IRISH exporters association

Irish Exporters Association

Pre Budget Submission

Budget 2017

Contents

Budget Recommendations Summary

The Irish Exporters Association *Pre-Budget 2017 Submission* sets out recommendations in the following areas:

Cost Competitiveness

Rising insurance costs

- Government intervention in the case of rising costs of insurance to deter the negative effect that that is having on business costs. Measures need to be taken to encourage new players to compete in the market to drive down the rising cost from insurance providers.
- These include a review of insurance costs at Oireachtas Committee level, a comparison of premiums and pay-outs against the UK and other EU countries, and a set of recommendations to be made for maximum pay-outs for insurance claims, in line with those in the UK.

Housing crisis

- It is clear that residential house building must increase drastically over the current levels. While the new Minister for Housing is welcomed, resources need to be focused to drastically increase supply and control measures need to be put in place to curtail rent inflations across the board, not just for tenants in situ.

Minimum wage restraint

- The IEA recommends there be no changes to minimum wage in Budget 2017 and that the current level be frozen for a minimum of 3 years in order for the long-term implications of the UK leaving the EU to be further clarified.
- In the event that there are increases to the minimum wage in Budget 2017, the IEA recommend a reduction in employers PRSI contributions to ensure no net cost to the employer. The UK will actively be targeting FDI and are already a serious competitor when Irish entrepreneurs are thinking of where to locate their growing business.

Measures to protect business against Sterling depreciation

- A National hedging strategy for GBP, managed by the NTMA and administered via the SBCI through the main commercial banks and relevant currency hedging providers. The aim of the product would be to offer a discounted exchange rate to those companies affected who want to avail of it, with the NTMA responsible for managing a set proportion of the underlying exposure.
- This should be supported by a coordinated vigorous campaign to help SMEs to understand the need to build hedging into the long-term strategic and day-to-day management of their businesses.

Mobile phone coverage and broadband access

- Immediate solutions need to be sought to the coverage deficits to businesses and homes across the country if Ireland is to remain competitive in a technological age, improvements in broadband and a mobile phone infrastructure need to be immediate. Government should consider partnering with private industry to facilitate the rollout of broadband in a similar manner to our road building partnership strategy which has transformed the road network.

Restraint in public pay

- Restraint in public sector pay increases – limited to no higher than the annual CPI rate. A bonus system that rewards and recognises effort but only where KPIs are achieved.

War for Talent

- Concentration of resources to retain students in courses that will meet skills shortages in areas such as Life Sciences, Finance, Engineering, and IT.
- Prioritise investment to address the skills shortages that exists and update the approved list of apprenticeships, elevating the standing of education through work. We also recommend incentivising employers to back apprenticeships of employees.

Diversification of Export Markets

- That Enterprise Ireland, Bord Bia and our Embassies receive a 10% funding to increase resources in high-growth markets specifically. This will ensure that resources in our biggest developed export markets are not affected. The role of our embassies should be reaffirmed and resourced to ensure they are mandated specially to deal with Irish exporters.
- The IEA should be given a specific role for a campaign in partnership with Government & funded by them to drive our exports.
- On 7th August 2014, Russia introduced an import ban for certain agricultural products originating from the EU including beef, pork and poultry meat, dairy products, fruits and vegetables. Russia has officially extended its ban on EU food imports until the end of 2017. Total goods exports to Russia halved from 2014 to 2015. Concentration of efforts at an EU level to resolve the issue of import bans in Russia as the indigenous food and drink sector in Ireland is being implicated and given that 44% of this sectors' exports are currently destined for the UK, this is a time when this sector needs to be protected.

Entrepreneurship

R&D Tax Credits

- Decrease the three year refund period by granting a full tax rebate in the year the qualifying expenditure is incurred capped at the payroll taxes paid by the company. To target the changes at smaller companies, consideration could be given to giving a refund in year one for refunds of €100,000 and less. This could minimize the cash outflow for the Exchequer while helping to accelerate the payments to smaller companies who rely on the credit as an important source of funds. The level of paperwork and documentation required to claim the benefit of the credit is extremely onerous and off-putting for start-up companies as it drains management resources. A more streamlined interview based approach would be welcomed in supporting any such claims.

Share Incentive Scheme for Entrepreneurs

- Introduce an approved SME share option scheme taxed only upon sale/redemption of shares at the capital gains tax rate.
- Exempt from benefit in kind, employer loans used by employees to fund the acquisition of shares/share options from their employers.

Intellectual Property

- S291A(7) and s766 could be amended such that the R&D credit and s291A could be claimed on expenditure incurred on self-developed IP.
- Alternatively, the law could be changed to facilitate some form of election back into s291 out of s291A in order that allowances would be available at 12.5% p.a over 8 years with such expenditure also qualifying for the R&D credit.

Withholding Tax

- Amendments to allow unused withholding tax credits to be carried forward to future periods and to be available for offset against future corporation tax.
- Amendments to allow the pooling of the credit against royalty income from other jurisdictions.
- Tax exemption for dividends and branch profits repatriated to Ireland.

Levelling the playing field in terms of tax for Entrepreneurs, PAYE & USC Rates

- A reduction of the higher USC rate for entrepreneurs as illustrated to PAYE levels.
- Phase out of USC over the medium term by reducing rates, increasing the band ceiling and increasing the exemption threshold to reduce very low earners.
- The introduction of the equivalent of the PAYE Tax Credit to entrepreneurs.
- Class S PRSI contributions for the self-employed that would allow qualification for social welfare benefits similar to those of employees.

Capital Gains Tax / succession planning for family owned export businesses

- That business relief is reviewed and the age limited eliminated (or at least increased to age 70) as a specific requirement to avail of the relief.
- A reduction in capital gains tax rate for entrepreneurs selling their business, similar to 10% and increase the €1m lifetime gain threshold to €10m. This should be extended to angel investors who invest in EIIS shares.
- A 10% tax rate on dividends from eligible companies with a €10m lifetime cap to make it neutral for an entrepreneur to realise profits by sale of shares or receipt of dividends.

Executive Summary

Ireland's exporting sector is one of Ireland's greatest strengths and has been the key driving force behind Irish economic recovery, economic growth and job creation. It is critical for the Government to recognise how vital Irish exporters are to Irish economic growth and use Budget 2017 to maximise the opportunities that arise from an increase in global demand.

Exports continue to lead the way in driving the Irish economy forward and are the most significant contributor to making Ireland one of the fastest growing economies in the world, helping to reduce unemployment, create new employment, and reduce our national debt. Exporting is the success story of the Irish economy and has helped to restore the country's image abroad and to attract greater Foreign Direct Investment as well as to foster the development of home grown Irish companies by encouraging more and more entrepreneurs to grow their businesses internationally.

Cost competitiveness within the Public Sector is critical to the success of the Irish economy, and it is relevant to all sectors of the exporting community – indigenous and FDI, small and large. To improve cost competitiveness the cost base must be minimized and the allocation of resources must be smarter; it must support and reward increased productivity. There is widespread recognition of the need for more resources rather than higher paid ones in many public services, particularly in the front line, and for exporters this means within Enterprise Ireland, Bord Bia and the Diplomatic Service, and in the way public monies could be used to enhance services to exporters in a way that opens up new channels to market not wholly dependent on expensive overseas deployment of state employees.

The Irish Exporters Association (IEA) assists its members to grow their exports to world markets. We drive and support the growth and development of all exporting businesses based in Ireland by:

Representation – leading the export agenda as the voice of Irish exporters
Member development – enhancing the export knowledge and skillset of members through a range of training services and export development programmes
Networking & Connectivity – connecting our members with government and business stakeholders domestically and in market
Export Services – enabling our members with practical assistance and critical support services

We are advising that the Government prepare a prudent Budget 2017 that will encourage the growth of Irish exports to world markets. If Ireland is to maintain growth, we need the Government to design a budget that shows a genuine commitment to:

1. Maintaining and improving our National **Cost Competitiveness**;
2. Putting measures in place that will combat the **War for Talent**;
3. Broadening our Export Base and **Diversification of Export Markets**, and
4. Encouraging and fostering **Entrepreneurship**.

Economic Background

Detailed GDP and balance of payments figures (which includes services exports information) on the second quarter of 2016 have not yet been released by the CSO but goods trade data in value terms is available for the January to June period. Looking at Table 1, the value of goods exports for the first half of 2016 was €55,401 million, an increase of €654 million (+1.2%) when compared with the first six months of 2015. Food and drink exports grew slowly and decreases were felt in *crude materials, inedible, except fuels* and *mineral fuels, lubricants and related materials*.

Table 1. Irish Goods Exports First Half 2016 at Current Prices

	H1 2015 €million	**H1 2016 €million**	**% change**
(0) Food and live animals	4,755	4,859	2.2%
(1) Beverages and tobacco	551	571	3.6%
(2) Crude materials, inedible, except fuels	954	738	-22.7%
(3) Mineral fuels, lubricants and related materials	467	330	-29.3%
(4) Animal and vegetable oils, fats and waxes	26	39	48.3%
(5) Chemicals and related products	31,980	32,202	0.7%
(6) Manufactured goods classified chiefly by material	1,051	1,076	2.4%
(7) Machinery and transport equipment	7,382	7,803	5.7%
(8) Miscellaneous manufactured articles	7,026	7,313	4.1%
(9 & unclassified) Other exports	555	468	-15.7%
Total Exports	**54,747**	**55,401**	**1.2%**

Source: CSO, Goods Exports and Imports

The nominal increase is a sharp contrast to the inflation in exports that was felt this time last year, an increase of 18.9% year on year to June 2015, but this was largely due to a very large increase in exports of *medical and pharmaceutical products* and *machinery and transport equipment*. The nominal increase in exports is consistent with Manufacturing PMI surveys which indicate that new orders have stagnated, ending a three-year sequence of expansion, and output dropped for the first time since May 2013. This suggests that the weakening of Sterling pre- and post- the UK referendum on June 23rd 2016 and the uncertainty surrounding 'Brexit', as well as weaker global manufacturing, may weigh on exports in the latter part of 2016. The nature of our trade with the UK and the intertwining of our supply chains means that it may take some time for the knock-on effects of any weakening in the UK economy to be felt here.

The immediate impact of 'Brexit' has been the weakening of Sterling, which as of July 2016 has reached a three-year low. In the medium term, a slowdown in the UK economy could mean less demand for Irish goods and services. The severity of the impact that the UK leaving the EU will have on the Irish economy is difficult to gauge currently. The UK is yet to invoke Article 50 and the outcome for Irish economic growth will be heavily dependent on the trade agreement that is negotiated between the EU and the UK. The potential impact to exporters could be changes in customs, tariffs, administrative costs, VAT, visa requirements and EU regulations & legislation, along with the need to take action, which may have a detrimental effect on employment and investment in Ireland, in order to secure the business they have in the UK. The impact of Brexit and the subsequent weakness in Sterling is likely to affect the export figures for the second half of the 2016. However, with the announcement of the closure of a mushroom manufacturer in Tipperary in early September 2016, we are already seeing the potential impact. The company cited weak Sterling as its reason for winding up.

It is in the exporting sectors that the long term future of the Irish economy lies. According to World Bank Data, in 2015 Ireland ranked 17th on the *Ease of Doing Business Index*, which rates countries by the most business friendly regulations. The UK ranked 6th on the same scale. Given the potential influx of investment and relocation of business, as a result of the UK exiting the EU, it is imperative that Ireland place itself as a competitive country for setting up business.

Cost Competitiveness

Maintaining Ireland's national cost competiveness is imperative to protecting Ireland's economic growth and sustainability. It would foster greater economic stability, lower national debt, lower unemployment, increase investment in infrastructure, in health, in education and in other public services, and provide better opportunities to attract suitable talent to Irish enterprise. Not only does cost competitiveness affect Irish companies' ability to compete domestically and internationally but the high cost of doing business in Ireland will make the country a less attractive prospect for Foreign Direct Investment. Ireland needs to position itself as an attractive place for business to set up, particularly when we are looking at a future where the UK will be more independent of the EU.

The IEA recently conducted a survey with its members regarding their export activity in Q1 2016. This is the first in a series of quarterly reviews scheduled for 2016. The survey, the *Quarterly Export Eye*[1], aims to identify and evaluate trends that affect the Irish export industry and supports the IEA with hard data in our representation. 62% of IEA members reported an increase in exports in Q1 2016, 8% a decrease and 31% remained unchanged. One third reported between 75% and 99% of their turnover is dependent on export and one fifth reported 100% of their turnover is dependent on export.

The rising costs of doing business in Ireland was cited by IEA members as one of the biggest challenges currently facing them. Looking at where increased costs were felt: Insurance (67%), Exchange Rates (64%); Labour (56%), Regulatory Burdens or Red Tape Costs (45%) and Legal Costs (43%). High business costs make Ireland less attractive for Foreign Direct Investment and reduce the competitive advantage of Irish goods in domestic and international markets.

Rising insurance costs

CSO inflation data shows that increases in insurance prices in Ireland are well in excess of EU trends and rising business costs are hampering the development of small businesses in Ireland.

Recommendations:

- Government intervention in the case of rising costs of insurance to deter the negative effect that that is having on business costs. Measures need to be taken to encourage new players to compete in the market to drive down the rising cost from insurance providers.
- These include a review of insurance costs at Oireachtas Committee level, a comparison of premiums and pay-outs against the UK and other EU countries, and a set of recommendations to be made for maximum pay-outs for insurance claims, in line with those in the UK.

[1] Quarterly Export Eye, Q1 2016, report can be viewed here.

Housing crisis

Rising costs of residential property, particularly in Dublin, Cork, Waterford and Galway cities, are a serious issue. The CSO recently reported that Ireland is the third most expensive EU country to live in. The residential rental sector in Ireland is currently in crisis mode and the overriding problem is one of supply. Shortage of new housing is a key factor contributing to house price inflation, and rental inflation. The current rent control measures that have been put in place restricting rent increases only curtail increases for those tenants who are not planning to move. This residential property crisis can heavily impact our ability as a country to attract and win FDI. The current housing crisis is driving up salary expectations and is affecting exporters' ability to compete on an international platform. Recent research by the ESRI suggests that it may take up to three years for supply in the Irish market to reach the underlying structural demand of approximately 25,000 units per annum.

Recommendation:

- It is clear that residential house building must increase drastically over the current levels. While the new Minister for Housing is welcomed, resources need to be focused to drastically increase supply and control measures need to be put in place to curtail rent inflations across the board, not just for tenants in situ.

Minimum wage restraint

The IEA continues to urge wage restraint. From 1st January 2016, the statutory minimum wage increased to €9.15 from €8.65 per hour. It is currently very difficult for indigenous companies to move to the proposed living wage. Restraint in pay will allow us to improve competiveness on an international platform while bringing up the standard of living in Ireland. When the Irish minimum wage is compared to that of the UK (Table 2), the UK is a much more attractive environment for a business to base itself. For example, an employee between the ages of 18 and 20 who has more than two years work experience is €115 more expensive per week (€5980 annually) in Ireland than the UK. With many Irish companies determined to hold onto their sales in the UK in a post-Brexit environment, many are considering the once imponderable option of switching production to the UK, and that will have consequences on jobs in Ireland. We need to take action now to prevent this.

Recommendations:

- There be no changes to minimum wage in Budget 2017 and that the current level be frozen for a minimum of 3 years in order for the long-term implications of the UK leaving the EU to be further clarified.
- In the event that there are increases to the minimum wage in Budget 2017, the IEA recommend a reduction in employers PRSI contributions to ensure no net cost to the employer. The UK will actively be targeting FDI and are already a serious competitor when Irish entrepreneurs are thinking of where to locate their growing business.

Table 2. Minimum Wage in UK versus Ireland

	Ireland Minimum hourly rate of pay in Ireland after 1st January 2016	UK National Living Wage and the National Minimum Wage from 1 April 2016	UK National Living Wage and National Minimum Wage in € (at rate 1 GBP = 1.16990 EUR as of August 2016)	Difference	Difference calculated at a 39 hour working week (Irish national average)
Over 18	€7.32 - €9.15*	£5.30 - £7.20**	€6.20 - €8.42	€0.73 - €2.95	€28.47 - €115.05
Under 18	€6.41	£3.87	€4.53	€1.88	€73.32
Apprentice	€6.86 - €8.24***	£3.30	€3.86	€3.00 - €4.38	€117.00 - €170.82

* In Ireland, an employee in the first year of employment over the age of 18 in entitled to €7.32 per hour, an employee who is in the second year of employment since the date of first employment over the age of 18 is entitled to €8.24 and an experienced adult worker is entitled to €9.15.
**UK rates for over 18 are as follows: £5.30/€6.20 (18 to 20), £6.70/€7.84 (21 to 24) and £7.20/€8.42 (25 and over)
***Irish Apprentice rates are as follows: €6.86 (1st one third period), €7.32 (2nd one third period) and €8.24 (3rd one third period)

Measures to protect business against Sterling depreciation

As a small, open economy, Ireland can be particularly vulnerable to economic fluctuations in global markets. A sharp depreciation in Sterling heavily impacts Irish exporters as the UK is our single biggest trading partner. The referendum in the UK is having an impact on Irish exporters, 89% of IEA members do business with or export to the UK and, as of June 2016, weakened Sterling has had an impact on 65% of their businesses[2]. Prior to the UK referendum, 68% did not plan to hedge Sterling and this drops to 49% who do not plan to hedge Sterling following the referendum.

Whereas this lack of hedging raises its own questions as to why this is such, along with the need to address this in a constructive and long-term fashion, the IEA calls on Government to put measures in place that will help businesses cope with at best a loss of revenue if Sterling continues to weaken, and at worst potential business failure. If Sterling reaches 90p against the Euro this could have serious risks to rising unemployment, especially to the indigenous Irish food and drink sector. 'Brexit' is having a very similar effect to certain sectors of the Irish export industry as the global and financial economic crisis of 2007 – 2009. In 2009, the Government, through the Department of Enterprise, Trade and Innovation, initiated the *Employment Subsidy Scheme (Temporary)*, managed by Enterprise Ireland, to support the retention of full time and part time jobs in viable enterprises, that might otherwise be made redundant as a result of the impact of the global and financial economic crisis. It was introduced to help employees maintain their jobs while at the same time assisting employers to retain their productive capacity. The scheme was implemented under the EU State Aid Temporary Framework Guidelines. An initiative such as this would assist exporters to retain their staff and productivity and absorb the impact of fluctuating currency.

We believe that the Government now needs to go beyond the *Employment Subsidy Scheme (Temporary*) and this support should be available to all companies whether they are supported by the

[2] IEA Brexit Member Survey, June 2016. Report can be viewed here.

State Agencies or not, as there are far more companies, even indigenous ones, who are exporting than are clients of the agencies.

Recommendations:

- A National hedging strategy for GBP, managed by the NTMA and administered via the SBCI through the main commercial banks and relevant currency hedging providers. The aim of the product would be to offer a discounted exchange rate to those companies affected who want to avail of it, with the NTMA responsible for managing a set proportion of the underlying exposure.
- This should be supported by a coordinated vigorous campaign to help SMEs to understand the need to build hedging into the long-term strategic and day-to-day management of their businesses.

Mobile phone coverage and broadband access

Mobile phone coverage and broadband access remain a huge issue for rural business in Ireland. While the IEA is relieved to hear of the establishment of the Taskforce on Mobile Phone and Broadband Access to report back to government by the end of the year on ways to improve mobile reception and broadband access across the country, there are still actions that need to be taken. The recent announcement of the rollout of a 1GB broadband service in Letterkenny using SIRO, the open-access wholesale broadband provider, is an example of how we can transform broadband infrastructure. Faster broadband encourages companies to establish outside of the main urban centres and acts as an enabler to attract business, including FDI, outside of Dublin.

Recommendation:

- Immediate solutions need to be sought to the coverage deficits to businesses and homes across the country if Ireland is to remain competitive in a technological age, improvements in broadband and a mobile phone infrastructure need to be immediate. Government should consider partnering with private industry to facilitate the rollout of broadband in a similar manner to our road building partnership strategy which has transformed the road network.

Restraint in public pay

Over the past 5 years, a real opportunity has been missed to introduce meaningful reform in our public sector; on the one hand, to acknowledge and reward the many ambitious and high performers who try harder and deliver more; but equally to sanction those who under-perform. Increasing our national cost base without commensurate improvements in productivity delivers only one certainty – reduced competitiveness. The principle of rewarding only those who try harder and deliver more, whether in the public or in the private sector, whether entrepreneur, employer, employee or job seeker, is not only just but serves the wider public interest and, indeed, a far larger electorate.

Recommendation:

- Restraint in public sector pay increases – limited to no higher than the annual CPI rate. A bonus system that rewards and recognises effort but only where KPIs are achieved.

War for Talent

The skills shortage in Ireland that has been left in the wake of the most recent recession, and compounded by the demand post recovery, is really being felt by all sectors of the Irish exporting community. IEA members are increasingly reporting difficulty in filling vacant roles with suitably qualified candidates, particularly in Life Sciences, Finance, Engineering, and the IT sector. The skills shortage is exacerbated by the high cost of living in Ireland, the fall of the number of adults in Ireland in their 20's and an extremely competitive tax regime in the UK. In the *Quarterly Export Eye, Q1 2016*, 44% of respondents stated that they had experienced difficulty in finding candidates that met the minimum criteria for vacancies in the first quarter of this year. Difficulties reported in recruiting and retaining staff in Q1 2016 include: lack of available talent in Ireland (24%), competition from other companies (22%), and meeting salary expectations (22%).

While Ireland has one of the highest higher-education participation rates among the OECD countries, recent research by the Higher Education Authority shows a significantly large drop-out rate from Irish third-level institutions. The proportion of new entrants in 2012/13 who do not progress to the following year of study is 16% across all sectors and NFQ levels. Students on Construction (29%), Services (26%), Computer Science (25%) and Engineering (23%) programmes display non-progression rates above the national average of 16%. Worryingly, the bulk of abandoned courses are in sectors which are needed to meet the skills shortage in the Irish economy.

Recommendations:

- Concentration of resources to retain students in courses that will meet skills shortages in areas such as Life Sciences, Finance, Engineering, and IT.
- Prioritise investment to address the skills shortages that exists and update the approved list of apprenticeships, elevating the standing of education through work. We also recommend incentivising employers to back apprenticeships of employees.

Diversification of Export Markets

Despite being a strong, open economy, Irish exports remain heavily dependent on three main export markets. In 2015, the European Union accounted for 53% of goods exported, excluding the UK from this equation, the EU accounted for 39% with 14% of exports going to the UK. With the USA accounting for a further 24%, our reliance on traditional European and US markets remains too high. The decision by the UK to leave the EU, and the uncertainty that this brings to Irish exporters, highlights more than ever the need to support Irish exporters in the diversification of their export markets so that an over-reliance on any particular single market does not have the potential to put our economy under a similar threat in the future. More focus needs to be given to high growth markets like China, India, Africa, South America, and on the emerging opportunities in places like Iran, so that Ireland can become less dependent on our trade relationships with the EU, USA and UK. IEA members sited 'establishing local relationships' as the most significant challenge to doing business overseas (40%) in Q1 2016.

It is vitally important that we use taxpayer resources in a way that secures the best value to the exporter and to the taxpayer for this spend. We need greater frontline support for exporters in Enterprise Ireland, Bord Bia and in our Embassies. The Irish Exporters Association's experience with our diplomatic service has been extremely positive, with strong engagement by our Ambassadors, (working side by side with Enterprise Ireland colleagues where Enterprise Ireland has offices) to secure business for Irish companies.

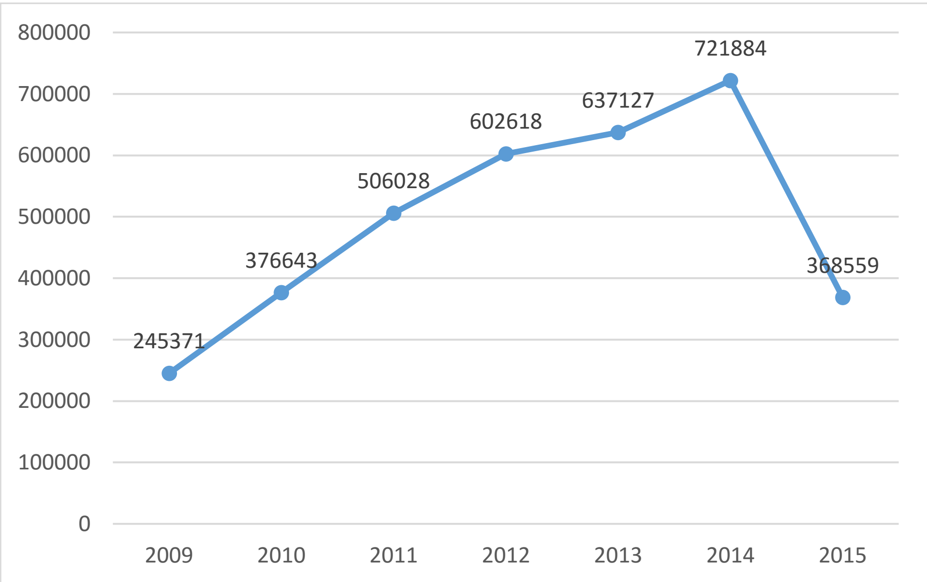
We are also aware of the need to balance resources between high growth and developed markets. Yet as all business people know, it is easier to win more business from existing customers than to go out and develop new ones. Therefore it is important not to cannibalise our assets in developed markets, but rather create extra resources that are required in faster growing regions.

Whilst we welcome the increase in State representatives abroad, we are aware of the cost of funding these requirements. We look forward to supporting them to develop in-market networks for Irish exporters that can work alongside the Embassies and State agencies.

Recommendations:

- That Enterprise Ireland, Bord Bia and our Embassies receive a 10% funding to increase resources in high-growth markets specifically. This will ensure that resources in our biggest developed export markets are not affected. The role of our embassies should be reaffirmed and resourced to ensure they are mandated specially to deal with Irish exporters.
- The IEA should be given a specific role for a campaign in partnership with Government and funded by them to drive our exports.
- On 7th August 2014, Russia introduced an import ban for certain agricultural products originating from the EU including beef, pork and poultry meat, dairy products, fruits and vegetables. Russia has officially extended its ban on EU food imports until the end of 2017. Looking at Table 3, total goods exports to Russia halved from 2014 to 2015. Concentration of efforts at an EU level to resolve the issue of import bans in Russia as the indigenous food and drink sector in Ireland is being implicated and given that 44% of this sectors' exports are currently destined for the UK, this is a time when this sector needs to be protected.

Table 3. Total Irish exports to Russia €000



Source: CSO, External Trade

Entrepreneurship

Innovation in the form of entrepreneurship is the driving force that sustains economic growth. It is key to building a strong indigenous economy to balance and compliment inward investment. The IEA calls on Government to deepen the economic recovery by promoting business friendly measures that would encourage and stimulate investment and entrepreneurial risk-taking. Key to this is encouraging companies to establish their operations in Ireland, not only the back office and administration functions but also to encourage active research and development to occur in Ireland. With much better tax incentives and tax reliefs available to entrepreneurs who establish their business in the UK, this is encouraging Irish start-ups to locate their business there.

R&D Tax Credits

Where a company is loss making and does not have sufficient corporation tax liabilities against which to utilize the credit, a refund of the R&D tax credit is paid over a period of three years, capped at the payroll tax liabilites for the period in which the R & D is taken. This can cause cash flow difficulties for smaller companies and can delay additional expenditure on R&D activities.

Recommendation:

- Decrease the three year refund period by granting a full tax rebate in the year the qualifying expenditure is incurred capped at the payroll taxes paid by the company. To target the changes at smaller companies, consideration could be given to giving a refund in year one for refunds of €100,000 and less. This could minimize the cash outflow for the Exchequer while helping to accelerate the payments to smaller companies who rely on the credit as an important source of funds. The level of paperwork and documentation required to claim the benefit of the credit is extremely onerous and off-putting for start-up companies as it drains management resources. A more streamlined interview based approach would be welcomed in supporting any such claims.

Share Incentive Scheme for Entrepreneurs

KPMG is committed to incentive share schemes for SMEs. At the moment employees are taxed under income tax rules on any share incentives they might be granted, even in circumstances where they haven't realised any actual gain on the disposal of their shares. Share incentives are an extremely useful and competitive tool in attracting talent, particularly for start-ups in the technology area. By allowing companies to incentivise employees in a way which does not result in large up front tax liabilities this has the benefit of both allowing them to attract talent and making it cost effective for both companies and employees.

Recommendations:

- Introduce an approved SME share option scheme taxed only upon sale/redemption of shares at the capital gains tax rate.
- Exempt from benefit in kind, employer loans used by employees to fund the acquisition of shares/share options from their employers.

Intellectual Property

In respect of Intellectual Property ("IP"), an area that needs to be addressed is the interaction of capital allowances under Section 291A of the Taxes Consolidation Act 1997 and the R&D credit under s766 TCA 1997. This is of great relevance to Irish companies in the software industry where this is regularly seen in practice. In addition, given the Government's focus on the software industry and FinTech under the IFS 2020 strategy document published, in our view, the below should rank high on the tax policy agenda.

S291A was introduced to allow a company to claim capital allowances on the cost of acquiring IP. The section can also apply to allow capital allowances in situation where a company capitalizes the cost of their own R&D expenditure. In most instances a company can claim R&D tax credits together with claiming a tax deduction for R&D labour costs (e.g. where those costs are not capitalized in the accounts). However, the R&D credit and s291A allowances are not available on the same expenditure even where an Irish tax resident company employs, say, 20 software developers in Ireland on a software development project which may be the situation for a start-up company.

Recommendations:

- S291A(7) and s766 could be amended such that the R&D credit and s291A could be claimed on expenditure incurred on self-developed IP.
- Alternatively, the law could be changed to facilitate some form of election back into s291 out of s291A in order that allowances would be available at 12.5% p.a over 8 years with such expenditure also qualifying for the R&D credit.

The net result of the above is that a company could claim a tax deduction for the cost of its capitalised labour / software developers together with an R&D credit tax credit. This would put software development companies on a par with other entities carrying on R&D activities.

Withholding Tax

Irish companies who are looking to expand abroad are often required to have a taxable presence in another country through either a subsidiary or a branch. The current tax system is complex meaning these profits are taxed when repatriated to Ireland with a potential credit for foreign tax. This is in contract to a more straight forward and transparent system that simply exempts such profits from tax in a similar manner to many other countries including the UK.

In relation to exporters who are subject to withholding tax in foreign countries and who are unable to offset the withholding tax in the current year on their Irish taxes, we recommend the following is implemented.

Recommendations:

- Amendments to allow unused withholding tax credits to be carried forward to future periods and to be available for offset against future corporation tax.
- Amendments to allow the pooling of the credit against royalty income from other jurisdictions.
- Tax exemption for dividends and branch profits repatriated to Ireland.

Levelling the playing field in terms of tax for Entrepreneurs

It is the view of the Irish Exporters Association that the current penalties suffered for being an entrepreneur and self-employed in Ireland are not only unjust but dangerously undermine one of the very important foundations of wider economic development. The IEA believe that serious reform of the Irish tax system is necessary to make Ireland an attractive destination to establish enterprise.

PAYE & USC Rates

Starting a business carries significant risk to the individual. If government shares our belief in the importance and value of entrepreneurs and is genuine when it says it wishes to foster entrepreneurship, then it needs to support policies that acknowledge those risks. Current policies send a very clear message to would-be entrepreneurs and it is not one of encouragement, nor of support or appreciation.

Successful entrepreneurs create companies that inevitably bring wider benefits for their community and for the country, generating employment and contributing to the exchequer. The benefits of entrepreneurship are far-reaching.

According to OECD figures, 17.6% of the Irish workforce were self-employed in 2015. Table 4 below illustrates the differences in the tax treatment of PAYE and self-employed incomes. Whilst the IEA recognises the introduction of an *Earned Income Tax Credit* to the value of €550 announced in Budget 2016 for self-employed and small business owners as a first step to further measures, we are disappointed that this is only 1/3 of the PAYE Tax Credit. With regard to Universal Social Charge (Table 5), there is a surcharge of 3% on individuals whose non-PAYE income exceeds €100,000 in a year.

Table 4. Personal Tax Credits

	2015	**2016**
PAYE Employee Tax Credit	€1,650	€1,650
Earned Income Tax Credit (max)	---	€550

Source: Revenue, IT1 - Tax Credits, Reliefs and Rates for the Tax Years 2015 and 2016

Table 5. The Standard Rates and Thresholds of USC

PAYE	**Rate**	**Self-employed**	**Rate**
Income up to €12,012.00	1%	Income up to €12,012.00	1%
Income from €12,012.01 to €18,668.00	3%	Income from €12,012.01 to €18,668.00	3%
Income from €18,668.01 to €70,044.00	5.5%	Income from €18,668.01 to €70,044.00	5.5%
Income above €70,044.00	8%	Income from €70,044.00 to €100,000	8%
		On the balance	11%

Source: Revenue, IT1 - Tax Credits, Reliefs and Rates for the Tax Years 2015 and 2016 and Universal Social Charge Frequently Asked Questions

Entrepreneurs and business owners are also penalised with regard to social insurance contributions. A PAYE employee, earning less than €18,304 per annum will not have to pay PRSI contributions. For gross earnings between €18,304 and €22,048 per annum, the 4% PRSI charge will be calculated at a tapered credit rating and above this limit PRSI is charged at 4%. Self-employed contributors with annual self-employed income over €5,000 pay Class S PRSI at the rate of 4%, subject to a minimum payment of €500. This difference is clearly distinct at the lower end of the income scale.

If we compare the benefits that are covered for Class A (Employees in the private sector and certain public servants) and Class S (Self-employed), as can be seen in Table 6 below, we can clearly see again that self-employed contributors are penalised. A serious drawback for an entrepreneur starting up in Ireland is the lack of protection that exists if the endeavour fails. PAYE employees are provided with so much more stability in their PRSI benefits even though self-employed contributors are paying the maximum on the scale.

Table 6. PRSI benefits Class A & Class S

Benefit	Class A	Class S
Adoptive Benefit	√	√
Carer's Benefit	√	
Illness Benefit	√	
Health and Safety Benefit	√	
Invalidity Pension	√	
Maternity Benefit	√	√
Occupational Injuries Benefit	√	
State Pension (Contributory)	√	√
Guardian's Payment	√	√
Treatment Benefit	√	
Jobseeker's Benefit	√	
Widow's, Widower's or Surviving Civil Partner's Pension (Contributory)	√	√

Source: Department of Social Protection

The IMF have indicated that a large tax burden on middle income households undermines female labour force participation, creates welfare traps for low skilled workers and discourages high skilled workers migration to Ireland. As well as introducing a level playing field for the self-employed it is also vital that we look to reduce the overall tax burden and pursue government strategy to reform USC whilst retaining a broad base of taxpayers.

Recommendations:

- A reduction of the higher USC rate for entrepreneurs as illustrated to PAYE levels.
- Phase out of USC over the medium term by reducing rates, increasing the band ceiling and increasing the exemption threshold to reduce very low earners.
- The introduction of the equivalent of the PAYE Tax Credit to entrepreneurs.
- Class S PRSI contributions for the self-employed that would allow qualification for social welfare benefits similar to those of employees.

Capital Gains Tax / succession planning for family owned export businesses

The rate of Capital Gains Tax is a key factor in determining investment into an economy. It is important to facilitate entrepreneurs in their business endeavours and to reward success. There are a number of specific areas relating to existing tax reliefs which, in our view, need to be addressed in the short term in order to create a tax environment that is supportive to the needs of small businesses, entrepreneurs and FDI in Ireland.

Currently when a business owner of a private company considers how to pass it on to the next generation if they have an interest they are faced with requirements that are very onerous to avail of business relief, including a requirement to pass on interests in the family business prior to the age of 66. Increasingly, people are having children later in life, and an age restriction of 66 to avail of the retirement relief often means that the next generations are not of sufficient age or experience to take over the family business within the timeframe allowed by the relief.

Separately, the CGT Entrepreneurs Relief in the UK in effect grants a CGT rate of 10% on all gains on qualifying assets. The existence of this relief in the UK puts Ireland at a distinct competitive disadvantage given that the Irish CGT landscape for entrepreneurs is far less rewarding for successful entrepreneurs. In Ireland, the equivalent rate is 33%. Although there is a specific relief in Ireland (under section 597A TCA 1997) it is extremely limited. The IEA welcomed a change in last year's Budget to Capital Gains Tax, which will see a reduced 20% rate apply to the whole or part disposal of a business up to the a limit of €1m in chargeable gains. However, we feel that this did not go far enough. Too often Irish entrepreneurs take the option of selling out their business to foreign investors, to realise any meaningful return on the risk they have taken, which can result in Irish jobs leaving the country. We should also provide Ireland's entrepreneurs with an alternative to selling their business in order to earn a meaningful return on their investment.

For companies seeking to raise funds through the EIIS, we need to make it as attractive as possible for angel investors to help these companies to develop and grow particularly at early stage development where the risks are highest.

Recommendations:

- That business relief is reviewed and the age limited eliminated (or at least increased to age 70) as a specific requirement to avail of the relief.
- A reduction in capital gains tax rate for entrepreneurs selling their business, similar to 10% and increase the €1m lifetime gain threshold to €10m. This should be extended to angel investors who invest in EIIS shares.
- A 10% tax rate on dividends from eligible companies with a €10m lifetime cap to make it neutral for an entrepreneur to realise profits by sale of shares or receipt of dividends.