The Voice of
Small Business

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Small Firms Association

Pre-Budget 2019 submission

Presented to:

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and
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SFA priorities for Budget 2019

1. Protect competitiveness by ensuring that Budget 2019 does not impose additional costs on small businesses

2. Reduce the headline rate of CGT to 20% for all

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

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

5. Introduce measures to boost the viability of residential property construction

Overview

Even in an economy that is growing strongly, less than half of SFA members tell us that their businesses are growing. Confidence among small business has dampened in recent months, with 53% believing that the business environment was improving in May 2018, compared with 62% in November 2017. This metric is at its lowest level since the immediate aftermath of the Brexit vote. Attracting talent and wage inflation are the biggest concerns identified by small businesses.

Ireland's competitiveness is under threat. The National Competitiveness Council has repeatedly described Ireland as a "relatively high cost location" and confirms that business costs are rising. Our recent history has demonstrated the danger of allowing costs to become unsustainable; in the event of an external shock, firms do not have the agility to scale down in a controlled way. Referring to Brexit and other external developments, the Summer Economic Statement identifies the most effective way forward: "With all of these measures beyond our control, it highlights the importance of taking the measures that we can in order to enhance the resilience of our economy." The SFA supports this view; the Government must take action in the areas within its control.

Improving the environment for small indigenous businesses represents a huge opportunity for the countrywide economy. This is an area where the Government can take decisive action and the positive effects will create a ripple effect in new businesses, job creation and regional development. The Government has acknowledged that continued economic growth cannot be taken for granted, but supporting the small business community offers the possibility of creating a more resilient indigenous enterprise base for the future.

A multi-year strategy for small business in Ireland

The Government's Stability Programme Update 2018 ranks the corporation tax concentration risk as 'high' and this issue has received much attention in recent months from the Oireachtas Public Accounts Committee, the media and others.

Ireland's heavy reliance on multinationals has also been identified by the SFA, not only as a risk, but as a major missed opportunity.

In contrast to the multinational sector, small business is not performing at its optimal level in many areas including the rate of start-ups, scaling, productivity and exporting. Changing government policy step-by-step has got the small business sector to where it is today. There are many State supports for small firms but, from an owner-manager's perspective, the environment is fragmented, confusing and inconsistent. There are many individual success stories but also many tales of struggling businesses and business failure. The potential of the sector has not been realised. That is why the focus should now be on creating a leap forward for small businesses, as outlined in the Programme for Partnership Government.

Multinational firms in Ireland are thriving. This means that:

a. Policy-makers can turn their focus to small businesses without jeopardising the FDI sector
b. Lessons from the FDI success story can be applied to small business sector

The Small Firms Association is calling for Government to shift its attention to the 98% of enterprises that are small firms, present in every city, town and village in the country.

Businesses know that strategies matter. The SFA is calling for a national Small Business Strategy just as ambitious as the strategic focus on FDI from the 1950s to the present day. In Ireland, we know exactly what it takes to create real, transformational change, as we have successfully built a world-class environment for multinational companies.

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

Such a strategy would outline a common vision for the future of small business in Ireland and include both short- and medium-term policy goals. The successful Action Plan for Jobs model could be harnessed as an implementation tool.

Some of the policy measures central to such a strategy are already evident and should be implemented as a matter of urgency in Budget 2019. These are set out below.

Priority actions for Budget 2019

#1 Ensure Budget 2019 does not impose additional costs on small businesses

This submission outlines what small businesses would like to see in Budget 2019, but equally important is what the Budget should not include. At a time when positivity among small businesses is at its lowest since the immediate aftermath of the Brexit vote, it is vital that all budgetary measures are assessed for their impact on small firms. No measures that impose additional costs on small companies should be introduced.

Half of the private sector workforce is employed in the small business sector, so Government must be particularly vigilant about the cost of employment. As the SFA outlined in its submission to the Low Pay Commission, there is no justification for a further increase in the National Minimum Wage in 2019, following a 10.4% increase since 2016, which has added over €20,000 to the annual wage bill of a small employer that has 10 minimum wage employees. The small business community also rejects mandatory minimum pension contributions by employers as another burden on those creating employment. The draft legislation on banded hours shows how policy making is too often totally removed from the reality of running a small business and endeavouring to sustain employment.

Flagged increases in the National Training Fund Levy should be suspended until the other elements of the funding triangle (student and State) have been progressed. Employers cannot solve the crisis of funding for Higher Education alone, and it is unfair to ask them to commence higher contributions now while the other elements are parked for political reasons.

The 9% VAT rate for the hospitality sector should be maintained, in particular to support Ireland's rural economy which is suffering from a continued fall off in UK tourists. Alcohol excise should not increase as this is now a dynamic growth sector in terms of export-oriented indigenous firms.

Government must ensure that the mistakes of the past are not repeated by allowing business costs to escalate in a period of economic growth. This is particularly important when the growth is driven by the FDI sector but the costs are borne disproportionately by small firms. Vigilance is required to ensure the cost burden on small firms does not increase in Budget 2019.

€€€ This action has no additional cost to the Exchequer

#2 Reduce the headline rate of CGT to 20%; and
#3 Increase the lifetime limit for CGT Entrepreneur Relief

A vital dimension of Ireland's competitiveness is its relative attractiveness as a location to start a business, attract expertise and investment to grow into a global company, and create attractive conditions to sell a business and reinvest. In the context of Brexit, Ireland's competitiveness vis-à-vis the UK is particularly important.

At 33%, Ireland has one of the highest rates of capital gains tax (CGT) amongst developed economies, stifling the flow of investment that is needed at every stage of the business life cycle. By comparison, the UK CGT rate varies between 18% and 28% depending on the size of income and capital gains. UK entrepreneurs benefit from a lower rate of 10% on the first £10 million of gains (lifetime limit).

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.

In terms of the headline rate, the SFA is calling for a reduction in CGT to 20% across the board, to make investing in a business in Ireland more attractive. Analysis by the Irish Tax Institute shows that CGT represents only 1% of the Government's tax revenue. In this context there is very little to lose by reducing the rate, and the benefits could be significant.

The SFA welcomed the reduction of the capital gains tax rate for entrepreneurs from 20% to 10% in Budget 2017. The retention of the lifetime limit of €1 million, however, has minimised the impact of that change. When the Entrepreneur Relief was introduced, the then-Finance Minister committed to reviewing the limit the following year. No change was introduced in Budget 2018 and the SFA believes that Budget 2019 should see Ireland improve its offering significantly when compared with the UK by increasing the lifetime limit to €15 million.

Feedback from SFA members has highlighted what these changes in CGT would mean for them.

> Company 1 – Food company in Co. Offaly:
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> *"There is likely to come a time when the business needs management/ownership that has experience of running larger businesses. We will have done an exceptional job getting from start-up to €15-20 million, but it may at that point need a different skillset from the owners. This is when the capital gains tax at 33% would be disadvantageous. With the higher tax rate, the ability for the start-up owners to sell to more experienced skills will require a higher level of investment from a buyer that might not be justified. At the same time a company capable of significant growth may be retarded because of the need to think and act bigger. This will reduce the job creation potential and also tax take on an ongoing basis."*

> Company 2 – Environmental laboratory in Co. Dublin:
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> *"My pension will derive from the sale of the business and although there is a reasonable amount which is not taxed from such a sale for over 55s, it won't necessarily be enough to fund a pension. A change in the CGT headline rate of the scale proposed by the SFA would make a meaningful difference to me and to people in similar situations. I'm not going to be supported by the State in my retirement, I haven't been a drain on the state while self-employed, and I have made very valuable contributions as an employer over the years. We kept our heads up during the recession and continued to provide employment but pension contributions were stopped to ensure that we could pay wages and keep people employed. That was painful but necessary, but it didn't do anything helpful for my future retirement plans!...Now as I head towards the time when I hope to be able to retire, my only prospect of funding my retirement is to sell the business and therefore the CGT rate is a significant issue for me."*

Company 3 – Electrical engineering company in Co. Galway:

"I have been considering selling my business recently, but I will not do so with the current CGT Entrepreneurial Relief limit of €1m. I feel that paying 33% CGT on any excess above €1m is a very poor reward for 33 years of hard work and dedication to starting and building up my business. On the other hand, if the company was bought, it seems likely that the new owners would invest in it and grow the business in a way that I cannot do."

€€€ *The cost to reduce the headline rate of CGT to 20% is €442 million.[1] The cost to increase the lifetime limit for CGT Entrepreneurial Relief is estimated to be €56 million[2].*

These costings assume no behavioural change. The SFA expects both measures to stimulate transactions, which would return more revenue to the Exchequer in future years.

#4 Increase the Earned Income Tax Credit to €1,650

Changes to taxation are the most effective measures the government can make to encourage more people to go into business for themselves. Tax changes can create incentives and mitigate risks, making entrepreneurship attractive. The benefits of a true entrepreneurial culture include job creation (new businesses in Ireland are the second fastest growing in the EU in employment terms), greater levels of innovation, increased tax revenues and more vibrant local economies.

The Programme for Partnership Government states "we will increase the Earned Income Tax Credit from €550 to €1,650 for the self-employed, to match the PAYE credit, by 2018".

Yet the gap persists, with the self-employed Earned Income Tax Credit (EITC) currently at €1,150. The Government must now deliver on this commitment in full, to finally end this blatant discrimination against the self-employed.

If a PAYE worker is considering starting a business, they face seeing their income tax credit drop by 30 per cent. The result of the unequal tax credit is that the self-employed pay more tax than employees on the same gross income. This is most stark at low income levels, which leaves business owners at a particular disadvantage during the early stages of their venture.

This is a clear disincentive to self-employment and business creation, and is a reminder of the contrast between the rhetoric of Government support for entrepreneurship and the reality. With tax compliance at very high levels in Ireland, any historic justification for the inequality of tax credits between the self-employed and employees is defunct.

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[1] Ready Reckoner – Post Budget 2018, Revenue Commissioners, May 2018
[2] PQ 54125/17

The small business community cannot wait any longer for the Government to deliver on this commitment to increase the Earned Income Tax Credit to €1,650 for the self-employed and proprietary directors.

€€€ The cost of this measure is estimated to be €42 million[3]

#5 Introduce measures to boost the viability of residential property construction

The housing supply crisis now represents a significant cost to business. High rental costs are fuelling wage demands, in an environment where wage inflation is already a major challenge for many small businesses. In addition, businesses that frequently need to recruit from outside the country to find the skills they need are reporting that for the first time, job seekers do not want to move to Ireland due to the cost of living and, in particular, concerns around securing affordable accommodation.

As bad as the problem is currently, it is only going to get worse. Lack of skilled construction labourers (shortfall of min. 80,000) as well as a growing population is going to exacerbate the housing crisis.

Housing shortages have been at the top of the political agenda for a number of years, but one important part of the equation has not been addressed, that is how to make residential development more commercially viable.

Stability and certainty are necessary to ensure the financial incentives needed for investment in housing projects. Essential to this is to introduce a site value tax to replace the commercial rates and vacant sites levy.

In terms of VAT, a number of changes would stimulate development. The SFA supports a permanent reduction in VAT for large build-to-rent developments in order to provide a level playing field with competing commercial developers. In addition, a temporary VAT reduction on the residential sector will bring the return on investment of housing construction back to a competitive rate.

A system of capital allowances for residential development should be explored. It is also necessary to reconsider building height to avoid urban sprawl and achieve a higher population density. Dublin and other Irish cities have among the lowest population densities in the EU.

€€€ Site value tax – no net cost
Permanent reduction in VAT – €10 million[4]
Temporary 9% VAT on residential construction – €220 million[5]

[3] Ready Reckoner – Post Budget 2018, Revenue Commissioners, May 2018
[4] Ibec pre-Budget 2019 submission
[5] PQ 27313/18

Conclusion

At the current juncture, there is a clear path open to the Government which would de-risk our economy from over-reliance on FDI and seize an important opportunity to future-proof our economic model. That path is to focus on small business and support this important sector to fulfil its potential. This would involve creating a whole-of-government Small Business Strategy, with a roadmap towards significant policy goals (increased productivity, export diversification etc.). Immediate changes would support the achievement of these goals, including ensuring that no additional costs are placed on small businesses in Budget 2019, reducing capital gains tax, increasing the self-employed tax credit and addressing the ongoing housing shortages.

Supporting small businesses in this way would mitigate some of Ireland's current vulnerabilities and create a true entrepreneurial culture with benefits for entrepreneurs, employees and communities.

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 Business, Enterprise and Innovation based on our knowledge and experience of the small business community, which comprises over 245,000 businesses. These businesses employ half of the private sector workforce, over 700,000 people, in good, local jobs.

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