The Voice of
Small Business

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Small Firms Association

Pre-Budget 2018 submission

Presented to:

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and
MINISTER FOR PUBLIC EXPENDITURE AND REFORM,
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MINISTER FOR ENTERPRISE AND INNOVATION,
Frances Fitzgerald TD

SFA priorities for Budget 2018

1. Increase the Earned Income Tax Credit to €1650 to equal the PAYE tax credit

2. Introduce a workable share-based remuneration scheme for employees of small firms

3. Increase the lifetime limit for CGT Entrepreneur Relief to €15 million

4. Increase capital expenditure to 4% of GDP per annum

Overview

Confidence among the small business community has increased strongly over the past six months. 61% of Small Firms Association members feel that the business environment is improving and half say their own businesses are growing. Almost three-quarters intend to invest in their businesses in the coming year with brand development, staffing and IT as the main investment priorities. 60% will create additional jobs.

These are positive signals that emerged from the SFA's Summer Business Sentiment Survey, conducted in early May. They are significant for the broader economy as 98% of all businesses in Ireland are small firms (less than 50 employees) and one in every two people working in the private sector is employed by a small business. They account for one third of the value of the Irish economy and of business investment. Small firms are also key to the vibrancy of our regions, as they represent more than half of total employment in 21 counties.

If we look beyond the headline sentiment statistics, however, the outlook for small firms is much more mixed. Despite an upswing in recent months, small business confidence is still below the levels we saw this time last year.

One clear external shock that businesses are reacting to is Brexit. 43% of exports from indigenous companies go to the UK. The immediate effect of the 'Leave' vote was a devaluation in Sterling, which wiped out the profit margins of many exporters. In the months that followed, the extent of other direct and indirect Brexit impacts began to emerge. Taking into account supply chains, data flows, investment and the movement of workers and customers, there is scarcely a business in the country, small or large, that is insulated from Brexit.

In this context, it is more important than ever that competitiveness is at the heart of Budget 2018. On 1 June 2017, the National Competitiveness Council stated once again that Ireland remains a high cost location with numerous barriers and disincentives for entrepreneurs and established businesses. The SFA calls on the

Government to place the same importance on competitiveness over the coming years as they placed on macro-economic stability in the period following the financial crisis.

The Taoiseach stated in his speech to the National Economic Dialogue that “we cannot take continued economic growth for granted”. For this reason, upcoming Budgets must give businesses the best possible opportunity to generate future economic growth by removing existing constraints and taking a “do no harm” approach with any new initiatives. Over the coming years it will be vital to decrease the marginal rate of tax, increase the entry point to the marginal rate, remove the USC surcharge that applies only to the self-employed, and maintain the 12.5% corporate tax rate. In addition, the Government’s spending review and search for “hidden fiscal space” should not lead to the abolition of schemes which have been positive for business, such as the 9% VAT rate for the hospitality sector (particularly the food side of the sector), the Foreign Earnings Deduction and the corporate tax exemption for start-ups.

Priority actions

In light of the severe restrictions on the fiscal space for Budget 2018, this submission focuses on a small number of carefully selected priorities. The SFA believes that these actions will create the biggest impact with the available resources.

#1 Increase the Earned Income Tax Credit to €1650

New businesses in Ireland are the second fastest growing in the EU in employment terms. This demonstrates the employment benefit to be derived from an increase in entrepreneurship and business formation. Other economic benefits include greater levels of innovation, increased tax revenues and more vibrant local economies. A change to taxation is the single biggest step the government can make to encourage more people to go into business for themselves.

Yet government policy continues to discriminate against the self-employed. The continuing gap between the self-employed Earned Income Tax Credit (€950) and the PAYE tax credit (€1650) means that entrepreneurs and owner-managers pay more tax than employees on the same gross income. This is particularly stark at low income levels, which leaves business owners at a clear disadvantage during the early stages of their venture, thus discouraging potential entrepreneurs from setting up their own business.

Many studies suggest that the monetary returns from going into business for yourself are little different on average than becoming an employee. The is despite the fact that entrepreneurs bear large financial risk, work longer hours (on average 10 hours more per week) and have less access to social welfare. In the US, the value to the median entrepreneur of a business lasting 25 years was 25% less than the value of a paid job over the same period.

The Government made a commitment in the Programme for a Partnership Government to level the playing field by Budget 2018. It must now **deliver on this commitment by increasing the Earned Income Tax Credit to €1650 for the self-employed and proprietary directors.**

€€€ The cost of this measure is estimated to be €80 million.

#2 Introduce a workable share-based remuneration scheme for employees of small firms

Changes to the system of taxation of share based remuneration in recent years have reduced the attractiveness of such schemes. Just 6% of employees in Ireland are shareholders in the company where they work, compared to the EU average of 21.7%.

Current employee share option schemes are largely unworkable for small firms and therefore their potential is not being realised.

An employee share option scheme tailored to small firms would have a range of benefits for small businesses and for the economy more broadly. This measure has the potential to improve management capacity in small business, which is a persistent contributor to the 50% failure rate among new businesses in their first five years. It would also improve staff retention and productivity in small and new firms, in particular at senior levels, by providing a long term incentive and increasing employee buy-in. In the US, paying employees partly through a stake in the business has allowed many start-up businesses to grow rapidly with relatively low costs, while employees can reap huge rewards.

A scheme similar to the UK's Enterprise Management Incentive (EMI) is needed for new and small firms in Ireland. The scheme should be simple and easy to understand. It should waive the income tax, USC and PRSI due (whether at granting and/or exercising). Instead, employees should only be taxed on the capital gain from the sale of the shares.

Furthermore, owner-managers should have the ability to target the share-based remuneration scheme at key individuals in the business rather than being obliged to open it to all employees.

€€€ In line with the experience in the UK, this would have minimal cost in the short term and no substantial cost (estimate €1 million-€5 million) in future years.

#3 Increase the lifetime limit for CGT Entrepreneur Relief

Addressing barriers to new and established businesses is vital in the context of Brexit. Despite the uncertainties that still exist, we need a truly Brexit-proofed Budget this year. One important element of this relates to addressing areas where the business environment in Ireland is significantly less favourable than the UK.

One of these relates to the limit on the Capital Gains Tax Entrepreneur Relief. The SFA welcomed the reduction of the Capital Gains Tax rate for entrepreneurs from 20% to 10% in Budget 2017, however, the retention of the lifetime limit of €1 million minimised the impact of that change.

Ireland must become a more attractive destination for starting a business or investing in a small firm. The UK, which is one of our biggest competitors for this investment, has a lifetime limit of Stg£10 million for entrepreneur’s CGT.

During the announcement of Budget 2017, the Minister for Finance committed to review the CGT Entrepreneur Relief limit this year. The SFA believes that **Budget 2018 should see Ireland improve its offering significantly when compared with the UK by increasing the lifetime limit to €15 million.**

International evidence (from Australia in the early 2000s, for example) as well as Irish data from the last two decades, has demonstrated that when CGT rates are reduced, revenue to the Exchequer increases, as economic activity and investment transactions are stimulated. A similar affect would be expected if the entrepreneur relief is extended, as it would effectively reduce the CGT rate on entrepreneurial gains from €1-15 million.

€€€ *The cost to increase the scope of this modest scheme is estimated to be €40 million, with the potential for dynamic impacts to return more revenue to the Exchequer in future years.*

#4 Increase capital expenditure to 4% of GDP per annum

Ireland has experienced a decade of underinvestment in infrastructure. The vast majority of capital expenditure is currently spent on maintenance and repair as opposed to growing the country’s social and economic capacity. This economic model is not sustainable if Ireland is to maintain its economic performance, and it is certainly not a recipe for improved competitiveness.

Ireland’s poor recent record of capital investment, coupled with its evolving demographics, is leading to bottlenecks in transport, education, broadband, water, health and other public infrastructure. The people of Ireland live in increasingly congested cities with deficient infrastructure. A two-speed economy has developed with Dublin accounting for as many jobs as the next 45 cities and towns combined.

Half of economic activity takes place in the Greater Dublin Area, which is totally out of proportion by international norms.

On this basis, the Government must take a more ambitious approach to capital investment, going beyond the additional €5 billion foreseen in the Programme for Government.

Capital expenditure must reach 4% of GDP as soon as possible. The Government should not undercut its ambition in this regard by creating self-imposed debt to GDP targets. Furthermore, Government should seek flexibility in the EU fiscal rules for spending on essential capital investment.

Priority areas for investment:

- Improving broadband infrastructure, particularly in rural areas
- Developing public transport links
- Building a real motorway network connecting regional cities
- Addressing housing supply shortages
- Enhancing education and in-work training

There is no doubt about the positive return on this investment. Studies show a 1% increase in public capital spending would lead to an increase in GDP of at least €1 billion per annum. More than this, however, government should be motivated by the crippling cost of non-investment, which would stunt the country for years to come.

€€€ Capital spending at 4% of GDP equates to an additional €2 billion in 2018, rising to €5 billion in 2021.

Conclusion

There are important choices to be made in Budget 2018. As stated by the Taoiseach, continued economic growth cannot be taken for granted. For this reason it is vital to support small businesses, which have been major contributors to growth, job creation and regional economic recovery in spite of the barriers and disincentives that are rife in the Irish business/policy environment. The priority measures outlined above will represent an important step towards achieving the SFA's vision of Ireland as the most vibrant small business community in the world, supporting entrepreneurship, valuing small business and rewarding risk takers. More than anything, Budget 2018 must deliver competitiveness improvements to allow small business to put its best foot forward, domestically and internationally.

About the SFA

The Small Firms Association (SFA) is the trusted partner of small businesses (less than 50 employees) in Ireland, with 8,500 members and four affiliated organisations, in all sectors and parts of the country. Its mission is to deliver business-focused advice and insights to member companies, influence government policy to the benefit of small businesses and connect its members in a thriving community.

The SFA has a vision of Ireland as the most vibrant small business community in the world – supporting entrepreneurship, valuing small business and rewarding risk takers. The SFA makes this submission to the Departments of Finance, Department of Public Expenditure and Reform and Department of Enterprise and Innovation based on our knowledge and experience of the small business community, which comprises over 235,000 businesses, employing half of the private sector workforce.

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