Submission to the Department of Enterprise, Trade & Employment on the National SME Growth Plan

October 2020

Dublin Chamber is the representative body for businesses in the Greater Dublin Area, with a diverse membership base spanning the spectrum from small start-ups to major multinationals. The Chamber's vision is that Dublin will be globally renowned for both its economic vitality and quality of life. We are pleased to make this submission to the Department of Enterprise, Trade & Employment in respect of Government's new National SME Growth Plan. Dublin Chamber's key recommendations are outlined in respect of each of the themes under examination by the SME Growth Taskforce. Further information on Chamber policy in these areas is available on the Chamber website or by contacting the Chamber team at policy@dublinchamber.ie.

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1. Productivity, Digitalisation & Competitiveness

1.1. Introduce a new 20% CGT rate for investments in unlisted trading firms

Helping Ireland's indigenous business base to recover and grow will require greater investment in SMEs. The ESRI identified a significant investment gap in the Irish SME sector in a joint study with the Dept. Finance several years ago, estimating that the gap amounts to over €1 billion annually.[1] The situation has deteriorated drastically due to Covid-19, with estimates of the revenue shortfall facing SMEs at the end of 2020 now ranging from €10.3 billion (Central Bank) to €15 billion (ESRI). However, Ireland's flat rate of Capital Gains Tax undermines efforts to promote investment in SMEs as there is no incentive to invest in a home-grown start-up rather than in a longer-established multinational company. On the contrary, the present Capital Gains Tax (CGT) regime effectively incentivises passive investment in 'blue chip' foreign firms over investment in higher-risk domestic enterprises by applying a flat 33% CGT rate, the third highest in Europe,[2] irrespective of the level of risk taken, or the contribution of the underlying investment to the Irish economy.

Dublin Chamber proposes introducing a new 20% CGT rate on investments in unquoted trading businesses, i.e. companies that are not listed on any Stock Exchange, where shares have been held for over 3 years. While still higher than the 10% rate available under the comparable UK Investors Relief scheme, this would be a significant measure to encourage investment in indigenous business. To keep the scheme open to small-scale investors, there should be no minimum percentage shareholding in order to qualify. We recommend establishing a lifetime limit on qualifying gains of €10m.

The Dept. of Finance has previously said it is unable to calculate the cost of introducing any version of the UK scheme in Ireland on the grounds that tax returns do not identify the amount of chargeable gains associated with unquoted shares.[3] It has been calculated that a blanket CGT reduction to 20%, applying to investments in both listed and unlisted firms, would reduce Exchequer revenue by €481 million in a full year.[4] However, this static costing does not account for the increased revenue generated by stimulating business investment and greater participation in share ownership, and is obviously larger than the static cost of a targeted reduction. Moreover, the cost compares favourably with the estimated €440 million cost of cutting the standard rate of VAT from 23% to 21% as part of the July Jobs Stimulus package.[5]

1.2. Improve R&D incentives to boost innovation in Irish SMEs

To address the growing productivity gap between the indigenous and multinational sectors,[6] the Government must increase innovation among SMEs. However, business R&D in Ireland remains dominated by larger, foreign-owned MNCs, with only 1% of small firms engaged in R&D.[7] The Research & Development Tax Credit is one of the principal schemes the Government uses to encourage R&D among businesses. Revenue figures reveal that 70% of the value of the R&D

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[1] "The magnitude of this "investment gap" is economically meaningful and is estimated to be just over 30% (in 2016) relative to SMEs actual investment." ESRI, Measuring the Investment Gap & its Financing Requirements for Irish SMEs, 8 March 2018, https://www.finance.gov.ie/wp-content/uploads/2018/03/180308-Measuring-the-Investment-Gap-and-its-Financing-Requirements-for-Irish-SMEs.pdf

[2] Tax Foundation, 'Capital Gains Tax Rates in Europe', 18 June 2020, https://taxfoundation.org/capital-gains-tax-rates-in-europe-2020/

[3] Dáil Éireann Debate, Thursday 5 July 2018, Question No. 86, Reference No. 29776/18. Deputy Pearse Doherty. Answered by the Minister for Finance Paschal Donohoe.

[4] Dept. Finance, *Capital Gains Tax Capital Acquisitions Tax, Stamp Duty, Tax Strategy Group -19/11*, July 2019, p. 10, https://assets.gov.ie/19127/bf33c368730e4dc58cc7c7930c9b8487.pdf

[5] Government of Ireland, *July Jobs Stimulus 2020*, p. 4, https://www.gov.ie/en/publication/c48ab-july-jobs-stimulus/

[6] OECD Economic Survey of Ireland 2018, https://www.oecd.org/eco/surveys/economic-survey-ireland.htm

[7] European Commission Research & Innovation Observatory Country Report 2017: Ireland, pp. 24-26

tax credit is claimed by companies in the 'Large Cases Division'.[8] Previous Chamber studies confirm a low take-up of the R&D tax credit outside the multinational sector. It has been particularly low among firms founded in Ireland and among firms that are SMEs by the European Commission definition. The same study indicated that use of the tax credit is almost twice as common among large firms as among SMEs and is almost four times more common among foreign firms as among firms founded in Ireland.[9]

The European Commission has advised that the emphasis in Ireland's R&D strategies for business should be to build up research and innovation capability within Irish SMEs, and has recommended that the R&D tax credit scheme must be targeted at SMEs specifically.[10] This was echoed by the OECD in its Review of SME and Entrepreneurship Policy in Ireland, commissioned by the Department of Business Enterprise & Innovation. Dublin Chamber previously called on Government to increase the tax credit to 30% for SMEs and welcomed the progress last year. The 30% rate should now be extended beyond small and micro enterprises to all SMEs in line with the above recommendations. Moreover, many SMEs, and most start-ups, face cash flow issues which make the 3-year deferred claim model unattractive or impractical. Allowing an upfront payment would make the R&D tax credit a more realistic option for early stage firms with lower cash resources. In the competitive context of Brexit, it is also worth noting the UK regime, where there is a special R&D Relief available to SMEs with extremely attractive conditions, including a super deduction of 130% of qualifying costs for SMEs.[11]

The R&D tax credit rate should be increased from 25% to 30% for medium enterprises.[12] Meanwhile, allowance should be made for an upfront claim of the R&D tax credit cash refund for SMEs, instead of the 3 year lagging cash-flow mechanism that currently exists. As this a cash-flow measure, it is would be cost-neutral over a three-year period, with minimal exchequer impact.

1.3. Adopt a smart approach to flexible working

Flexible working and digitalisation must be considered complementary rather than disruptive to existing regional and planning policy, i.e. the National Planning Framework (NPF) and subsidiary plans. The majority of Ireland's SMEs are located in cities and town centres, and continued support for these urban clusters will be critical to the economy. Mismanagement of the digitalisation process, through a one-size-fits-all approach for example, could have negative implications for future prosperity.

While the remote working phenomenon will continue at some level and may be transformative with respect to improved quality of life, surveying confirms that most employees favour a blend of home and office working post-Covid-19. For example, the results of AIB's July Sustainability Index show that a large majority of workers would prefer a blend of remote and in-office working on a sliding scale of a number of days in the office per week, while only a minority are interested

[8] Dept. Finance, TSG 19/05 Tax Incentives for SMEs, p. 29, https://assets.gov.ie/19118/6aaf283f06f74698a49833ea74100098.pdf#page=29
[9] Dublin Chamber Business Risk Outlook Survey Q2 2018
[10] European Commission Research & Innovation Observatory Country Report 2017: Ireland, p. 26
[11] HM Revenue & Customs internal manual, Corporate Intangibles Research & Development Manual, CIRD90000, https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird90000
[12] The cost of raising the rate to 30% for all SMEs was estimated at €30 million. Dáil Éireann Debate Thursday 5 July 2018, Question No. 87, Reference No. 29777/18. Answered by the Minister for Finance Paschal Donohoe.

in a full time remote work set up.[13] Some of the cited challenges of remote working include isolation, loneliness, and motivation, according to a recent study from NUI Galway.[14] It showed that the biggest challenges facing remote workers were different in April, when they were more based on practicalities, to those faced after the summer months, when loneliness and isolation were more prominent. Full time remote working for years as opposed to months may have further impacts on mental health; this remains unknown.

Business feedback suggests similar plans among employers. In the long term, full time remote working is unlikely to be viable for most businesses as functionality and competitiveness must be maintained. The learning environment, teamwork, and creativity cultivated in an in-person office environment cannot be adequately replicated when home working full time. The future of work should therefore include remote working as merely one aspect of a fuller flexible working policy, this is both to the benefit of employees and businesses. Flexible working practices encompass staggered working hours, core working hours, compressed working hours, and more. The goal should be a healthy work-life balance for employees which supports business functionality and national economic competitiveness.

Offices will continue to operate, albeit somewhat differently from before, and will remain important for our cities and other urban centres, where most SMEs are located. The solution to regional development therefore remains a city-regions-based approach as outlined in the NPF, with thriving cities being the drivers of employment and economic development in their respective regions.

1.4. Prioritise upskilling and reskilling for the green economy

In light of the medium-to-long term economic uncertainty Ireland faces, the focus of new upskilling and reskilling programmes should be on an area that has been very well sign-posted for some time now – climate change and the need to transition to a green economic model through carbon emissions reduction and green business practices. This represents the 'safest bet' in terms of a growth area to secure future prosperity. In particular, reskilling and upskilling should be focused on areas of job creation that support the goals of the EU Green Deal. Consideration should be given to seeking required funding for this as part of the European Social Fund. More broadly, it is crucial that there is a cross-Government action plan and infrastructure in place to ensure that Ireland maximises the potential of the European Green Deal.

1.5. Introduce an SME tax credit for 'Going Green'

To accelerate the transition to a sustainable economy, the National Economic Plan must also consider ways of encouraging individual businesses of adopting green business practices. Many of the changes required for a business to 'go green' involve a significant initial outlay, and Government support would assist SMEs in making the transition. It would support both innovation in the SME sector and Ireland's overall shift towards sustainable business practices, carbon emissions reduction, and the circular economy.

[13] AIB Sustainability Index, https://aib.ie/social/blog/2020/07/aib-sustainability-index-covid-impact-on-consumers-making-sustainable-decisions
[14] NUI Galway Remote Working during COVID-19: Ireland's National Survey http://whitakerinstitute.ie/project/remote-working-during-covid-19-irelands-national-survey/

As part of its plan for SME Growth, the Government should consider a tax credit for SMEs that have undertaken and completed three items from an approved list, or 'Sustainable Business Register', to significantly reduce greenhouse gas emissions or otherwise improve sustainability. Items on the list could for example include: facilitation of remote and flexible working; retrofit and energy efficiency measures; green supply chain guarantees; waste management practices; circular economy measures; and adoption of low emissions transport. The tax credit would be linked to the costs incurred in completing these items, and would be modelled on the R&D tax credit, calculated at 25% of qualifying expenditure.

2. Entrepreneurship

Transforming the environment for entrepreneurs in Ireland will require changes to the tax system. Accordingly, the National SME Growth Plan should make provision for the following measures over the lifetime of the plan.

2.1. Improve Entrepreneur Relief

Entrepreneur Relief from Capital Gains Tax provides for disposals of qualifying business assets by entrepreneurs to be charged at a lower 10% CGT rate up to a lifetime limit on chargeable gains.[15] To qualify, among other conditions, an individual must own at least 5% of the business and have spent a certain proportion of their time working in the business as a director or employee for three out of the previous five years prior to disposal. The aim is to encourage entrepreneurs to found, operate, and dispose of businesses in the State, and to build a reputation for Ireland as a country that welcomes and rewards enterprise. Dublin Chamber made the case for the revised Entrepreneur's Relief in 2015 and welcomed its introduction in Budget 2016. Government has previously acknowledged that 'retention [of the relief] is important in the context of possible Brexit impacts and other issues than may arise as the UK exits the EU'.[16]

However, Ireland's offering to entrepreneurs remains starkly uncompetitive in relation to the UK's, which includes a lifetime cap of £10 million (c. €11.1 million in current market prices) on qualifying gains for Entrepreneur Relief. This compares with a €1 million cap in Ireland. A larger limit is required to encourage greater ambition and scaling by entrepreneurs. To send a strong signal that Ireland intends to compete with the UK in the context of Brexit, the Government should upgrade Entrepreneur Relief to surpass the UK. Consideration could also be given to given to amending the 5% share requirement to refer to the point of investment, ensuring that entrepreneurs who retain their initial investment are not penalised as subsequent external investment is received.

The cost of bringing Ireland's lifetime limit up to the nominal UK equivalent of €10 million, as promised by the previous Government, has been estimated at €81 million using the static costing model employed by the Department of Finance. A further increase in the limit to €15 million

[15] Qualifying business assets include those in most productive businesses, excluding businesses involving land dealing or holding investments.

[16] It has previously been argued that Ireland's less generous scheme is compensated for by the existence of Retirement Relief, which can be claimed to values ranging from €500,000 to €3 million. However, this ignores the reality of successful serial entrepreneurship today, which often takes place well before retirement age. Moreover, the combined value of the current reliefs is still substantially lower than the UK equivalent. Dept. Finance, TSG 17/11, Capital & Savings Taxes, 25 July 2017, p.5.

would incur an added annual cost to the exchequer of just €3 million, according to the same model, while positioning Ireland at a clear competitive advantage against the UK.[17]

2.2. Reduce tax on dividends for entrepreneurs to 30%

To develop prospering indigenous businesses on a large scale, it is critically important that Ireland provides a supportive environment for entrepreneurship throughout the life cycle of a business, rather than merely during the start-up phase. Promotion of a start-up culture must be combined with effective long-term rewards for entrepreneurs who choose to stay on and scale their businesses rather than accept the allurement of a short-term reward by selling the firm prematurely. Ireland's present tax regime lacks this holistic and long-term approach. While the State has made a commitment to 'strengthen the competitiveness of Ireland's tax regime to support start-ups, small and medium enterprises (SMEs) scaling',[18] Ireland's competitive position is clearly wanting at present. In the UK, the effective total tax rate on share dividends at the higher rate is 32.5% compared with 52% in Ireland, a stark differential in the context of Brexit.

Under the current system of incentives, divestment is the only means by which entrepreneurs can extract large-scale value from their firm in a manner that is not subject to the full rate of income tax, as Entrepreneur Relief only applies to CGT on the value of shares. Recent changes introduced by the Finance Act 2017 have further increased the difficulty.[19] The result is an 'inefficient incentive' that drives successful businesspeople to 'sell up' rather that stay on and grow their business further. While divestment is an appropriate and desirable outcome for serial entrepreneurs, for example, it should not be the only option that is encouraged. In many cases the scaling of Irish SMEs may be of greater long-term value to the Irish economy.

Dublin Chamber proposes that entrepreneurs should be taxed entrepreneurs at a lower rate of 30% on income from share dividends to outmatch the UK offering ahead of Brexit. [20] The qualifying criteria for this lower rate would be the same as those that apply to individuals and firms with respect to Entrepreneurs Relief from Capital Gains Tax. This should encourage more entrepreneurs to retain and grow their business, reducing the number of "trade sales". Consideration should also be given to extending this dividends relief to income from distributions paid to employees in qualifying start-ups to help them attract and retain staff.

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[17] Dept. Finance, TSG 19/05 Tax Incentives for SMEs, p. 22, https://assets.gov.ie/19118/6aaf283f06f74698a49833ea74100098.pdf#page=22

[18] DBEI, *Enterprise 2025 Renewed: Building resilience in the face of global challenges*, p. ix, https://dbei.gov.ie/en/Publications/Publication-files/Enterprise-2025-Renewed.pdf#page=13

[19] Finance Act 2017 introduced the new Section 135(3A), TCA 1997, as an anti-avoidance mechanism. In practice it serves to convert many genuine transactions from distributions that are subject to CGT into distributions subject to income tax. E.g. management buyouts are a traditional mechanism to allow key stakeholders to exit or retire from their businesses. But making these transactions subject to income tax undermines their attractiveness; it pushes businesses towards sales to third parties or liquidation if a CGT exit is to be achieved.

[20] Revenue tentatively estimated the total cost of a 30% income tax rate on dividend income from Irish resident companies (replacing all income tax, PRSI, and USC currently collected) *applied universally* at €95 million. Restriction of the scheme to qualifying entrepreneurs would of course limit the cost to a fraction of this figure. Dáil Éireann Debate Thursday 5 July 2018, Question No. 85, Reference No. 29775/18. Answered by the Minister for Finance Paschal Donohoe.

3. <u>Internationalisation</u>

2.1. Promote the EEN service to encourage SME internationalisation

Any Government strategy to boost internationalisation among Irish SMEs must include a central role for the Enterprise Europe Network (EEN) which is funded by the European Commission. The EEN is the world's largest support network for SMEs with international ambitions, helping them to innovate and grow on an international scale. Active in over 60 countries, it brings together 3,000 experts from 600 member organisations, all renowned for their excellence in business support, including technology poles, innovations support organisations, universities and research institutions, regional development bodies, and chambers of commerce.

The EEN supports SME internationalisation through a range of services including:

- A free business partner sourcing service, providing access to a database of over 10,000 business opportunities in 65 countries, including companies offering to act as distributors, suppliers, manufacturers, and partners for joint venture, franchising, services, and outsourcing agreements.
- Advice on new markets, including information on domestic legislation, regulations, and local agencies in target countries.
- Advice on access to finance & EU funding.
- Advice on EU legislation.
- Networking opportunities with international trade missions.

88% of all exporters in the EU are SMEs, and there will be a large emphasis on EEN services as part of the EU priorities for its new single market vision. Dublin Chamber is an official EEN service provider, operating a European Commission-backed consortium that includes Cork Chamber, Enterprise Ireland, and other stakeholders.

EEN is a highly effective service to support SME internationalisation. Of Irish companies who participate in the network:

- 89% reported a market improvement.
- 84% reported a quality improvement.
- 70% reported a positive impact on jobs.
- 58% have improved competitiveness.

Government guidance to SMEs must prominently include important information about EEN to increase business awareness of existing opportunities.

2.2. Support chambers of commerce in provision of export services

Dublin Chamber plays a key role in provision of export documentation services, including by providing a fully licensed certification service for ATA Carnets and Certificates of Origin, and legalisation of export documents. The Government should work closely with chambers of commerce in the context of Brexit and plans for greater SME internationalisation, and ensure that official advice to businesses includes guidance on the availability of export services from experience and recognised providers such as Dublin Chamber.

4. Clustering & Networks

4.1. Use chambers of commerce as platforms in new SME support programmes

Chambers of commerce play a critical role in business networking on a geographic basis. They represent pre-existing clusters of business that must be considered in the context of any successful new policy in this area.

For example, Dublin Chamber runs a Sustainability Academy to help businesses become more sustainable and reduce their carbon footprint. It offers a range of supports including access to a dedicated series of sustainability events, green public procurement training, and peer-to-peer learning. Dublin Chamber identified the need for these supports through member surveys and business focus groups. In the context of the Covid-19 crisis, the Chamber has also partnered with Google, Facebook, and the Digital Marketing Institute to support SMEs on the pathway to digitalisation.

Valuable private sector activity in these areas (networking, training, trade development, etc.) should be supported by the Government and special care must be taken not to crowd out such initiatives. National SME policy should establish a test for the avoidance of crowding out existing activities by chambers of commerce and others, before providing further public funding or a more enhanced role for Local Enterprise Offices, for example: Can private sector bodies such as chambers of commerce provide these services more effectively?

4.1.Raise awareness of existing supports available through chambers of commerce

Chambers of commerce offer a range of valuable support services through their networks. In Dublin Chamber's case this includes, for example:

- EuroSTART: a programme offering management support for SMEs, start-ups and entrepreneurs.
- Mobilise SME: a business exchange programme for staff and owners of SMEs to upskill.
- Erasmus for Young Entrepreneurs: an international business exchange programme to strengthen business ties across the EU and develop skills in recent or aspiring entrepreneurs.

Any new national policy for SME growth must include efforts to raise business awareness of these existing support services and maximise the benefit from these opportunities.