BY
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Brexit and Budget 2019

In this article, Cormac Mohan, President, CPA Ireland, proposes the way forward to support Entrepreneurs.

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Introduction

Ireland has a track record for attracting quality foreign direct investment. Brexit can create an opportunity to attract new investments into Ireland across a range of sectors including the Agri-food, financial services and funds sectors.

Certainty is a key ingredient of tax competiveness to investors and makes Ireland a significantly more attractive jurisdiction for inward investment. However, there is also opportunity for Irish business to grow and expand by accessing European markets which may not have been previously considered. With regards to this, Government will need to provide targeted support to Indigenous Irish businesses with growth potential to compete internationally.

There are a number of measures outlined in CPA Ireland's pre-budget document which Government should consider for adoption in order to improve conditions for entrepreneurs and growth orientated businesses.

Personal Taxation

Income tax was introduced in 1799 on a temporary basis to fund the Napoleonic war and in 2011 we were all assured USC was also a temporary measure. It is now proposed to merge PRSI and USC. It will be a complex endeavour as one is calculated on a weekly basis and the other cumulative, they also have differently calculated rates. Changing the title does not make these taxes any less permanent. As this proposal would result in a temporary tax becoming permanent CPA Ireland feels that this is a retrograde step and would not be in favour of this proposal.

Overall the current employee marginal rate (comprising income tax, USC and PRSI) of 52% is still too high to attract key staff from abroad and the self-employed marginal rate of 55% unfairly penalises this sector. We recommend that the 3% USC surcharge where non-PAYE income is more than €100,000 a year be removed.

Recent surveys among the entrepreneur community highlights how the high marginal tax rate of up to 55% is a major barrier to Irish entrepreneurship as it penalises risk-taking and discourages individuals from accessing cash to enjoy the fruits of their labour. It is disappointing that "creative measures" are not being considered by our Government to encourage entrepreneurship in this country. A roadmap should be developed to determine the approach and timing to reduce the marginal tax rate on a phased basis.

Corporation Tax Surcharge

The corporation tax surcharge on undistributed profits of service companies is punitive and anti-entrepreneurial in that it drains developing companies of much needed capital. In the event that the capital is distributed to shareholders it is subject to full income tax/USC/PRSI. The effective doubling up of corporation tax rates on undistributed profits is a major disadvantage to the effective and timely management of such companies.

Business & Entrepreneur Community

Although CGT Entrepreneur relief is welcome, it is of limited value when compared to similar benefits offered under the UK regime. The relief currently applies a reduced CGT rate of 10% on qualifying gains of up to €1m in a vendor's lifetime. The UK equivalent applies up to a £10m threshold. This has led to entrepreneurs questioning whether Ireland is the best location from which to operate their business, particularly given the proximity of the UK. We would suggest that this relief is improved up to a limit of €10m in line with our UK counterparts in order to enhance Ireland's attractiveness to entrepreneurs and help ensure indigenous companies develop beyond the start-up phase. Furthermore, the conditionality attached to the relief is overly onerous and currently lacks commerciality for vibrant businesses.

In order to encourage entrepreneurs to commit to their business for the longer term, the CGT position should be amended by granting such individuals higher lifetime limits and lower rates of CGT commensurate with how long they have held their shares in the business. In addition, cash extraction and exit measures reflecting a longer holding period should be considered to further incentivise an entrepreneur to stay in the business and grow it for either an exit strategy through a flotation or the next generation.

Brexit

We must be mindful of the impact of Brexit, Irish-owned firms rely heavily on the UK as the source of intermediate inputs, which are goods used to produce a final product. Over 50% of the total imports used by Irish-owned firms are sourced in the UK with many importing solely from the UK market. Many Irish-owned companies are therefore highly exposed to cost increases in the case of a hard Brexit, which could damage their competitiveness and impact their export performance. It is imperative as Accountants we are alert to the extent of the risks posed by disruptions in the supply chain post-Brexit and the distribution of risks including foreign exchange exposures across the different sectors, particularly focusing on domestic and medium sized enterprises.

As we face into this post Brexit world SME's will likely need to consider expanding their business into Europe and international markets other than the UK. In order to assist SME's and food businesses which will be heavily impacted by Brexit, Minister for Finance, Paschal Donohoe, should announce further reliefs and supports in the form of tax reliefs on top of the current loan scheme in place to assist these companies in managing their working capital requirements.

The Brexit Loan Scheme should be of assistance to a number of SME's to assist them in expanding into foreign markets. However, this is a funding measure and does not provide any tax incentives to entrepreneurs who have taken significant risks to expand and grow their business. The current relief does not do enough to incentivise Irish entrepreneurs.

The Loan Scheme is offered in partnership with the Department of Business, Enterprise and Innovation, the Department of Agriculture, Food and the Marine and is supported by the SME Guarantee Facility, with the financial backing of the European Union under Horizon 2020 Financial Instruments. The loans are available through the main Irish retail lenders where approval of these loans are subject to the banks own credit policies and procedures. This is perceived as a barrier and should be tailored to international expanding businesses.

KEEP

A new Key Employee Engagement Programme (KEEP) has been introduced to assist SME's attract and retain top talent. Where employees are given share options as part of their remuneration package, any gains arising to employees on the exercise of these options will be liable to CGT on a disposal of shares rather than being subject to income tax, USC and PRSI on exercise of their share options as is currently the case. This rate of tax should be significantly reduced to retain talent, give them a sense of ownership and take a long-term view of their career path within Irish indigenous businesses.

R&D

The R&D tax credit system should be tailored to the size of the entity attempting to avail of it. The 2016 Department of Finance Economic Evaluation of the R&D Tax Credit "show that it is mainly older, larger and non-Irish firms who derive financial benefit from the scheme".

The scheme needs to be streamlined with timelier processing of R&D claims and greater support given to indigenous Irish growth orientated companies.

For Ireland to remain competitive with other jurisdictions such as the UK, the government must act to make them fit for purpose for SMEs. An important measure of commercial vitality is a country's spending on research and development. Total spending on R&D in Ireland was just over 1.6% of GDP in 2014, below the EU average of 2.1% and less than half that of Finland, one of Europe's top performers. Of the already small amounts, only one-third is accounted for by home-grown companies.

Capital Taxes

In relation to CGT and CAT, the current rate of both taxes remains excessively high at 33% therefore acting as a disincentive for assets to pass to the next generation. It is recommended that the CGT rate is reduced significantly from 33% to a figure in line with most other EU countries.

The tax-free thresholds for CAT, particularly those with regard to close family relations and strangers remain historically low.

While the Class "A" threshold (parent to child) has increased slightly in the last few Budgets it is still significantly behind where it was prior to the recession. Given the increases in property values in the last number of years and the changes to CAT residential relief, the tax-free thresholds should be restored to their pre-2009 levels.

Further, the quantum of the annual small gift exemption of €3,000 should also be reviewed to reflect current cost of living/ assets values. This is particularly acute since Finance Act 2014 effectively abolished the ability of a parent to provide support to their children once out of full time education.

Conclusion

In summary Budget 2019 must provide supports to both our Indigenous Irish businesses and appropriate incentives to international business to base themselves in Ireland in a post Brexit environment. It must encourage rather than discourage investment in business and valued employees. It can do this through an overall simplification of the personal taxation system, a streamlining of the business supports and a reduction in the corporate and personal tax rates.