The Budget and Finance Bill

A View from the SME Perspective.

by David FitzGerald

This article reflects on aspects of the Budget and Finance Bill insofar as they impact on the SME sector. First, it is necessary to provide the statutory health warning – this article is being written at the end of October and the eventual Finance Act may differ materially from the Bill.

In relation to the Budget context, readers will be aware that the Finance Minister was the beneficiary of a surprise once off windfall of €1 billion literally days before his budget presentation. This arose from a change in accounting treatment for multinationals. We all like positive surprises but readers who have spent many years in business will know that unpleasant surprises can also arise and the ideal situation is not to have any surprises at all.

Thus, the development does put focus on the role of the FDI sector in our economy. The President of CPA Ireland, Cormac Mohan recently drew attention to this by highlighting that ten companies contribute 40% of all corporation tax, which leaves the economy very exposed to the fortunes and location of these organisations. Given the external environment, including the current US administration's ambitions to repatriate tax and business, overreliance on the FDI sector is not ideal for an economy.

The fact that he chose to spend the bulk of the €1 billion windfall to plug the hole in the 2018 (recurring) health budget overrun is a matter for another discussion. One wonders how he will make up the 2019 health overrun.

A further example of imbalanced enterprise policies is the SARP regime. The scheme provides a tax break of up to €50,000 for high paid executives to work on assignment in Ireland, usually for FDI companies. Meanwhile Irish entrepreneurs are taxed at a personal tax of over 50% on withdrawing income over €45,000 from their business.

99% of businesses in Ireland are SMEs and employ around 1.5 million people.

Thus, they play a much more central role in the economy than the FDI sector. The SME sector may wax and wane but generally speaking it is unlikely or unable to up sticks and leave in large numbers.

So, it is essential to nurture the SME sector and to create the climate where risk is rewarded economy. Additionally, it is critical to have an environment where entrepreneurs are valued and where the rules of the game do not disadvantage SMEs relative to other actors in the economy. These issues will be even more critical in the post-Brexit world. Many SMEs will be adversely affected by Brexit and will not have the resources or mobility to deal with it as say, the FDI sector.

So, how did the Budget/Finance Bill measure up against these yardsticks? An objective answer would have to be that it didn't really measure up.

In overall terms, with two exceptions, from the perspective of the SME sector the Budget could be characterised by "nothing to see here, move along". In addition to the two exceptions there are a number of SME tweaks but in reality, the Budget is more remarkable for what is not included, rather than what is. To be fair it was impossible to announce Brexit mitigation measures given that the Brexit negotiations were incomplete.

Of the two key SME measures the first was an announcement by the Minister of a €300 million allocation to a "future growth loan scheme" for SMEs. We await details of this scheme.

The second key measure was the restoration of the 13.5% VAT rate in the hospitality sector (from 9%). This is not good if your business is in the affected sectors but not so bad for others. This was a tricky one politically for the Minister. On the one hand there are areas of the country that are still struggling and for whom this change may have a major negative impact. On the other hand, the sight of full restaurants and hotels (with prices to match) in the main cities made it difficult for the Minister to look the other way (not to talk about the €xxx million to be gained from the measure).

There was some discussion around the possibility of having differential VAT rates for different parts of the country - an impossible aspiration. As many of the badly affected businesses are outside the main urban areas it is likely that other SMEs are struggling in these areas also. So those other SMEs could ask why their sector was excluded from the lower VAT regime. Some imagination or creativity would have been welcome, for example the mitigation of business rates in certain counties which might have a targeted impact. The disappointing feature was that no creativity appears to have been considered.

Some good.............

There are some measures which will benefit the SME sector specifically. The relaxation of the KEEP programme conditions is welcome but only time will tell if they result in an appropriate amount of traction. A further welcome measure is the extension of start-up relief for 3 years up to December 2021.

Addressing the issues around EII and SURE schemes is another welcome development. Bringing clarity to these issues is important.

A further welcome measure is the previously announced proposal to introduce accelerated capital allowances for gas propelled vehicles and employer provided childcare, but this may not in practice benefit many SME employers. For farmers stock relief has been extended for a further 3 years.

Some other measures will benefit the SME sector indirectly. The increase in the standard rate band and the (marginal) reduction in USC will result in some higher take home pay which may be of some assistance to SME owners in addressing pay claims.

Stock relief in the agri-sector has been extended for a further 3 years and restrictions on claiming income averaging have been removed. Again, some good news for the agri SME sector.

.............Some bad.............

It may seem contradictory to list the increase in the Earned Income Tax credit to €1,350 (from €1150) in the "bad" list. Any tax reduction is good news, but the discrimination in the tax code between employed and self-employed persists. When Finance Minister Noonan finally announced in 2015 an end to this discrimination, he also announced that the EIC would be phased in over 3 years. But instead of being fully in place for 2018, it will be at least 2020, when parity is reached, if ever. This, combined with the very arbitrary 3% USC surcharge on self-employed incomes over €100,000 is unjustifiable. It makes one wonder how committed the government is to the SME sector in reality.

A further unwelcome measure is the increase in the National Training Fund Levy by 0.1% in 2019 and in 2020.

.............and the dogs that did not bark.

The budget was disappointing in terms of measures which were not introduced. Among these was the absence of any movement on Entrepreneur Capital Gains tax relief. Applying to qualifying individuals this involves a CGT rate of 10% to the first €1 million of capital gains. The UK, by contrast, has a similar 10% rate but applies to the first £10 million. We are out of step with the UK and in a post Brexit world we need to reduce such differences.

The Capital Gains tax rate of 33% remained. Many submissions were made to retain, if not increase, the rate in order to generate more revenue. Some of these submissions were made by well meaning, if ill informed, campaigning organisations who have an endless list of worthy projects on which to spend taxpayers' money. They failed however to understand the dynamics of the tax system and believe that to raise more revenue, one must raise rates. Sometimes this is true, but they should recall the late Albert Reynolds, who, when he became Finance Minister announced a cut in CGT rate from 40% to 20%. The result? In the year after he cut it the yield from CGT increased by 800%.

Overall SME perspective

Apart from the VAT change there was very little of huge significance for the SME sector in the Finance Bill. It was a cautious, steady as she goes budget. Given the Brexit issues and the possible slowdown in the economy generally this is a pity. A little more imagination wouldn't go adrift.

David FitzGerald
CPA Director of International