



CHAMBERS
IRELAND
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Submission to the Department of Finance on

Tax and Entrepreneurship Review

14 July 2015

Introduction

Chambers Ireland is the largest business network in the State. With almost 50 Chambers located in every major town and city in the country, we are well positioned to understand the needs and concerns of the business community and to represent their views.

We welcome the opportunity to feed into this consultation and the ongoing efforts by the Department of Finance to incentivise entrepreneurship.

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

Entrepreneurship must be placed at the heart of the Irish economy since it creates jobs, new products and grows our economic output. A culture of entrepreneurship must be supported and promoted within all sectors.

The national system of taxation systems plays an important role in supporting entrepreneurship. Depending on the objective, tax systems can be structured to either promote or discourage innovation, appropriate risk taking and entrepreneurial activity. By putting in place the right tax structures we can send the right market signals to encourage entrepreneurship in the Irish economy.

It is the view of Chambers Ireland that our tax structures should recognise and appropriately reward the risks taken by entrepreneurs in establishing businesses and creating employment. We believe that our tax system insofar as possible should encourage the development of new enterprises, products and innovation.

Given the Irish economy's heavy reliance on FDI and exposure to external shocks, we believe that using taxation to encourage the growth of strong indigenous businesses must be a primary consideration in how our future tax system is structured.

It is worth noting that we see entrepreneurship as not being limited to start-ups or new company formations. Our tax system should not only encourage the establishment of new businesses, but should also support entrepreneurial activities within established enterprises.

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

The lack of social safety net available to entrepreneurs and owner-directors (in particular Illness Benefit, Invalidity Pension, Injuries Benefit and Jobseekers Benefit) constitutes a barrier to establishing enterprises. Without full social welfare protection, self-employed people and their families are subjected to very high risks by setting up on their own. One cohort of potential entrepreneurs comes from those who are currently employed, but may have a concept or innovative idea that could potentially evolve into a successful business. These potential entrepreneurs need to be reassured that there will be an effective social safety net should their business not succeed.

Equally problematic is the message sent by having a discriminatory tax system which easily can be misinterpreted as entrepreneurs being considered second class citizens within the Irish economy.

3. What existing tax measures are effective in supporting small businesses and encouraging entrepreneurs?

Our corporation tax of 12.5% plays a major role in ensuring the competitiveness of Irish entrepreneurs and attracting new businesses. In light of forthcoming changes to the UK corporation tax and ongoing discussions at EU-level regarding a Common Consolidated Corporate Tax Base, we recommend that Government reaffirms its commitment to maintaining Ireland's transparent corporate tax rate based on the stated principles of rate, regime, and reputation.

The launch of the SURE tax refund scheme for entrepreneurs was welcomed by Chambers Ireland as a step in the right direction towards incentivising entrepreneurship in Ireland. The Seed Capital Scheme was in desperate need of an overhaul and the revamped SURE scheme has great potential to encourage new start up businesses and ultimately create jobs. In particular, we support how the SURE scheme is simpler and more broadly applicable than its predecessor, as well as how it incentivises a wide range of people to start up a business particularly those recently made redundant.

Moreover, the changes made to the Employment and Investment Incentive in last year's budget were encouraging and should open the scheme up to a wider audience. However, we believe that the scheme can be made more effective by considering two further revisions:

- i. Investing in a start-up or new enterprise is inherently risky even with a 30% relief, and the requirement that the investor wait for 3 years before being potentially able to reclaim the balance of 11% relief pushes the risk profile of the proposition beyond many investors. The full 41% relief should be granted from the date of the investment.
- ii. Following the EII's 3 year removal from the high income earner restriction in 2014, it is worth assessing the impact this has had on investment levels thus far. Increasing the annual investor cap above €150,000 may then become a viable means of expanding the scheme.

These revisions would have no consequences for the Exchequer overall but would require that investment relief is granted upfront.

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?

Capital Gains Taxes (CGT) – particularly for active investors in business – are too high. This creates a disincentive to invest in start-ups and small businesses with high growth potential. If we are to be serious about instilling a culture of entrepreneurship in Ireland, we also need to support a culture of investment. Failure to have a tax system that supports investment will stifle entrepreneurship and hinder the growth of those businesses that are capable of expanding.

Given the high numbers of micro and small businesses in the Irish economy, it is important that we focus on how best to ensure that there is a diverse range of funding options open to them. Non-bank lending will become increasingly important in the coming years, and to secure private equity investment, the CGT regime must be reevaluated. This is particularly the case given the low rates in effect in the UK which, in addition to the UK Government's recent decision to cut corporate tax, makes the UK market increasingly attractive for investors.

We must ensure that our tax system rewards entrepreneurship and recognises the risk associated with business assets and business share disposals. Chambers Ireland advocates reducing the Capital Gains Tax rate to 20% for active investments to incentivise investment and reward entrepreneurship.

CGT raised €561 million in 2014 and we believe that buoyancy in revenues and increased investment activity would outweigh any reduction in taxation to ensure no material impact on this tax head.

We believe that the impact of a reduced rate on non-passive investment will considerably outweigh any revenue loss and ultimately be self-financing given increased investment and potential for job creation.

5. *Income tax: Given the difference in the treatment of the self-assessed and PAYE taxpayers in terms of pay & file, tax credits and allowance expenses, is there scope for greater alignment?*

Chambers Ireland encourages Government to ensure that the tax system does not punish those willing to take the risk of establishing a company and creating jobs.

Current Irish tax structures discriminate against the self-employed and owner directors on a number of fronts. Firstly, those earning over €100,000 are faced with an additional USC burden of 3% over and above what PAYE workers earning the same income must pay. In order to encourage and support entrepreneurs and investors, the USC for self-employed earnings over €100,000 should be brought in line with that of PAYE workers (currently at 11% vs. 8%).

Secondly, the lack of full social welfare entitlements available to entrepreneurs and owner-directors is out of step with modern taxation practices and the necessity for our economy to support entrepreneurship and small businesses. Owner-directors should be allowed to opt-in to a scheme to pay additional social contributions that will entitle them to social protection should their business fail.

Given that the Government in its National Policy Statement on Entrepreneurship acknowledges the critical role of entrepreneurs for the future Irish economy, it would be appropriate that the tax system is adjusted to also reflect this outlook. A tax credit similar in size to that available to PAYE workers (€1,650) should therefore be made available to the self-employed on earned income.

In parallel with aligning tax credits, we believe that tax rates imposed on entrepreneurs should be reduced. We welcome the indications given that both income tax and USC are to be reduced. At present, PAYE workers earning above €33,800 p.a. are faced with a rate of tax of 52% (the self-employed are faced with an even greater rate of tax of 55%). At the same time, the entry level to a high rate of tax at an income of only €33,800 is significantly lower than elsewhere in Europe.

If we are to encourage entrepreneurship, innovation and enterprise, individuals must be rewarded for their labour and originality. This can be done by increasing the entry-point to paying the higher rate of tax while also ensuring that the total marginal tax rate for higher earners (both the self-employed and PAYE workers) is brought below the headline rate of 50%. We believe that bringing the rate below 50% will stimulate entrepreneurship, improve our international competitiveness and make Ireland an attractive location for highly skilled workers. By reducing the marginal rate of tax,

we also believe that employees would be encouraged to develop new skills, strive for betterment and thus improve productivity, and that businesses would find it easier to persuade recent emigrants to return to Ireland.

6. *Capital Gains Tax: 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 introduction of the Capital Gains Tax Entrepreneurial Relief in Budget 2014 was a welcome initiative to encourage serial entrepreneurs to establish further enterprises. Efforts to support entrepreneurship and incentivise investment in startups are positive, but this initiative could be greatly improved and expanded if two key reforms were made to it.

One of the requirements for an individual to avail of the relief is that the person must be a full time executive director in the new company in which they invest. We believe that this restriction precludes many potential serial investors from taking part in the scheme. We believe it is far more likely that a successful entrepreneur will be more positively inclined to avail of the scheme and invest their capital and time in several ventures simultaneously rather than confine themselves to becoming a full time executive in one start-up for a partial relief on their CGT.

We also believe that the scheme could be brought more closely in line with the UK's system of Entrepreneurs Relief. This scheme allows for qualifying directors who own 5% or more of a company to avail of a reduced rate of CGT of 10% rate on disposal of company shares up to a lifetime limit of £10 million. We note that the UK system is in compliance with EU State aid rules and consequently it could also be adopted here.

We consider the potential costs of this measure to be minimal as there is a relatively small cohort of individuals to whom this relief will apply while the effect of the measure would stimulate investment for the creation of jobs.

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

In order to maximise the growth potential of viable businesses and entrepreneurs, it is important that we facilitate serial investors to make investments. By encouraging more investment through better targeted CGT reliefs, entrepreneurs with a great idea or product will be able to grow their businesses, create employment and stimulate the economy.

In addition, by changing the relief to enable more private investment, SMEs and entrepreneurs will become less reliant on banking institutions to grow their businesses.

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 of the carry-forward provisions introduced in Finance Act 2013?**
- e. What role does the relief play on 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?**

N/A.

9. Other comments

We conclude this submission by outlining a number of further recommendations which we consider relevant in the context of making Ireland an ever more attractive destination for entrepreneurs and small businesses to prosper.

Allowance for Corporate Equity

In our view, Irish SMEs over reliance on banks needs to be addressed as part of improving the environment in which entrepreneurs operate.

While we acknowledge recent progress in enabling SMEs regaining access to finance, too many Irish SMEs rely too heavily on financial institutions to access credit. Irish SMEs over reliance on banks is problematic for a number of reasons. Firstly, many SMEs still find it difficult to access credit from banks that continue to battle with losses suffered during the recession. Secondly, credit from Irish banks is subject to higher interest rates than elsewhere in Europe. Thirdly, the documentation required from SMEs to access credit through traditional routes is sometimes burdensome and may cause in a delay in lending.

As part of assisting SMEs in securing finance and thus support entrepreneurial activity, Chambers Ireland recommends the Department of Finance to consider the merits of introducing and allowance for corporate equity (ACE).

ACE systems have already been introduced in several European countries (including in Belgium, Italy and Portugal) to address debt bias and over reliance on bank lending by combining the deductibility of actual interest costs with a deduction of a notional return to equity. In Portugal, for example, a notional deduction of 5% is granted to SMEs for cash contributions on incorporation or for equity capital increases. The allowance is granted for four years and the tax benefit cannot be greater than €200,000 over a three year period.

Match Fund a Portion of Commercial Rates for Local Economic Development

The role of Local Authorities and local economic actors in advancing the growth of their communities has never been more important. Locally focused actors have always played an integral role in the economic development of their area, but with the ongoing reform of Local Government and the development of Regional Action Plans for Jobs, a renewed emphasis has been placed on Local Authorities and communities as drivers of local economic development.

Drawing on the examples of Cork City and County Councils and international best practice, the establishment of a development fund in each Local Authority can be effectively used to support local enterprises and projects with growth potential. This practice should be incentivised by centrally match funding a portion of the fund. Development funds could then focus on driving business growth throughout a region by providing supports into targeted projects to enhance the business environment subject to applications detailing stated objectives for each initiative. For example, funds could be utilised to invest in initiatives such as start-ups, festivals and markets, start-up hubs, etc.

We suggest that development funds form part of a national local economic development system which with the support of Central Government could be rolled out via Local Authorities and Chambers of Commerce across the country. A portion of these development funds can be targeted to support local entrepreneurs.

Develop State-Supported Crowd Funding Programmes

Similarly, there is scope to develop state-supported local microfinance and crowd-funding programmes to fund both traditional entrepreneurs and social entrepreneurs.

The opportunities presented by crowd-funding have already been embraced by UK local councils. Faced with budgetary constraints, British councils have turned to crowd-funding platforms to rejuvenate high streets and support their local entrepreneurs. Using crowdfunding, Councils can pitch ideas to the local community so that the cost of a project is shared among those who benefit. Councils use this approach to top up available funding from Exchequer funded grants, while others may look for the full cost associated with a project. Successfully funded projects in the UK include the conversion of an empty property into an entrepreneur hub in High Wycombe.

Incentivise Employee Share Schemes

There has been much recent public commentary on calls for increases in wages throughout the economy. We believe that the next twelve months will prove a crucial period in Ireland's economic recovery.

There is a risk that a general upward pressure on wages throughout the economy will lead to an erosion of Ireland's international competitiveness. Ireland already has high wage costs relative to our competitor nations and further increases to companies' wage costs will ultimately hinder Ireland's competitiveness and ongoing economic growth. Many industry sectors and most small businesses are not yet in a position to increase their wage bill.

A methodology to link employee remuneration directly with increased company productivity and performance would mitigate the potential erosion of competitiveness arising from general increases to wages. This could be achieved through incentivising employee share ownership schemes. The increases to CGT rates over recent years and the fact that employee shares are liable for both PRSI and USC have diminished their value relative to non-share based remuneration. To incentivise the uptake of share based remuneration schemes, liability for PRSI and USC on shares should be reduced.

Conclusion

In conclusion, Chambers Ireland believes there is scope to further improve the tax system to better support our indigenous SMEs and entrepreneurs. In this submission we have outlined the key issues which we believe constitute a barrier to entrepreneurial activity and made recommendations as to how these can be removed.

We trust that our recommendations will be given due consideration and look forward to further engage with the Department on this important matter.