



A SMALL BUSINESS STRATEGY FOR IRELAND: A SUPPORTIVE TAX ENVIRONMENT FOR SMALL FIRMS

PKF O'CONNOR, LEDDY & HOLMES LIMITED
SMALL FIRMS ASSOCIATION



SFA

Small Firms Association

PKF

For more information please contact:

Elizabeth Bowen

Small Firms Association

Direct: + 353 1 6051626

Email: elizabeth.bowen@sfa.ie

Catherine McGovern

PKF O'Connor, Leddy & Holmes

Direct: +353 1 496 1444

Email: c.mcgovern@pkf.ie

Foreword

The Irish economy is performing strongly, yet sentiment among small firms dropped in the first half of 2018. This shows that their experiences do not always match the overall economic data.

It is clear to many of us working with small businesses that the story of the Irish economy is based largely on the phenomenal success of the foreign direct investment (FDI) sector. From a policy perspective, this amounts not only to a risk (heavy reliance on FDI in an uncertain global environment), but to a major missed opportunity for Ireland. Small business with less than 50 employees make up almost 99% of all businesses and employ half the private sector workforce, some 720,000 people – but this sector is not fulfilling its potential in terms of productivity, added value, exporting, innovation and scaling.

That's why the SFA has launched a campaign for a national Small Business Strategy for Ireland, just as ambitious as the strategic focus on FDI from the 1950s to the present day.

We need a Small Business Strategy to ensure that all parts of the State system get behind Ireland's indigenous businesses to unlock their untapped potential. We need a clear statement from government that it will support home grown enterprises and stand behind those individuals who take the risk to start their own business.

The first publication of this campaign highlighted the key facts and figures that show that small businesses are the backbone of the Irish economy. The second made the case for a national Small Business Strategy, showing how the absence of such a strategy has left small businesses lagging far behind multinationals (for which there is a clear national strategy) on many important metrics. It highlighted the potential benefits of such a strategy and the key considerations for its development. Both of these publications are available on the SFA website at www.sfa.ie/0/NSBS

Our previous work has highlighted that one of the most important pillars of a national Small Business Strategy would be a comprehensive tax policy. Taxation is one of the most powerful tools available to government to achieve its objectives. If this Government or a future one decides to get behind small businesses, tax policy must be activated to work towards this goal.

Working together, drawing on insights from our respective member and client bases in the small business sector, SFA and PKF O'Connor, Leddy & Holmes have produced this paper outlining the main tax changes that would be required. It proposes changes to current tax rates, amendments to existing tax reliefs, ideas for new targeted reliefs and suggestions on how to reduce the burden of tax administration on small companies. These proposals are grouped under three themes:

1. Investment
2. Employment
3. Administration

I would like to thank PKF O'Connor, Leddy & Holmes for their collaboration on this paper, in particular Tax Partner Catherine McGovern. Her deep tax knowledge, combined with extensive experience as a practitioner advising businesses, has been invaluable. Sincere thanks also to the owner-managers who make up the SFA National Council, many of whom have worked tirelessly for years and decades to achieve a tax system that supports entrepreneurs and small businesses.

The proposals contained in this document would make a real difference to the small businesses of Ireland. I urge all policy makers to get behind the SFA's vision of making Ireland the most vibrant small business community in the world – supporting entrepreneurship, valuing small business and rewarding risk takers.



Sven Spollen-Behrens
Director
Small Firms Association

Key recommendations

1. Reduce the current CGT rate of 33% immediately to 28% and ultimately to 20%, in line with the OECD average.
2. Increase the lifetime limit of €1m for Entrepreneur Relief immediately to at least €5m and in the longer term to €15m.
3. Introduce investor relief at a 10% CGT rate up to lifetime taxable gains of €1m.
4. Establish an R&D centre of excellence in Revenue whereby the R&D Tax Credit claims could be reviewed more efficiently.

Introduce a method for companies to obtain R&D Tax Credit pre-approval from Revenue.
Simplify the system of claiming the R&D Tax Credit and the level of records required.

5. Increase EIS relief from €150,000 to at least €500,000 per annum.
Allow the EIS tax relief to be claimed in its entirety in year 1 at 40% and apply the relief to PRSI and USC also.
6. Review the KEEP legislation to make it more widely available and attractive to companies and employees, to ensure that it satisfies the purpose for which it was created to provide tax efficient share options to employees and that they can avail of CGT rates on the disposal of their shares (even to the issuing company).
7. Make the payment of professional subscriptions by employers tax exempt.
8. Create a new talent regime for small firms, so that they can attract talented and skilled employees from outside Ireland to enable them to grow their business.
9. Issue Revenue guidance to clarify the designation of an individual as an employee or self-employed for tax purposes.
10. Reduce the interest rate for late payment of tax and amend fixed penalties to be more proportionate to the level of the tax liability.

Introduction

Tax policy can have a very significant impact on several areas affecting Irish small and indigenous businesses such as:

- Expansion of business within the Irish and export markets
- Promoting innovation
- Attracting and retaining key members of staff
- Capital investment
- The number and frequency of business transactions
- Raising finance to achieve the above goals

Various countries in the OECD have introduced tax policies to promote entrepreneurship and to support small businesses.

There are several Irish tax reliefs to promote the above such as:

- Capital Gains Tax Entrepreneur Relief
- Research and Development (R&D) Tax Credit
- Employment Incentive and Investment Scheme (EIS)

We are of the view that amendments to these existing reliefs are required in addition to new tax reliefs in order to assist small firms in the development of their companies, both within Ireland and abroad. In addition, we would recommend amendments to certain areas in the administration of the tax system that can be burdensome and costly for taxpayers.

On consideration of the concerns affecting our members we have structured our tax policy recommendations under three pillars which we will discuss in turn:

Investment

Employment

Administration

1. Investment

Funds are required by companies for investment in equipment, personnel, and innovation to grow the business. External finance investors can also bring their experience, business contacts and provide mentoring and advices to companies.

Investment tax policy is critical as it can:

- Impact the amount and frequency of investment in small businesses
- Encourage business disposals when a company has reached its maximum potential under the current ownership

Our tax proposals for investment encompass the following strategies:

- Reducing capital gains tax (CGT) liabilities for both business owners and investors
- Attracting angel investors to small firms
- Making R&D Tax credits more assessable to small firms
- Amending EIS relief to make it more attractive as to the amount and timing of the tax relief

1.1 CGT Rate

Ireland's CGT rate of 33% is currently the third highest in the OECD.

Ireland – 33%

OECD Avg – 23%

UK – 20%

We would recommend that the CGT rate is reduced to 20% over the next few years, with an immediate reduction to 28%.

CGT represents only 1% of the State's tax revenue, so there is very little to lose by reducing the rate, but the benefits could be significant

1.2 Entrepreneur Relief

This relief reduces the CGT rate from 33% to 10% on the first million lifetime capital gains. This low limit has minimised its attractiveness for entrepreneurs.

IRE Entrepreneur Relief	€1m x 10% CGT
UK Entrepreneur Relief	£10m x 10% CGT
UK Investor Relief	£10m x 10% CGT

The SFA and PKF call on Government to:

- Reduce the 50% working time test to make Entrepreneur Relief more widely available
- Increase the current limit of €1m to €5m immediately, with further increases to €15m over time
- Introduce investor relief at a 10% CGT rate up to lifetime taxable gains of €1m
- Provide for relief or an apportionment of relief when there are investments in the group/company

1.3 Research and Development Tax Credit

12.5% corporation tax deduction + 25% R&D Tax Credit = 37.5% tax saving on R&D

Research and Development (R&D) is important for product innovation, productivity and growth. The Revenue Commissioners' report (April 2018) on 2017 and 2016 corporate tax outlined that 70% of Ireland's R&D Tax Credit is claimed by foreign companies.

Claiming the R&D Tax Credit is costly for small businesses. We note that many claims are now being reviewed by Revenue and it can take months for a business to have its entitlement clarified.

Therefore, consideration should be given to the following:

1. A centre of excellence in Revenue
2. Clear sector-specific guidance to claim this relief
3. Preapproval from Revenue for small companies, so they have clarity on whether they will qualify for the relief and avoid costly correspondence with the Revenue in the future

1.4 EIS

EIS is particularly important in relation to start-up companies and companies in the expansion phase. EIS relief is a tax relief whereby, if an individual invests in certain qualifying companies, they may claim an income tax deduction. Currently the limit is €150,000 per annum and the relief of 30% is claimed in Year 1 and 10% in Year 3.

To make EIS more attractive the following changes should be made:

1. The €150,000 per annum limit should be increased when compared to the UK which is £1m per annum
2. The full tax relief of 40% should be claimed in Year 1
3. Relief should also be available in connection with PRSI and USC

2. Employment

To be competitive in the Irish and the international market, a company needs to have a talented workforce. Despite the many personal and professional advantages to working in a small firm, it is often difficult for them to compete with larger firms on salaries. Wages in multinationals are 64% higher than in domestic companies.

Small firms are experiencing difficulties in attracting and retaining talented and skilled employees, which can then restrict their potential to grow and to trade globally. This was cited as the number one risk to members' businesses in the SFA Business Sentiment Survey in May 2018.

Our tax policy for employment encompasses the following strategies:

1. What tax relief would assist small firms to attract the right employees?
2. How can a small firm reward an employee tax efficiently to retain them?

2.1 KEEP

Share awards can become a critical part of an employee's remuneration when a small firm cannot pay the same level of salary as multinationals. We note that KEEP was introduced in 2017 however, it has several issues and is quite restrictive.

In brief KEEP provides that:

1. Employees are not subject to income tax on the exercise of share options once the share options are granted at market value.
2. They only pay the tax i.e. capital gains tax, when the shares are sold.

The following are only some of the key recommendations we would propose to make KEEP more accessible and attractive:

- That the annual amount of share options granted is not restricted to 100% of the employee’s annual remuneration but is instead capped at an absolute amount.
- That an employee is not restricted to working for a single company but can carry out duties for other group companies.
- That the requirement for the employee to work full time in the company is removed.
- That the requirement for KEEP shares to be new shares is removed.
- That Revenue confirms that CGT treatment will apply even if the shares are acquired by the issuing employer company. There may not be a ready market for the shares and therefore the issuing company may be the only potential purchaser. There are circumstances that income tax can apply on the proceeds for the sale of shares to the issuing company. Therefore, the KEEP relief should provide that the disposal of KEEP shares would automatically qualify for CGT treatment.
- That Revenue provides guidance on share valuation in connection with the scheme.

2.2 Foreign Talented Employees Relief

We propose a new tax relief for small businesses similar to SARP (Special Assignee Relief Programme) to attract foreign talented employees from other countries. SARP applies to the assignment by international group companies of their foreign employees to Ireland. SARP reduces the excess salary over €75,000 by 30% for income tax.

The effect of the relief would be that the qualifying employee would not be subject to income tax on their entire Irish employment income.

Example of SARP

Salary	€100,000
SARP Relief	(€7,500)*
Taxable income	€92,500

$$*(€100,000 - €75,000) \times 30\% = €7,500$$

A similar relief may attract foreign employees to accept positions in Ireland despite the high marginal income tax rates. We would also suggest that the threshold level of €75,000 is reduced.

2.3 Subscriptions

In the past, employees’ professional subscriptions that were paid by employer companies were not taxable if the fees were incurred wholly, exclusively and necessarily in the performance of their employment.

Revenue now apply a stricter interpretation of the “wholly, exclusively and necessarily” test to narrow when the payment of the subscriptions would not be taxable. The income tax cost of these subscriptions may likely become a further cost to employers. We would therefore urge that the commercial basis of why companies pay these subscriptions for their employees is re-assessed and the statutory basis for exemption from income tax is reinstated.

2.4 Income Tax

Income tax rates and bands are hugely important for businesses trying to attract and retain staff. Ireland’s personal tax regime has highly progressive tax rates which can remove the incentive for employees to progress and to attract foreign employees. Many of our members are experiencing staff shortages and therefore Ireland will have to compete with other countries with more favourable tax rates to attract foreign talent. The rates below will be effective from 1st January 2019.

Example:

Employees earning the average wage of approximately €35,000 are paying income tax at the marginal rate of 40% in excess of €35,301. The total marginal rate is 48.5% including USC and PRSI for income between €35,301 to €79,044.

The introduction of the Earned Income Tax Credit was welcome; however, it is currently €1,350 compared to the PAYE Tax Credit of €1,650 for an employee. Facing a 18% drop in the tax credit is a clear disincentive to self-employment and business creation. The equalisation of this tax credit should be rectified immediately.

A reform of the personal tax system is required urgently to create a clear plan that can be phased in over five years to address the marginal tax rates, the entry level to the higher tax rates, USC and PRSI.

3. Administration

There are several tax administration considerations that should be reviewed to lower the cost of doing business in Ireland and reduce the time spent by owner-managers on administrative duties. As an overview, more Revenue guidance is required in several areas to assist small businesses to reduce the administration burden and cost of operating the tax system.

3.1 Interests and penalties

Interest is charged by Revenue at a rate of 8% and 10% per annum for the late payment of tax. In the UK the rate is 3%.

Fixed penalties apply to breaches of tax administration. These penalties can amount to in excess of €3,000 for each case of non-compliance even if there is no loss to Revenue.

A review of the proportionality of interest rates and fixed penalties should be undertaken.

3.2 PAYE administration

Companies are assigning their employees to foreign jurisdictions to develop foreign trade, which has both Irish and foreign tax implications. There can be an exposure to tax in both countries, which can be relieved under certain conditions and applications to the Irish Revenue. The current relief process can be time consuming. The application of the relief should be more straight forward to reduce the cashflow for the company and the cost in operating and administering the relief.

3.3 Contractors

Small firms can engage contractors to provide services. There are on-going reviews by Revenue in relation to whether a contractor is an employee or self-employed from a tax perspective. The Department of Finance issued a consultation paper in January 2016 regarding 'The Use of Intermediary Type Structures and Self Employment Arrangements', however no clear Revenue guidance has since been issued since this consultation paper.

If Revenue determine that a contractor is an employee from a tax perspective, then significant tax costs can arise for the company. We have outlined an illustrative example and note that the tax consequences depend on the circumstances.

Example:

Company engaged a contractor and paid them €10,000 excl VAT.

Revenue later determine the contractor is an employee.

Revenue deem that the €10,000 payment is net salary and is re-grossed for tax purposes. The gross salary may be deemed to be €20,833 (52% tax).

The illustrative cost to the employer is €10,833 (tax PRSI and USC) and employers' PRSI €2,240.

Total potential cost €13,073 before interest and penalties to the company.

This is a significant concern for companies whereby Revenue can review the position in the future and if Revenue determine that the contractor was an employee, this could give rise to a considerable tax cost to the company.

Revenue Guidance is required to respond to the points raised in the consultation paper to clarify the tax position:

- Where an individual, who would otherwise may be an employee, establishes a company to provide his or her services, and
- Where an individual, who may be dependent on a single company, is classified as a self-employed individual



SMALL FIRMS ASSOCIATION (SFA)

84-86 Lower Baggot Street, Dublin 2

T: +353 (0)1 605 1664

E: info@sfa.ie

www.sfa.ie

