Submission to Department of Finance Public Consultation on Tax and Entrepreneurship

14th July 2015

Introduction

"One of the strategic objectives of the National Policy Statement is to create a business environment – including the tax environment - in Ireland where it is easy to start up and grow a new business."

Dublin Chamber fully supports the above statement of intent to facilitate and protect entrepreneurship in Ireland. In this submission, Dublin Chamber discusses the measures that can be taken to achieve this aim and enhance the environment for entrepreneurs.

In developing this submission, Dublin Chamber consulted with its membership which comprises firms over 1,300 businesses of all sizes in a wide variety of sectors. Direct quotes from this consultative process are included in blue boxes throughout the document, and the recommendations have been approved by the Chamber's governing Council.

The Chamber's recommendations were elaborated through engagement with member companies and its directly elected Council. In addition to the Chamber's response to the consultation, this submission includes direct quotes from member companies, which are presented here in blue boxes. The views expressed do not necessarily reflect the opinion of the Chamber or the Council but are offered as insights into the range of views from Dublin businesses.

1. **What role, if any, should the tax system play in encouraging entrepreneurship?**

The Department's consultation paper cites the economist William Baumol, who describes the entrepreneur as "an individual who organises, operates and assumes the risk of creating a new business". Dublin Chamber considers that this element of assuming risk is one of the most important components of entrepreneurship, and one that should be recognised and encouraged.

Starting up requires confidence, and starting up again after a first failure even more so. Irish entrepreneurs should be confident that if a venture does not work out on one occasion, the business environment and the tax system will support them in trying again.

At present, 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.

2. **What barriers to establishing enterprises exist in the current tax system?**

Many Government supports are in place to assist entrepreneurs in establishing their business. The Government is correct to focus on encouraging entrepreneurship but this means supporting entrepreneurs through <u>all stages</u> of the business cycle, including growth and scaling. The Irish tax regime does not currently encourage entrepreneurs to grow their businesses domestically to a scale where they have the potential to internationalise and become world leaders.

Small, indigenous Irish businesses should be encouraged to transition from micro (less than 10) to small (10-49 staff). 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 becomes more onerous. The costs of recruiting key staff must be reduced.

The Government could improve the situation by reforming employer's PRSI as outlined below.

Employer's PRSI is the same regardless of the size of the business, creating a significant barrier for small businesses and inhibits their capacity to create jobs and scale. 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. **What existing tax measures are effective in supporting small businesses and encouraging entrepreneurs?**

In recent years, Government has introduced a number of highly-targeted measures designed to support growth and employment. Some of the schemes identified by Dublin Chamber members as being effective include:

- Start Your Own Business Relief – exemption from Income Tax up to a maximum of €40,000 per annum for a period of two years to individuals who set up a qualifying business; having been unemployed for a period of at least 12 months prior to starting the business

- The Back to Work Enterprise Allowance – unemployed people starting a business can keep 100% of their social welfare payment in year 1 of trading and 75% in year 2 (in addition to income earned from the business)

One thing we should push for is "allowing failure". Currently in Ireland if you fail in business not only are there no supports for you but the system actually works against you getting back into business. If you were on the Back to Work Enterprise Allowance (BTWEA) before your business failing, and are unlucky enough to become unemployed again, you are not allowed to return to the BTWEA and start a business for a further 5 years. We should not be discouraging those that are courageous enough to get up and start again. Valuable learnings come through failure that make failure unlikely a second time.

- 12.5% rate of corporation tax and 3 year holiday from this rate on start up

- Grants and supports through the LEOs and Enterprise Ireland

LEO, BIC and EI are amazing services to advise and orientate, but there are no funding solutions available if not loans.

Even if your company qualifies as a HPSU with Enterprise Ireland, they are not keen to finance until another investor ready made an investment.

- Microfinance Ireland – facility for entrepreneurs who are unable to access credit through traditional channels

- Employment & Investment Incentive Scheme

- Innovation Vouchers

The Innovation Voucher scheme is useful, however higher amounts would be more effective.

- Jobs Plus and Jobs Bridge for hiring new staff
- Startup Refunds for Entrepreneurs (SURE) - tax relief incentive scheme –

Although very new, this is a welcome initiative.

- Accelerated Capital Allowance Scheme

These measures have helped to provide the necessary infrastructure and access to finance for new businesses and businesses with high growth potential.

However, these measures can be simplified, extended and improved in order to ensure that the tax regime for individual entrepreneurs is sufficiently competitive to attract and retain individual entrepreneurial effort in Ireland.

In the next section, Dublin Chamber outlines the measures that can be taken to improve the above and other schemes.

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

JobBridge

JobBridge has helped with two hires for us but we had to go through a lot of CVs and interviews to make it successful. This is time consuming. I note that Glasgow Chamber of Commerce has a 'work readiness' scheme where the unemployed have to be trained and certified as 'work ready', which has, I believe, been very successful.

Funding

The biggest issue I think entrepreneurs have in Ireland is the difficulty getting funding, whether from the EI venture funding or from the so-called European funding from the banks. This results in company founders giving up huge swathes of equity just before they commercialise. This is especially the case in the high tech agri-food sector. The end result of this is that these companies never reach their full potential. The promoters need to stay in the companies longer if they are to achieve international scale. It is ridiculous to say on one hand that entrepreneurs should have access this funding and on the other that they can't have it unless most of the company is given away before starting. There is a big gap between early funding and access to commercial funds. It takes at least €1,000,000 to take a High Potential Start-Up (HPSU) to international trading, even in the most optimistic situation. Most companies can get to €500,000, however you generally hit a wall right when the European fund etc. should be coming on stream. At present if you are not an IT company, in bill pay technology or something similar, then there is little interest and even less understanding or knowledge of your business potential.

The Feasibility Grant from LEO would work, however it's dedicated to funds that have to be injected and not the ones that are already invested.

Rental income

Interest against rental income is deductible where the borrowing is used to purchase, improve or repair the rented premises. However the deduction is limited to 75% in the case of residential premises. This discriminates against many of the self-employed who work from home.

Income Tax

5. **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?**

Dublin Chamber considers that there is scope for greater alignment between the treatment of self-assessed and PAYE taxpayers. 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. The Government can help to recognise the role of entrepreneurs in job creation by levelling the playing field.

PAYE allowance
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.

The Government could rectify the situation by introducing a PAYE allowance for sole traders and Proprietary Directors. 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.

Personal taxation
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 Irish rate is perceived as unfair, appearing to take over half of executives' income starting from a low level.

Furthermore, the USC charges levied on the self-employed are punitive and discourage entrepreneurial effort. Those earning more than €70,000 pay 8% USC on any income over this amount, and an additional 3% USC on earnings above €100,000.

The Government must fulfil its commitment to abolish these rates, a measure that was promised for Budget 2015, but not delivered.

Capital Gains Tax

6. **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?**

The CGT environment for entrepreneurs in Ireland could be improved through the adoption of three recommendations as set out below.

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%.

A similar approach is outlined in the Dublin Startup Leadership Group submission to this consultation, which proposes a measure that would compete with the UK's Seed Enterprise Investment Scheme (SEIS).

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%.

Amend rollover relief from CGT to encourage uptake from entrepreneurs
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.

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.

7. **What specific aims and rationale would underpin such changes to the relief?**

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.

8. **Corporation Tax**

Section 486C of the Taxes Consolidation Act 1997 provides relief from corporation tax for certain start-up companies. The relief was extended in Finance Bill 2014 until the end of 2015 to allow for a comprehensive review of the measure in 2015 in line with the New Guidelines for the Evaluation of Tax Expenditures. The Department would welcome detailed submissions from interested parties in respect of Section 486C. The relief will be reviewed on the basis of the following questions:

a. Has the relief led to an increase in employment and economic activity?
b. How many jobs have been supported by this relief?
c. What types of companies are using the relief?
d. What has been the impact have the carry-forward provisions introduced in Finance Act 2013?
e. What role does the relief play in decisions by start-up businesses on whether or not to incorporate?
f. Are there specific elements of 486C that should be considered as part of the review?

The relief is good, however we might not benefit from it since we're getting on board a foreign investor hence we have to move the company abroad with 5 FTEs and up to 13 FTEs projected in the next year. Even on this point the cause is lack of funding.

The relief plays a big role play in decisions by start-up businesses on whether or not to incorporate. We wish we could benefit by being an Irish company, however again when there is lack of funding and the financial support comes from abroad, you have to transfer the company.