or compensation for services and must have held the stock for at least five years. The corporation must have had gross assets both before and after the share issuance of no more than $50m. During the period that the stock was held by the individual, at least 80% of the value of the corporation's assets must be applied in the active conduct of a trade or business. In addition, roll over relief may be available to defer the capital gain arising where the disposal proceeds are reinvested in shares of a qualifying company within 60 days of the original disposal and provided the reinvestment satisfies a number of other criteria for eligibility to the rollover relief.

Recommendation: Equalise the tax rate on dividends to entrepreneurs and CGT

Dublin Chamber recommends the creation of the same tax rate (10%) on dividends paid to entrepreneurs from qualifying companies. When combined with a 12.5% corporation tax rate on the profits of the company from which the dividends are paid, the rate of tax received by the Irish Exchequer would still exceed 20%.

Under such changes, dividends paid by a qualifying company to a qualifying entrepreneur are eligible to be taxed at an income tax rate of 10% which represents the final tax on the dividends. The dividends are exempt from Universal Social Charge (USC) and Pay Related Social Insurance (PRSI). The payment would be subject to a lifetime limit of €15m, for example. Excess dividends over this limit remain taxable at the standard rate of income tax, Universal Social Charge (USC) and Pay related Social Insurance (PRSI).

For a period of at least one year before receipt of such dividends, the individual must own at least 5% of the ordinary share capital, 5% of the voting rights and be an officer or employee (full or part time) of the company. The dividends should be funded from profits of the company from periods during which the individual meets the above qualifying conditions and the company meets conditions equivalent to those outlined above for qualifying companies under the CGT Entrepreneurs' Relief.

The Dividend Withholding Tax yielded €268m in 2014. If 10% of qualifying individuals claiming dividends are entrepreneurs (a high estimate), the impact of this proposal on the Dividend Withholding Tax receipts would only be around €14m. However, the overall impact would be dependent on the general income tax position of the individual, as the Tax is withheld at the standard rate only.

4.2. Rollover relief on CGT

In simple terms, Capital Gains Tax (CGT) rollover relief is just a deferral of a CGT liability – it is not an exemption from paying it.

The Tax Strategy Group in its 2012 papers (TSG 12/17) asked proponents of the re-introduction of roll-over relief to "provide some concrete proposals for how such a relief could be introduced for specific asset disposals subsequently used for productive investment and the benefits that would accrue to the economy as a result." The Chamber offers the following recommendations in this context.

In Germany, gains on shares can make use of a rollover relief principally available up to a maximum ceiling of €500,000 of eligible gains. The relief may be used to reduce the acquisition or manufacturing cost of qualifying replacement assets acquired or manufactured after the gain was realised. Qualifying replacement assets are:

- Shares and other depreciable movable assets acquired or manufactured within the next 2 years; and
- Buildings acquired or manufactured within the next 4 years.

The rollover relief for buildings and movable assets other than shares is limited to the taxable gain (i.e. 60% of the total gain). Further benefits may apply in the case of a share-for-share exchange.

There is an opportunity in the UK for a UK resident individual to defer taxation on a normal (non-10% eligible) gain which would otherwise have arisen by subscribing for shares of a company which meets the criteria for eligibility under the UK Enterprise Investment Scheme (EIS) rules. The deferral provides more funds to the entrepreneur for new investment in shares of an EIS qualifying company. The gain deferred by the entrepreneur on disposal of the old assets is triggered on disposal of the new company shares and taxed at 28% at that date. A gain realised on disposal of the new company shares may be taxed at the 10% CGT rate, if the conditions for Entrepreneurs' Relief are met.

Recommendation: Amend rollover relief from CGT to encourage uptake from entrepreneurs

Dublin Chamber recommends that Ireland's current Entrepreneurs' Relief be reshaped to offer a rollover similar to the UK or a deferral facility rather than the current approach of offering credit relief on a second qualifying gain. The suggested features of an Entrepreneur Rollover Relief are set out below.

- CGT on normal (non 10% eligible) gains realised by individuals can be deferred where the proceeds on the disposal are used by the individual to subscribe for new share capital in a company which meets the conditions to be an eligible company for the Employment and Investment Incentive (EII) relief.
- The company does not necessarily have to raise capital under EII relief but simply needs to meet these conditions.
- The CGT on a gain deferred by the individual on the original disposal becomes due when the new investment in shares of the company are ultimately disposed of.

This encourages an existing investor to become an entrepreneur and invest in a qualifying new venture. This should mean a more effective targeting of the relief at SMEs and startups with high growth potential and a greater likelihood that the relief will increase revenue from a tax collection perspective. The combination of an Entrepreneur Relief offering a simple tax rate at 10% and this opportunity to defer tax on normal gains and free up capital for investment should reinforce opportunities in Ireland for serial entrepreneurs.

II. Bottlenecks to growth

1. INTRODUCTION

The Dublin region is the engine of the national economy (accounting for 42% of Ireland's GDP and half of all employment) and generates a majority of the tax revenue (55% of Ireland's tax revenue). Given its importance for Ireland's economic wellbeing, Budget 2016 must ensure that the region remains competitive on the world stage.

The Government and Dublin Chamber of Commerce are supportive of the renewed economic growth, but growth brings with it a new set of problems: busier roads, longer commute times, congested buses and trains, rising rents, and a dwindling housing supply.

In this section, Dublin Chamber sets out its propsals for addressing the infrastructural and regulatory barriers that, if left unresolved, will slow down and potentially halt the positive movement towards growth we have seen in recent times.

2. ATTRACTING TALENT

Attracting international executives through their tax treatment is a sensitive political issue, but has significant potential for domestic job creation. For Ireland to compete globally and attract both business and key skills into the country, a more appealing income tax regime is essential.

2.1. Personal taxation

In Ireland, the top rate of personal income tax combined with USC and PRSI is 52%, applying from an income level of €33,800. This actual rate of tax is one of the highest in the world, and the income level at which this rate applies is very low. By comparison, the top rate in the UK comes into effect at approximately €182,000 and in the US at €290,000. The rate is perceived as unfair, appearing to take over half of executives' income starting from a low level.

Recommendation: Reduce the high marginal rate of tax

2.2. Share-based remuneration

To mitigate the penal rates of labour taxation, most multinational companies and many listed Irish companies incentivise their employees by providing equity compensation as part of a long term incentive plan. In addition, many startup companies offer long term equity compensation as it is often the only way they can attract the required talent to develop and grow their business.

Long Term Incentive Plans (LTIPs) are designed to achieve various objectives such as attracting and retaining employees, driving growth by attaining sustainable performance targets, aligning the interests of employees with that of the shareholders and encouraging entrepreneurial activity. It makes sense to use the tax system to encourage a culture of entrepreneurship and share ownership among Irish employers and their employees.

However, the current environment can be improved upon. Dublin Chamber recommends that the Government conduct a review of share-based remuneration to address the limitations that exist.

Recommendation: Improve tax reliefs for share-based remuneration

In conducting the review, the Government could consider introducing a tax relief for Long Term Incentive Plans to encourage domestic companies to support greater employee/founder share participations.

The existing legislation (Section 128D, Taxes Consolidation Act 1997) provides tax relief for employees who acquire shares in their employer companies and where there is a written agreement in place under the terms of which there is a restriction on the freedom of the employee to dispose of the shares for a period of time. The relief operates to abate the market value of the shares on award by 10% for each year of the restriction subject to a maximum abatement of 60% where the restriction is more than 5 years. While this relief can be worthwhile in certain circumstances it has two main drawbacks.

First, the relief is narrowly defined. Second, the tax is payable in year one on the market value of the shares less the abated amount requiring employees to fund the payment of tax from their own resources as they cannot dispose of any of the shares due to the restrictions nor can they pledge the shares as security for a loan.

To make the relief more attractive in encouraging domestic companies to support greater employee/founder share participations, the legislation could be amended to include tax relief for LTIPs. By doing so the relief will no longer 'put off' globally mobile employees and encourage domestic companies to support greater employee/founder share participation.

The following measures could be also considered:

- Widen the definition of shares;
- Provide for tax to arise on expiration of the hold period by reference to the market value on date it was awarded reduced by the abated amount and the amount paid;
- Set a minimum hold period in the LTIPs of 3 years as this would be quite common for these types of structures;
- Schedule the abatement at the market value by reference to the hold period in the LTIP as follows (for example: 30% for 3 years; 40% for 4 years; 50% for 5 years);
- Exempt the LTIPs awards from employer PRSI;
- Provide that the base for cost for capital gains tax purposes would be the market value on award; and
- Ensure that dividends paid in respect of the shares would be taxed as appropriate.

3. SPACE TO GROW

The Chamber is concerned with the issue of a lack of space for growth in Dublin. The problem is three-pronged:

- Housing – The affordability and availability of housing is essential for attracting and retaining staff. Ensuring adequate supply of housing will help keep costs down for staff and the knock impact on competitiveness.
- Offices – SME business models are starting to work again and create profits which allow owners to draw fairer salaries and pay back their investors. However, rent increases on office space could reverse these positive trends.
- Hospitality – the tourism industry in Dublin is in full growth mode with a target of achieving attracting 6.2m visitors per year by 2020. However, this growth is simply unachievable if hotel supply and bed capacity is not increased.

The lack of available housing in Dublin is well documented. The ESRI has forecast that 90,000 new homes will be needed in Ireland by 2021, with 60% of these needed required in Dublin. A further 26% these new homes are needed in the commuter belt counties of Louth, Meath, Kildare and Wicklow. In tandem with this trend, it is clear that Dublin businesses are hiring again. Dublin Chamber's member survey indicates that more than half of Dublin businesses (53%) have grown their staff numbers since last year. The affordability and availability of housing is essential for attracting and retaining staff, and continued rent increases driven by a lack of supply threaten Dublin's competitiveness and ability to create new jobs. Budget 2016 must allocate funding to ensure an adequate supply of housing in the Greater Dublin Area, which will help to keep costs down for staff and increase companies' potential for job creation.

SME business models are starting to work again and create profits which allow owners to draw fairer salaries and pay back their investors. However, rent increases on office space will strain and even reverse these positive trends. Many Dublin-based SMEs have been hit by year-on-year office rent increases, sometimes by as much as 5 and 10%.

The recovery of the Dublin tourism market and targets for further growth has drawn attention to the hotel vacancy rates in Dublin which are in single figures. The demand is such that it is difficult for the organisers of large conferences to book rooms in block. This hotel bottleneck will make it difficult for the region and Ireland to achieve tourism number targets and, therefore, job creation from that market.

All of these problems relate to space, and have been exacerbated by a prolonged period of 'no-build' in the city, which has reduced supply. Efforts to re-energise construction activity are slow and developers face cash flow challenges due to the high costs of developing in Dublin.

3.1. Development levies

Building projects will not move forward while construction is not financially viable. The best way to address the space problems outlined above in a way that does not distort the market, is to reduce the barriers to investment generally.

Sector-specific and market-distorting tax schemes for construction need to be recognised by policymakers as mistakes in the past. However, it is clear that measures with appropriate limitations attached could reduce the barriers to construction activity and begin the process of addressing the issue of lack of housing, commercial and hotel space, which is acute in the Dublin region.

Dublin Chamber acknowledges the proposals laid out in the draft Urban Regeneration and Housing Bill "to ensure that any potential barriers in the planning system are removed with a view to facilitating increased activity in the housing construction sector" (quote from Minister 5th June 2015). It is proposed under the new legislation to offer development levy cuts of around 20% when selling houses.

Dublin Chamber considers that this legislation does not go far enough, given the scale and urgency of the problem. The supply of housing has reached crisis levels in Dublin, but the supply of office space and hotel rooms is also on a knife edge.

Recommendation: Implement a two year waiver on development levies to address the housing and space crisis

In order to reduce barriers for new development projects, Dublin Chamber proposes that local authorities (in the case of development charges) and the State (in the case of project-specific levies) waive the application of development levies for a two year period.

In weighing up the cost of implementing such an initiative, Government should consider the potential revenue that would accrue from new developments. If development levies were waived for a limited period, and construction was kick-started as a consequence, the Government could expect new revenues from the commercial rates and property tax to be paid on new developments. These gains would offset the cost somewhat, but the guiding principle behind such a measure is that without this infrastructure Ireland will lose competitiveness and growth may stall.

3.2. The 9% VAT rate

The Government's creation of the 9% VAT rate was a positive move that create a real impact on a labour intensive industry. It improved Ireland's competitive position vis-à-vis other EU Member States, particularly in the food and restaurant sector. Other countries are moving in a similar direction: Germany, France and Spain all currently operate low VAT rates for hotel stays and last year Switzerland announced a 4 year extension of its reduced rate.

In his Budget 2015 Statement, the Minister for Finance mentioned "reports of rising prices" in the tourism sector and reminded that the VAT relief must continue to be "passed through fully to the consumer".

Removing the 9% rate of VAT would threaten the entire Irish tourism industry just as it begins to recover from a deep recession. There has been strong growth in urban tourism, but this growth may stall if the lack of hotel capacity is not addressed. Any change or message of uncertainty with regard to the 9% rate will damage the business case for hotel investments.

Recommendation: Retain the 9% rate of VAT

Dublin Chamber recommends that Government continue to operate the 9% reduced rate of VAT. It has been a clear success for the tourism sector and is the mechanism by which the Government's ambitious tourism targets can be achieved.

The impact of increasing the rate would either be an increase the price of goods and services, which would harm competitiveness, or if prices stayed constant, a reduction in the amount of money available to re-invest in the industry. Either outcome would negatively impact on the private sector investment needed to meet Government tourism targets for growth of 2.7m visitors (from 7.3m in 2014) by 2025.

3.3. Vacant sites

A crucial element in realising the Government's plans for liveable, sustainable cities in Ireland rests on the refurbishment and redevelopment of existing vacant lots in urban areas.

There are 63 hectares of vacant land in Dublin, comprising approximately 300 individual sites. The success of projects such as Granby Park, City Assembly House and the Chocolate Factory, together with the positive public response to news of the Iveagh markets and Victorian fruit and vegetable market redevelopments suggest that Dubliners are keen to see vacant sites and buildings put to good use. Dublin Chamber fully supports such developments which boost local businesses and enhance community ownership of urban amenities.

The draft Urban Regeneration and Housing Bill proposes to introduce a levy to be charged on the registered owners of vacant sites at a rate of 3% of the market value of each site, with reduced or zero rates applying in certain circumstances. If adopted, this levy should apply to <u>all</u> vacant sites including those in public ownership.

However, Dublin Chamber is concerned that the current discussion around the vacant site tax seems to assume a high incidence of 'hoarding' by land owners. The Chamber considers that the real issue is that many owners and developers find it extremely difficult to raise the finance necessary to develop their sites. The Government must address the barriers to financing development to ensure that those who want to build are capable of doing so. This would leave only a small minority who are 'land-banking' property.

Recommendation: Introduce a levy for all vacant sites and address the barriers to financing development

Furthermore, any vacant site tax should only apply to (a) zoned land that is (b) capable of being developed and (c) is viable if developed now.

a) <u>Zoned Land</u> Developers should not be penalised if the local authority has not zoned the land for development or the developer is seeking to alter the planning permission. So, if the landowner can prove that they are actively engaging in advancing the development by incurring significant costs in design teams and planning consultants or if they can prove that they are engaging with the local authority, then they should be exempt from the tax.

b) Capable of Being Developed Dublin Chamber is aware of a practical example in which, due to planning restrictions, a large parcel of land in Dublin requires the completion of a 3 million sq. ft. town centre before any residential construction can begin. This is unacceptable in the current climate, in which space is at a premium. An exemption to the vacant site tax should apply to developers who are in the process of assembling a parcel of land for development. A solicitor can certify that various offers have been made and possibly refused.

c) Viable The viability of a development depends on a number of factors such as the price paid for the land or the demand for commercial space/housing in the area. If the site is not viable, then no levy should apply.

3.4. Flexibility in and objectives of the planning system

The Chamber urges the Government to follow through on its commitment to greater planning flexibility as set out in the Construction 2020 plan.

The rezoning of brownfield sites remain a significant challenge. If unlocked, they could provide sites for tens of thousands of accommodation units in the Dublin region. In addition, Dublin Chamber welcomes the review of NAMA strategy and strongly supports the proposal for an accelerated disposal strategy that will mean at least 80% of the assets will be disposed of by end 2016.

Recommendation: Allow for greater flexibility in the planning system

The seven storey limit in place in Dublin is excessive, and acts as a strong impediment to development. Increasing density in urban centres will reduce the cost of infrastructure, such as transport and water.

More broadly, Dublin Chamber believes that a Forward Planning model should be developed and implemented. Appeals can cause significant delays. As a result, Dublin Chamber believes that a statutory deadline, rather than a statutory objective, should apply to appeals to An Bord Pleanála. If this deadline is missed then automatic approval for the application should ensue.
Finally, the third party appeals system should be addressed as part of a wider review of public participation. Consideration should be given to allowing Local Authorities or the Board to grant or deny leave to appeal to third parties.

4. INFRASTRUCTURE TO SUPPORT GROWTH

Despite the return to growth in recent years, capital expenditure in Ireland has not recovered from its precipitous fall during the recession. The country is now suffering the consequences of underinvestment and spending must be returned to appropriate levels if Ireland's recovery is to consolidate and continue.

Dublin Chamber acknowledges the Government's Capital Plan 2016-2020 (the details of which have not been announced at the time of publication of this pre-Budget submission) which proposes to raise capital expenditure to 2.5% of GDP. Along with Government, the Chamber advocates a counter-cyclical approach to spending, and recognises that it is poor economic policy to adjust strategic investments according to economic cycles. The Chamber is concerned that the fiscal policy is being driven by availability of funds rather than meeting the strategic needs of the country. Decision makers must learn the lessons of the past – spending money when it is available is poor use of taxpayer monies. The Chamber is concerned by data presented in the EU's Post-Programme Surveillance report on Ireland, which indicate that as the economy grows the Government is increasing expenditure to match.

However, it is worth noting that capital expenditure currently stands at about one third of what it was at its peak of some €9 billion in 2008. Although not necessarily advocating a return to such levels, Dublin Chamber reminds that a consistent, sustainable approach to capital expenditure is one of the building blocks of a healthy, growing economy.

4.1. Transport

A survey of Dublin Chamber's members in late 2014 indicated that over 80% of businesses believe that congestion will become a competitiveness issue for Dublin. Three out of five businesses surveyed said they were already paying the price of congestion through its impact on suppliers, customers or staff.

The situation is now urgent. Under current government planning, the commencement and delivery of major projects is at least ten years away and, in the interim, the GDA will continue to grow without the necessary infrastructure. Capacity has been rapidly filled in recent years and it is clear that action is required now to prevent Dublin coming to a standstill.

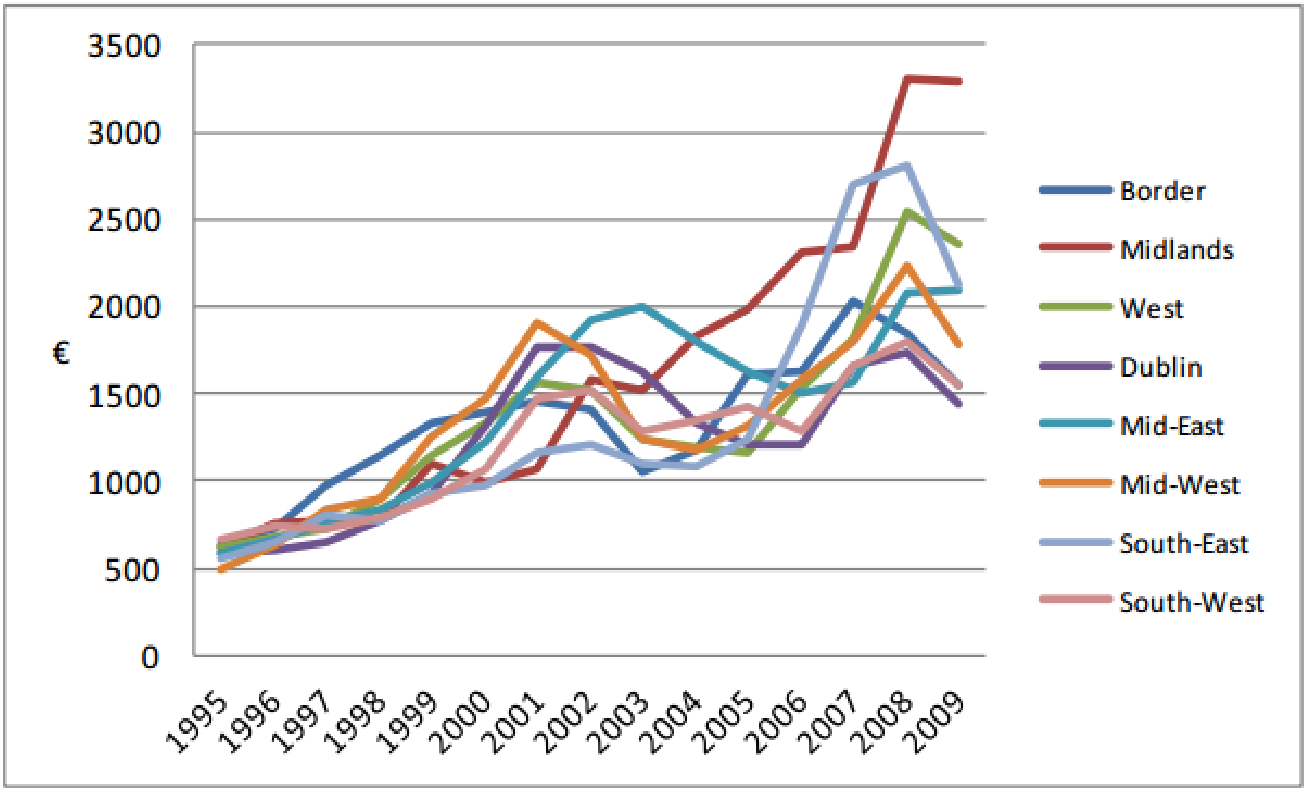
A thriving business community depends on the sustainable transport of goods and people into, out of and through the Greater Dublin Area. From a FDI perspective, one of the key factors influencing a company's decision on where to locate their business is 'ease of travelling around within the city', according to Cushman & Wakefield's 'European Cities Monitor 2011'.

Recommendation: Develop a long term, appropriately-funded plan for investing in Dublin's transport network

Dublin Chamber considers that underinvestment in transport is the main contributing factor behind this worsening issue. At present, the transport capital envelope for Dublin stands at approximately €150m p.a. Benchmarking Dublin against its global competitors, it is clear that (a per-capita adjusted) London invests some €462m p.a., while Manchester invests €367m p.a. The Minister for Transport has repeatedly stated that €1.3 billion is needed each year simply to maintain our existing transport system. Yet, in 2015, total Exchequer investment amounts to around €1 billion. This means there is currently a €300m shortfall for maintaining the system as it is - without any investment in new infrastructure.

In Budget 2016, the Government must commit to closing this gap, by tripling annual investment in Dublin's transport system. Delivering improved services and increased capacity means significantly upping investment levels. Contrary to popular belief, Dublin has not received over and above its 'fair share' in public capital expenditure. In fact, investment the GDA has been considerably lower than per capita levels across Ireland. A paper prepared by Edgar Morgenroth of the ESRI for the Department of Transport studied the level of per capita expenditure across the regions, finding that the Midlands region received the highest expenditure in 2009 and Dublin received the lowest per capita expenditure. These findings are illustrated in the graph below. This analysis is offered to counter a commonly held view. Dublin Chamber wishes to emphasise that a 'pie cutting' approach to regional transport investment is wrong in principle. Decisions must be made according to the costs and benefits for the national economy.

Real per capita public capital expenditure by region



Source: The Regional Development Impacts of Transport Infrastructure, Edgar Morgenroth, 2014