Tax and Entrepreneurship Review

A submission to the Department of Finance

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Dear Sirs/Mesdames:

We are pleased to submit comments on behalf of Deloitte in response to your call for public consultation on the Tax and Entrepreneurship Review. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives and are available to discuss anything in this document, as needed. In the meantime, if you have any queries please do not hesitate to contact me or Tom Maguire on 01-417-2200.

Yours sincerely,

Pádraig Cronin
Vice Chairman & Partner – Tax Services

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Key Recommendation and Message

We are delighted to have the opportunity to submit our comments on this public consultation relating to tax and entrepreneurship which is a very important issue in Irish tax policy. In formulating our thoughts and recommendations on the various important issues dealt with in this public consultation we have sought, where possible, to draw a comparison with other jurisdictions, such as the UK and the United States and how those other jurisdictions prioritise their tax policy objectives to foster an environment that supports entrepreneurship and innovation.

In the current competitive environment for investment; technology and the ease with which entrepreneurs can trade across borders allow them to conduct their business from nearly anywhere. If Ireland wants to present itself as an entrepreneurial hub, then it must remain competitive from a tax perspective. If we do not recognise the ineffectiveness of certain existing measures in supporting small businesses and entrepreneurs, and indeed certain other facets of tax policy relevant to supporting small businesses and entrepreneurs where we simply do not participate, and adjust our tax policy objectives accordingly, then our entrepreneurs will simply go elsewhere and we will be unable to generate the tax revenues needed to sustain our economy in the medium term.

Public perception is arguably that prior Budgets have focused on tax measures to attract FDI and that supportive tax measures for small businesses and entrepreneurs have received less attention. The very nature of the type of successful entrepreneur that we should be trying to attract into business is that they are astute business people that will look for the best deal on the table with a view to maximising their potential for long term success. Success for the entrepreneur facilitates success from an 'Ireland Inc.' perspective given the employment potential such entrepreneurs make possible and therefore we look forward to reviewing the outcome of this public consultation process in Budget 2016.

Yeats said, *"Do not wait to strike till the iron is hot; but make it hot by striking"*, therefore, we suggest the following bold moves as part of our recommendations:

- ***20 per cent tax rate on certain dividends*****:** A 20 per cent tax rate should be provided on dividends, subject to a €100,000 per annum limit once the business has been in existence for five years, which would: (a) encourage entrepreneurs to grow their business for five years; and (b) retain cash for re-investment in the company during this start-up period

- ***Capital Gains Tax (CGT) Tapering Relief*****:** With a view to designing a tax system that encourages individuals to stay in business for longer, CGT tapering relief should be introduced for individuals who have worked full time in the business for over five years, as follows:

    - 0 – 5 years – 33 per cent rate of CGT
    - 5 – 10 years – 16.5 per cent rate of CGT
    - 10 years and over – 8.25 per cent rate of CGT.

  This relief would encourage entrepreneurs to 'stay the course' and scale their business internationally thus creating a better prospect of replicating the Kerry, CRH and Glanbia success stories

- **100 per cent rollover relief** to be provided for entrepreneurs that exit the business earlier, but who re-invest 75 per cent of the proceeds in shares in another trading company, the disposal of which would be within the CGT charge

- ***Tax-Efficient Financing Arrangement***: We recommend that a loan finance arrangement be introduced whereby individuals can lend money to SMEs and, provided certain safeguards are in place, for example, market interest rates are applied, then, the individual will be taxed on the coupon received at the standard rate of income tax (i.e. 20 per cent) as opposed to the marginal rate of income tax (i.e. up to 55 per cent)

- **Removal of Employed v Self Employed Disparity:** A self-employed person with before-tax profits of less than the industrial wage for the year of assessment (€35,768 for 2014)[1] should be granted a self-employed credit of the same amount as the PAYE credit that the individual would have been entitled to had they been in a PAYE employment.

We need to ensure that entrepreneurs are no longer over taxed and under appreciated.

[1] http://www.cso.ie/en/releasesandpublications/er/elca/earningsandlabourcostsannualdata2014/#.VZqg5o3bKZN

1. Responses to Consultation Questions

1.0 Question 1

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

Myron S. Scholes et al once wrote: *"Success is achieved when the tax rules subsidize activities that benefit society as a whole more than they benefit the individuals engaging directly in the activities".* Entrepreneurs drive business and this comment applies in the SME world.

All commercial success stories, whether it is the largest technology company in the world or a lucrative local family run grocery business, all arise from a strong sense of entrepreneurial spirit. Given that the Irish domestic economy needs to further fuel FDI, while at the same time stimulating growth in our domestic economy, it is imperative that Ireland provides an attractive entrepreneurial landscape for upcoming successful entrepreneurs both, at domestic and international levels.

Striking a balance between foreign and domestic direct investment is the key to ensuring future economic stability. Entrepreneurship is a common denominator between both forms of investment. Therefore building a solid entrepreneurial foundation for business in Ireland will naturally fuel both domestic and foreign direct investment.

There are numerous forces which will drive a successful entrepreneurial landscape in Ireland, such as a skilled workforce, financial and technological resources and infrastructure, etc. Critical to all of these forces that drive entrepreneurship is our tax system.

Our domestic tax system is pivotal in propelling our national entrepreneurial sector. It is imperative from an entrepreneurial perspective that our tax system incentivises innovation, encourages longevity and does not punish failure.

A well-designed tax system, with the necessary incentives and appropriate safeguards, will be the key to Ireland's entrepreneurial success.

Given global mobility and increasing international tax transparency, it is paramount that Ireland offers an entrepreneurial tax system that offers a competitive rate, a transparent tax regime and that garners a positive reputation. This is in line with the Government's International Tax Strategy set out in August 2013.

So, let's make sure that Ireland continues to contribute national and global commercial success stories by offering an attractive tax regime for budding entrepreneurs, and let's make Ireland the global capital of entrepreneurship.

2.0 Question 2

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

2.1 Introduction

As noted in our response to **Question 7** of this public consultation, the Irish tax system has an important role to play in attracting enterprises to Ireland. This is increasingly the case in the modern era where international boundaries are of little concern to entrepreneurs given the role of technology in facilitating global trade. We have identified a number of areas that we consider to be barriers to establishing enterprises in Ireland and have set out our recommendations under three headings to address same.

These headings can be divided into categories corresponding to an investor's activities in respect of establishing and maintaining an enterprise, as follows:

Our response to this question regarding barriers to establishing enterprises follows this approach.

However, before going further it is necessary to look to other jurisdictions to ascertain how Ireland compares in the international arena under these three headings. Given the visibility of international tax rates, it is important that Ireland offers its indigenous entrepreneurs and potential foreign investors a competitive tax rate in relation to entrepreneurial investment. Otherwise, Ireland runs the risk of losing future tax revenues through national entrepreneurs investing abroad.

The below example highlights how unfavourable our domestic Irish tax rates are when compared to other foreign tax jurisdictions across the three activities outlined above. Should such rates remain the same, Ireland will be failing to compete on the entrepreneurial front compared to other jurisdictions. Failing to compete leads to a failure to attract investment.

Three investors compared (Irish, UK and United States):

- An Irish SME technology company seeks a €1.5 million investment to fund its expansion
- It sources funding from three equity investors - one Irish, one UK-based and one based in the United States.

The following table illustrates the tax analysis for each investor over a five-year holding period:

	Irish-resident investor	UK-resident investor	U.S.-resident investor
Investment	€500,000	€500,000	€500,000
Marginal tax rate on dividend income	55%	32.5%**[2]	20%
Tax rate on exit after 5 years	33%	10%*	20%

[2] http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-unitedkingdomhighlights-2015.pdf

**Assumes individual qualifies for entrepreneurs' relief on the disposal.*

***Assumes taxable income of below GBP 150,000*

2.2. Making the investment

Many SMEs require access to financial support in various stages of their development in order to continue and grow their business. Without such support it may not be economically viable to operate. Due to the current economic environment, debt funding from third-party financial institutions may be limited and thus alternative means of funding are paramount. We propose a number of alternative measures which aim to support SMEs. It is necessary to note that the funding issue has two elements: (1) the funding itself; and, (2) the tax efficiency of the return to the investor on that funding. The return on investment could equally be a part of the 'maintaining the investment" activity heading, but it is discussed here for convenience; that said, it would also form part of the deliberations regarding the term of that investment, which could also affect exit decisions.

2.2.1 Loan/equity finance arrangement

An alternative to debt funding from financial institutions would be to introduce a special loan finance arrangement whereby individuals can lend money to SMEs in the EU (and based on the EU definition of an SME) and provided certain safeguards are in place (for example, market interest rates are applied), then the individual will be taxed on the coupon received at the standard rate of income tax (i.e. 20 per cent) as opposed to the marginal rate of income tax (i.e. up to 55 per cent).

This alternative funding option for SMEs is vital as while the Employment and Investment Incentive is a welcome source of finance for SMEs, the unfortunate reality is that, from an investor's perspective, the shares acquired under this scheme rank behind trade creditors on liquidation. This results in a significant concern regarding the security of the investment. The loan finance arrangement should alleviate these concerns.

In addition, many potential investors have capital held in deposit accounts, et cetera, which give a particular rate of return. This loan finance initiative should act as an incentive to 'relocate' those funds into 'active' investments with the potential for a higher market rate return taking account of the additional risk being borne by the investors.

2.2.2 Dividends taxable at the standard rate

With a policy objective in mind of encouraging entrepreneurs to keep cash in the business and to reward successful entrepreneurs that have emerged from the start-up period, a 20 per cent tax rate on dividends could be provided to entrepreneurs subject to an annual dividend cap of €100,000 and subject to the company's having been trading for a period of five years.

Currently, preferential rates of tax on dividends apply in the UK and the United States and we would recommend that Ireland update tax policy in this area, which will aid in attracting and retaining entrepreneurs.

2.2.3 SURE

The Start-up Relief for Entrepreneurs (SURE) is a very welcome tax incentive that should provide financial assistance for individuals who seek to start up their own company.

Nevertheless, we believe that the scope of trades which qualify for this relief is too narrow and should be expanded to include companies engaged in the provision of professional services, such as architects, dentists, auctioneers, opticians and veterinary surgeons, etc.

Including the above types of companies would provide valuable financial support for many qualified professionals to start up their own business. Such a measure would enhance the national entrepreneurial spirit. In addition, such a measure would create further potential for employment for the national economy and would be likely to create a positive multiplier effect on the domestic economy through direct domestic investment.

In addition, it is important to draw the comparison with the corresponding relief available in the UK, the Seed Enterprise Investment Scheme (SEIS). Provided all of the conditions are met over the appropriate time periods, the tax reliefs available include income tax relief of 50 per cent of the investment made (up to an annual investment limit of £100,000 per individual) as well as a CGT exemption on sale of the SEIS shares. Capital gains on other assets can also be either reduced, or potentially effectively made exempt, where a SEIS investment is made, depending on the tax year in which the gains are or were realised and when the SEIS investment is made.

While the income tax relief available under the SURE scheme is competitive with the corresponding UK position under the Seed Enterprise Investment Scheme, currently the CGT reliefs available on investments made in companies qualifying under SEIS are significantly more competitive than the Irish equivalent under the SURE scheme, which does not provide for any form of CGT relief on the shares in the start-up company by the investor. From a competitiveness point of view, we would recommend that the SURE scheme be updated accordingly to provide similar CGT reliefs at the level of the investor, as is the case in the UK under the Seed Enterprise Investment Scheme.

2.2.4 Employment and Investment Incentive Scheme (EIIS)

Finance Act 2014 proposed a number of changes to the EIIS scheme, which provides income-tax relief to investors in eligible companies. The income-tax relief of up to 40.75 per cent is available in two tranches subject to meeting certain qualifying conditions; however, when compared to the corresponding tax relief available in the UK under it's Enterprise Investment Scheme (EIS), the Irish EIIS is inferior and should be further enhanced.

By way of comparison with the UK EIS scheme, provided all the conditions are met over the appropriate time periods, the tax reliefs available include an income tax deduction on investment of up to £300,000 in any one year, together with a capital gains tax exemption on sale. Capital gains on other assets can also be deferred by investing into EIS shares. Relief from inheritance tax may also be available. We would recommend that the Irish EIIS scheme be enhanced to bring it in line with the corresponding UK tax relief currently in force.

In addition, currently the Irish EIIS scheme contains restrictions such that for pre-trading companies the funds received must be applied in incurring qualifying R&D expenditure for the purposes of Section 766 of the Taxes Consolidation Act 1997 and the use of the money must contribute directly to the creation or maintenance of employment in the company. We would recommend that these restrictions be removed from the EIIS scheme, which we believe would further enhance the attractiveness and utilisation of the relief.

2.2.5 Philanthropy

One area that should be considered as part of this public consultation is the tax policy objectives around philanthropy. In the United States, there are tax rules in force that are designed to support philanthropy. These have been effective in shifting the balance in terms of public funding being used to support social

causes/charitable enterprises. By way of illustration, in 2007 Government social spending was 16.2 per cent of GDP in the United States, compared to 19.2 per cent in the OECD. The corresponding ratios in two of Europe's largest economies, Germany and France, were 25.2 per cent and 28.4 per cent respectively. Therefore, the United States is a good place to look to in terms of what a well-designed tax system to support philanthropy could do for Ireland's domestic economy.

In the United States, contributions to charitable/social organisations (for example, organisations established with a charitable, religious, scientific, testing for public safety, literary, educational, prevention of cruelty to animals and fostering national or international amateur sports competition stated purpose[3]) are deductible by the donor, unless the donee organisation uses any of its net earnings to benefit a private shareholder, or if it attempts in any way to influence political campaigns or legislation. A contribution to a charitable/social organisation need not be a "gift" in the statutory sense of the word to be deductible by the donor. The donor's allowable deduction will be reduced, however, by the amount of the "substantial benefit" conferred upon them as a result of their contribution.

It should be noted that instances of philanthropy commonly overlap with instances of charity (though not all charity is philanthropy, or vice versa). A report published by the Forum on Philanthropy and Fundraising in May 2012 stated, *"philanthropy is a particular kind of charitable giving…focused on the root causes of problems and making a sustainable improvement, as distinct from contributing to immediate relief"*. An accepted, modern definition of philanthropy is *"private initiatives, for public good, focusing on quality of life"*[4] and it is geared towards driving the not-for-profit sector.

Irish tax law does provide for tax relief for certain donations to approved bodies in Section 848A of the Taxes Consolidation Act 1997, and *Finance Act 2013* brought about positive changes in a philanthropic context through the decoupling of Sections 848A and 485C of the Taxes Consolidation Act 1997 and the introduction of a €1 million cap per annum on the donations scheme. With a view to enhancing the tax landscape for philanthropy in Ireland further, we would recommend that the following additional changes be considered as part of this public consultation:

- The definition of "approved body" for the purposes of Section 848A of the Taxes Consolidation Act 1997 should be expanded to include grant-making foundations, trusts or donor advised funds[5] with a philanthropic purpose
- The €1 million annual cap on donations qualifying for tax relief under Section 848A of the Taxes Consolidation Act 1997 should be removed.

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[3] **http://www.irs.gov/irm/part7/irm_07-025-003.html#d0e732**

[4] **http://www.philanthropicdirectory.org/about-us/philanthropy-explained**

[5] **http://www.nptrust.org/what-is-a-donor-advised-fund/**

In addition, from the perspective of the donee, currently where an Irish company receives a donation from a philanthropic foundation/organisation, a potential CAT liability can arise for the shareholders of the company. This is another area that needs to be addressed in the context of designing Irish tax policy in a way that supports philanthropy in Ireland, as the risk of CAT at 33 per cent arising on a philanthropic donation for the recipient is contrary to the aims and objectives of the philanthropic foundation in making the donation to support a particular activity that meets various criteria from the perspective of the donor. We would recommend that this potential CAT issue be addressed as part of this public consultation.

2.3 Maintaining the investment

2.3.1 Share schemes

Another area of Irish tax policy that can act as a barrier to enterprise is the current tax rules relating to share based remuneration.

Share options are widely used by companies to incentivise and motivate employees however the current Irish tax treatment applicable to such share options is not as closely aligned to incentivising employees as it could be given that employees are subject to Irish income tax rates on any share option gains triggered on exercise of the underlying options. The underlying objective behind the granting of share options to employees can be to incentivise employees to work to the goals of the company and to increase shareholder value as the holders of the share options will then be entitled to participate in this value increase through the exercise of their share options. However, the fact that any share option gain triggered will attract the marginal rates of income tax in the hands of the employees can act as a dis-incentive for the employees.

In reality, employees have accepted, as part of their remuneration, share options in the company and have therefore taken on a level of commercial risk in the sense that if the company does not generate increases in shareholder value over the vesting period of the options then the share options have little or no value for the employees. In this situation, the employees are likely to be de-motivated as they may have been better off accepting an additional salary payment subject to full PAYE, PRSI and USC deductions at source rather than the share options.

If, on the other hand, any share option gains realised by the employees attracted a final rate of tax on income equivalent to the Irish CGT rate of 33%, this would act as a further motivator for the employees to maximise shareholder value in line with the company’s goals and objectives. Additionally, the employees would perhaps be happier to accept the commercial risk associated with the share options in the knowledge that any share option gains would attract the lower final rate of tax on income of 33%.

We would therefore recommend that, in order for share options to fulfil their commercial purpose of acting as an incentive for employees to maximise shareholder value, a final rate of tax on income equivalent to the Irish CGT rate should apply to share option gains realised on exercise. Our comments on tapering relief in **Question 6** of this response to the public consultation apply here also as it would encourage employees to remain with existing employers. Furthermore, we are of the view that, in order to avoid a potential for abuse, the value of share options awarded on grant should not exceed 10% of the relevant director/ employees’ gross salaries. This would also avoid the development of salary sacrifice arrangements with the aim of converting a higher income tax liability into a lower income tax liability under this proposal for a final rate of tax on income equivalent to the Irish CGT rate on exercise of the underlying share options. Furthermore we would recommend that this proposed tax treatment apply equally to Restricted Stock Units (RSUs) which are a common form of stock based compensation used in the modern era.

We acknowledge that there was an Approved Share Option Scheme legislated for under Section 519D and Schedule 12C of the Taxes Consolidation Act 1997 which was abolished from 24 November 2010. This gave income tax relief on the exercise of share options subject to a number of conditions. There was limited take up of approved share options due to the onerous conditions and, therefore, if the re-introduction of a similar initiative is contemplated as a result of this review in order to provide income tax relief on the exercise of certain share options for entrepreneurs, it will be imperative that the conditions are less restrictive.

It should be noted that the UK operate certain Enterprise Management Incentives (EMIs) which are tax advantaged share options. They are designed to help small, higher risk companies recruit and retain employees who have the skills to help them grow and succeed. They are also a way of rewarding employees for taking a risk by investing their time and skills to help small companies achieve their potential. Tax advantaged share options with a market value of up to £250,000 may be granted to a qualifying employee of a qualifying company, subject to a total share value of £3 million under EMI options to all employees. The shares must be in an independent trading company that has gross assets of no more than £30 million. The grant of the option is tax-free and there will normally be no tax or National Insurance contributions for the employee to pay when the option is exercised. There will normally be no National Insurance contributions charge for the employer. A CGT charge arises on the ultimate disposal of the underlying shares. This regime has greatly enhanced employee ownership in UK start-ups and aided entrepreneurs in attracting top talent and we would therefore recommend that consideration is given to the introduction of a similar initiative in Ireland.

In addition, there is a level of bureaucracy around share schemes that all companies have to deal with but which dis-proportionately effect start-ups and entrepreneurs. Two examples include the requirement for a trust company for the ”clog shares” arrangement under Section 128D of the Taxes Consolidation Act 1997 and also the wide impact of the convertible securities legislation under Section 128C of the Taxes Consolidation Act 1997. Our recommendation is that action is taken to remove this increased bureaucracy which has the effect of increasing costs for smaller companies operating share schemes.

A separate point worth noting under this heading is that relating to the tax treatment of ‘long options’ with a vesting period in excess of 7 years which under current Irish tax law could attract an income tax charge up front on the granting of the share options concerned if they are offered at a discount. This can be viewed as a particularly punitive provision from the perspective of start-up companies in, for example, the pharmaceutical or technology space which can typically go through an investment period in excess of 7 years until shareholder value is created given that the business is based on the success of the underlying research and development taking place. In this context, it is relevant to note that the Australian Government has recently announced the extending of the maximum time for tax deferral on share options from 7 to 15 years, which is aimed at giving companies more time to build their businesses and succeed. We would recommend that Ireland follows suit in this regard and introduces a similar change in law to recognise the investment period required for certain start-up companies.

2.3.2 Relaxation of pension restrictions

Currently, for small self-administered pension schemes investments in private companies (those not listed on a stock exchange) can only be a maximum of five per cent of the pension’s assets and a maximum of 10 per cent of the company’s share capital[6].

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[6] As set out in section 19.4 of the Revenue pensions manual which can be accessed **here**

There should be a relaxation of these pension restrictions for investment in private companies controlled by unconnected third parties and invested in a controlled manner (i.e. like an EIIS/BES fund, so risk is spread). Given that debt financing from financial institutions may not be available, the above would provide an alternative financial support to SMEs.

2.3.3 Premises

We believe Ireland has a lot to offer in the tourism, culture and heritage sectors. While there are various supports available to the tourism sector to promote enterprise, in our view, as a nation we could do more to promote the culture and heritage sector.

One way of achieving this would be to grant accelerated capital allowances/enhanced deductions for start-up companies that refurbish and occupy derelict buildings for the purposes of an enterprise in the fields of arts and culture with a view to centralising the activities of such companies. This would, in turn, enhance the visibility and attractiveness of the sector as a whole. Our heritage and culture is seen as a significant tourist attraction, so let's build on the success of other initiatives, such as the reduced VAT rate for tourist endeavours.

2.3.4 R&D tax credit

Currently under Irish tax law, certain unutilised R&D tax credits can be claimed as a cash repayment over three years. The tying up of cash flow in this way may require an enterprise to seek funding from external sources with an additional financing cost attached. In our view, the tying up of much-needed resources over a three-year period should be reconsidered with a view to reducing the term over which the cash refund can be given to, for example, 12 months.

Additionally, in the context of R&D tax credits, consideration should be given to a move to quarterly refundable credits, rather than once-a-year only events. This one simple change could have profound effects on cash flow for start-ups and make the very risky early stages considerably more manageable for those doing new and innovative work.

2.3.5 Intellectual property

The reader is referred to this firm's submission in relation to the recent consultation on the Knowledge Development Box.

One additional area of tax policy relevant to entrepreneurs in the context of IP that needs to be addressed relates to the interaction of capital allowances under Section 291A of the Taxes Consolidation Act 1997 and the R&D tax credit. This is particularly relevant to Irish entrepreneurs in the software space where the issue comes up regularly in practice and, given the Government's stated focus on the 'fintech' industry under the IFS 2020 strategy document published, in our view the below should rank high on the tax-policy agenda.

In effect, the R&D tax credit and s291A allowances are not available on the same expenditure even where an Irish tax resident company employs, say, 50 software developers in Ireland on a software development project, as may be the case for a fintech start up company.

In order to improve the position for fintech and indeed other industries, the following could be considered:

- 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

- As an alternative, 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 per cent per annum over eight years, with such expenditure also qualifying for the R&D tax credit.

We strongly recommend that this issue be given careful consideration as part of this public consultation.

2.3.6 Special Assignee Relief Programme (SARP)

A key criterion in certain successful entrepreneurial activities is the sourcing of key talent. Such talent may need to be sourced overseas if it is not available in the Irish market. This is where SARP has a key role, but in the past it has had limited success, though the changes introduced in *Finance Act 2014* were most welcome in improving certain aspects of the relief.

In our view, the following are the key issues which continue to hinder the uptake of SARP by key executives relocating to Ireland:

- The individual concerned must have worked for the relevant employer on a full-time basis for a period of six months immediately before their arrival in Ireland and exercised the duties of their employment for that relevant employer outside of Ireland. This means that 'new hires' are excluded

- For 2015, an application needs to be made to Revenue within 30 days of the individual's arrival in Ireland – this can be hard to meet as at that point it may not be known if the individual will be eligible to claim SARP or if indeed workday relief may be more beneficial

- The employer SARP form needs to be submitted by the P35 deadline – this is an issue because in many cases companies don't know at that point if the individual will be claiming SARP relief and also, if so, the amount of earnings taking the SARP into account (see below)

- In practice, many assignments of key executives into Ireland are tax equalised and, therefore, as part of the calculation companies need to do a regross to reflect the benefit of the SARP relief. This means that the P35 figure will not equal the pre-SARP employment income amount on the tax return, which will inevitably lead to confusion and issues with Revenue in the absence of amending legislation.

In our view, resolving these issues would go a long way to making SARP a more viable option for hiring badly needed talent.

2.4 Exiting the investment

In deciding to make an investment in a start-up enterprise, many investors will consider both the periodic return on that investment together with the return of that investment at some point in time. The latter will, of course, depend on how successful that enterprise is and is in itself a key driver of that investment decision. It is generally in the enterprise's interest that the entrepreneur remain actively involved with the enterprise for as long as possible. In the past, reliefs such as tapering relief *et cetera* from a CGT perspective recognised this fact and incentivised that very activity. We would argue that the need for such an incentive has not gone away and outline some suggestions in this regard.

2.4.1 Overview

The relief from CGT under s597A is looked at as part of **Questions 6** and **7**.

However, it is our experience that in many instances the enterprise would benefit from the entrepreneur's remaining with the business. Take the example of a successful entrepreneur who builds a business to a particular size such that he or she is offered, say €10 million for their investment. The owner knows that the business has the potential to reach a multiple of that if she/he remained, giving the necessary direction for, say, another five years. An incentive for remaining with the business may be a reduced rate of CGT where an investment is held for a particular point in time. This is not without precedent in that the *Capital Gains Tax (Amendment) Act 1978* had provisions for "tapering relief" before its repeal in 1982. This is dealt with further in our response to **Question 6** of this response to the public consultation.

2.4.2 Commercial Reality

Due to the financial downturn that took place in recent years, the commercial reality is that in many instances people will have to remain in business for longer before realising a significant return on their investment and this commercial reality is not currently recognised through the tax system applicable to entrepreneurs.

Retirement relief, provided for in Sections 598, 598A and 599 of the Taxes Consolidation Act 1997, is currently drafted in such a way that individuals are encouraged to leave their businesses earlier, which is not aligned to the commercial reality facing Irish entrepreneurs as a result of the economic downturn. In this regard, and as referred to in **2.4.1** above, one of our recommendations to address this is to introduce some form of tapered tax relief similar to that previously introduced in the 1970s by the then Minister for Finance. This tapered tax relief could operate in such a manner that the applicable rate of CGT would be reduced on a pro rata basis depending on the length of ownership in the relevant assets by the individual concerned. We set out further comments in relation to this recommendation in our **Question 6 response** below. The introduction of such a relief should not require EU State Aid approval on the same basis as applies for the UK Entrepreneurs' Relief and as set out in further detail in **Appendix I**.

It should be noted that retirement relief was also previously in force in the UK also until such time that the relief was abolished and replaced with "Entrepreneurs' Relief"[7]. An alternative recommendation to the above CGT tapering relief is that a similar approach to the UK be adopted in Ireland, with Sections 598, 598A and 599 of the Taxes Consolidation Act 1997 being supplemented by a new "UK Entrepreneurs' Relief"-style CGT regime for entrepreneurs, which, as mentioned in our response to **Question 6** of this public consultation, should not require EU State Aid approval. As referred to above, we have attached an analysis in **Appendix I** of the application of the EU State Aid provisions to the scenario where a similar CGT relief to the UK's Entrepreneurs' Relief is introduced in Ireland which supports this assertion that EU State Aid approval should not be required in this scenario. Such a relief should be drafted in such a way that similar conditions to that in the existing retirement relief provisions are included in the context of the working director requirements applicable to a disposal of shares.

Furthermore, we recommend that, in the case of disposals within the family which currently fall within Section 599 of the Taxes Consolidation Act 1997, the €3,000,000 restriction on the market value of assets that can be disposed of tax free by an individual greater than 66 years of age be removed, as this acts as a barrier for passing wealth to the next generation. Further, it does not take account of the commercial

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[7] **https://www.gov.uk/entrepreneurs-relief/eligibility**

reality spoken about above that, as a result of the economic downturn, people will remain in business for longer.

In addition, currently from a Capital Acquisitions Tax ("CAT") perspective, the receipt of a gift or inheritance of agricultural property may qualify for agricultural relief or business relief subject to the relevant conditions being satisfied. Agricultural relief can currently be claimed on a gift or inheritance of agricultural property without any requirement to operate the agricultural property as a farm on an economic basis.

On the basis that the purposes of the underlying tax reliefs from CAT are to stimulate activity in the Irish economy, we would recommend that agricultural relief be abolished and that provision be made in Irish tax law that transfers of agricultural property will be able to qualify for business relief on the condition that the agricultural property in question is operated as a farm within 12 months of the transfer. Such changes to agricultural relief and business relief would assist in driving economic activity, given the requirement to operate the agricultural properties in question as a farming business within 12 months of the gift or inheritance, which should be the aim of such tax measures.

Finally, from a CAT perspective, there are currently certain restrictions on the availability of business relief on cash transfers connected with the transfer of a business. As a result of the financial downturn in Ireland over the past number of years family businesses have been very cautious and have accumulated cash in order to ensure the sustainability of their businesses. Due to the above-mentioned restrictions applicable to business relief in the context of cash transfers, in the event of a transfer of the business to the next generation, as it stands 33 per cent of this cash balance that has been accumulated throughout the financial downturn may be lost in CAT instead of it being invested in a productive capacity in the business. We would recommend that business relief be amended such that cash transfers which do not exceed 25% of the net assets of the company can qualify for business relief subject to such cash balances being re-invested in the business within a period of 5 years.

3.0 Question 3

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

In our view there are a number of existing tax measures in place which are effective in supporting entrepreneurs in Ireland, such as the:

- R&D Tax Credit
- Micro-brewery excise duty relief
- Home Renovation Incentive
- Employer PRSI exemption from share-based remuneration
- 9 per cent rate of VAT for tourism-related goods and services.

It is necessary to note that the above reliefs are not without their limitations. These are addressed in **Question 4**.

4.0 Question 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?

Following on from **Question 3** above, there are also a number of measures that are ineffective in supporting small businesses and encouraging entrepreneurs. These have been dealt with throughout our response to this public consultation, but for ease of reference we have produced a table below highlighting the measures concerned and the section of this response that outlines our views and recommendations to improve the effectiveness of same in encouraging small businesses and entrepreneurs.

Tax measure	*Location of our comments*
Start-up relief for entrepreneurs (SURE)	**2.2.3**
Employment and Investment Incentive Scheme	**2.2.4**
Irish tax treatment of share schemes	**2.3.1**
Investment restrictions applicable to pension funds	**2.3.2**
Cash refund of unused R&D tax credits	**2.3.4**
Intellectual property regime and interaction with the R&D tax credit	**2.3.5**
Special Assignee Relief Programme (SARP)	**2.3.6**
CGT landscape for entrepreneurs	**2.4.1**, **2.4.2**, **question 6** and **question 7**
CAT Business relief and agricultural relief	**2.4.2**
Pay and file requirements for the self employed	**5.1**
Tax credits for the self-employed	**5.2**
3% USC charge for non PAYE income in excess of €100,000	**5.4**
Start-up relief for companies under s486C TCA 1997	**Question 8**

5.0 Question 5

Given the difference in the treatment of the self-assessed and PAYE taxpayers in terms of pay and file, tax credits and allowable expenses, is there scope for greater alignment?

5.1 Pay and file

Given the amount of tax obligations that a non-PAYE taxpayer must fulfil in order to be fully tax compliant, there is an excessive business cost and cash-flow demand on the non-PAYE taxpayer to achieve compliance compared to the PAYE taxpayer. It is imperative that an unfair burden is not placed on non-PAYE taxpayers in order to be fully tax compliant and that the necessary mechanisms are put in place to assist and encourage such tax compliance.

5.2 Tax credits

Non-PAYE taxpayers do not receive a PAYE tax credit similar to PAYE taxpayers. This means that self-employed individuals could potentially pay €1,650 in additional tax compared to a PAYE taxpayer in a similar earnings position.

We suggest that the above differential should be bridged, as it is extremely discouraging from an entrepreneurial perspective that such individuals are required to pay an additional amount of tax on equivalent earnings to a PAYE taxpayer, despite the fact that the non-PAYE taxpayer is already required to carry the burden of economic and commercial risk.

Given the cost involved in eradicating this difference and the limited budgetary scope available to the Government, we recommend that a self-employed person with before-tax profits of less than the industrial wage for the year of assessment (€35,768 for 2014)[8] should be granted a self-employed credit of the same amount as the PAYE credit that the individual would have been entitled to had they been in a PAYE employment. This would equalise an inequity that has existed for too long to the detriment of hard-working small entrepreneurs who have shouldered the burden of starting businesses and creating jobs that have contributed greatly to Ireland's economy. Based on 2012 CSO data we have analysed which shows that circa 130,644 self-employed individuals earned below the industrial wage[9], the cost of granting a self-employed credit of €1,650 to these individuals would amount to a little over €215 million.

5.3 Allowable expenses

As duly noted in the consultation document, there appears to be a perception that there are greater allowances available to the non-PAYE taxpayer via tax deductible expenses. The consultation document provides as follows:

"In general terms, there are more allowances available in respect of self-assessed income, in recognition of the expenses incurred in the course of a trade or profession."

It is important to realise that there is little advantage to the non-PAYE taxpayer in respect of deductible expenditure compared to the PAYE taxpayer. The non-PAYE taxpayer is merely allowed to deduct such expenses that are necessary in generating trading income and in calculating the individual's taxable profit (i.e. his or her potential take home element before tax). Any expenses that contain a private element or are not incurred wholly and exclusively in generating such taxable profit are not deductible in the hands of the non-PAYE taxpayer.

It is generally accepted that the scope for the PAYE taxpayer to deduct expenses in connection with their employment for tax purposes is narrower compared to the non-PAYE taxpayer.

In saying that, although the tax deductible element may not be comparable between the PAYE and non-PAYE taxpayer, the PAYE taxpayer may nevertheless be reimbursed tax free from their employment in respect of expenses incurred in relation to their duties of employment. For example, travel and subsistence costs, etc.

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[8] **http://www.cso.ie/en/releasesandpublications/er/elca/earningsandlabourcostsannualdata2014/#.VZqg5o3bKZN**

[9] **http://www.cso.ie/px/pxeirestat/Statire/SelectVarVal/saveselections.asp**

It should be noted that the PAYE taxpayer does not carry the same level of burden of any commercial risk and thus should be legally entitled to receive remuneration regardless of the business' performance whereas the non-PAYE taxpayer has to bear the commercial risk and is not provided with any compensation for same. In any case, PAYE taxpayers are not in a comparable position to non-PAYE taxpayers in terms of the expenses they are required to incur in generating their employment income.

Although the PAYE tax credit is welcomed for PAYE taxpayers, the non-PAYE taxpayer should not be disadvantaged from further tax benefits or allowances as it is ultimately the non-PAYE taxpayer that has to incur the necessary expenditure that is used to generate the trading income, which will be used to cover the costs of operating the business, paying the employees' wages and salaries and covering the cost of any expenditure incurred by his or her employees.

Thus, as can be seen from the above, that any benefit that the non-PAYE taxpayer may receive from increased scope in tax deductible expenditure is being offset by the burden of commercial risk which he/she must bear. The deductible expenses are a mechanism for the self-employed individual to calculate his/her taxable profits.

5.4 Universal Social Charge (USC)

There is currently an additional 3 per cent USC charge levied on self-employed individuals earning in excess of €100,000 compared to an equivalent PAYE taxpayer.

This additional levy does not reward entrepreneurial success, but rather in effect penalises our successful entrepreneurs.

Such tax disparity has been criticised in a 2013 ESRI report which questions the *raison d'êtree* on this additional tax burden on self-employed individuals.[10] It has also been criticised by numerous groups and bodies concerned in this sector for its discriminatory effect.

We would recommend that this USC differential be eliminated so as to reduce the tax burden for Irish entrepreneurs so that they can continue to grow their business and be treated in a similar fashion to a PAYE taxpayer. As noted from the public consultation document, there are only 28,200 tax cases relating to this 3 per cent levy; so, given the small proportion of individuals affected by this additional levy, their success should be rewarded and not effectively penalised.

It was expected that the above issue was to be addressed in the recent Budget 2015 and we would encourage Government to follow through on this change in the upcoming budget.

5.5 Summary

We believe the above measures are appropriate and necessary given the difference in the treatment of the self-assessed and PAYE taxpayers in terms of pay and file, tax credits, allowable expenses and USC. It is imperative that equitable measures such as the above are provided to non-PAYE taxpayers to put them on an equal footing with the PAYE taxpayer if Ireland is to truly represent itself as a leading location for business.

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[10] [10] **Taxes on Income: Ireland in Comparative Perspective – Callan et al, June 2013**

6.0 Question 6

Given the targeted nature of CGT entrepreneur relief under s597A TCA 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?

6.1 Overview

Initiatives to encourage investment in Irish businesses are most welcome. It is clear that Section 597A of the Taxes Consolidation Act 1997 is aimed at owner/managers of businesses, rather than serial or angel investors who would typically have a much shorter investment cycle than three years. To maximise the relief, the full proceeds from the first disposal (net of CGT) may need to be reinvested.

Unfortunately, we understand this relief has had very limited uptake to date due to its restrictive nature. It is only available after an initial disposal is made upon which CGT has been paid where some or all of those proceeds are applied in acquiring chargeable business assets (as defined) and the relief then being available on a subsequent disposal of those assets after a period of three years. Furthermore, the relief is capped at the lower of the part of the CGT paid on the initial disposal that corresponds to the proceeds applied in acquiring the chargeable business assets or 50 per cent of the CGT payable on the subsequent disposal of the chargeable business assets concerned.

This relief is difficult for entrepreneurs to understand as a result of its complexity and requires entrepreneurs to pay the CGT first, to then make a subsequent risk capital investment with the proceeds and to claim the CGT relief later if a gain arises on the later disposal. If no gain arises on the subsequent disposal, then no CGT relief accrues to the individual and s597A of the Taxes Consolidation Act 1997 has no application. Put simply, the relief available under this provision of the Taxes Consolidation Act 1997 is entirely disproportionate to the commercial risk required to be consumed by the entrepreneur through the reinvestment of the after-tax sales proceeds from the earlier disposal. It's a bad deal for Irish entrepreneurs.

In 2014, the National Policy Statement on Entrepreneurship in Ireland[11] was produced, wherein a number of strategic objectives were identified. Among these strategic objectives were to:

- Celebrate and reward successful entrepreneurs
- Create a business environment in Ireland where it is easy to start up and grow a new business in terms of company law, tax, regulation and licensing, and where it is one of the most attractive environments in Europe.

The current Irish CGT system and associated reliefs, firstly, do not celebrate and reward successful entrepreneurs and, secondly, do not present Ireland with one of the most-attractive tax systems in Europe from an entrepreneur's perspective. Therefore, in order to better align the Irish tax system with the published strategic objectives for entrepreneurship, significant changes are required. This is particularly apparent when we look to the CGT landscape for entrepreneurs in the UK, where the CGT Entrepreneurs'

[11] http://ebn.be/downloads/PolicyStatementEntrepreneurshipinIreland.pdf

Relief in effect grants a CGT rate of 10 per cent on the first £10 million of qualifying gains. The existence of this relief in the UK puts Ireland at a distinct competitive disadvantage, insofar as the Irish CGT landscape for entrepreneurs is far less rewarding for successful entrepreneurs.

We set out our recommendations below regarding possible changes to the CGT landscape for entrepreneurs in Ireland.

6.1 CGT Tapering Relief

We recommend that some form of tapered tax relief similar to that previously introduced in the 1970s by the then Minister for Finance be introduced. This tapered tax relief could operate in such a manner that the applicable rate of CGT would be reduced on a pro-rata basis, depending on the length of ownership in the relevant assets by the individual concerned. The 1970s tapering tax relief operated in such a manner that the applicable CGT rate was reduced after every three years in which an individual had company ownership, with no CGT being charged for ownership periods in excess of 21 years. The very reason for the introduction of this form of relief is commensurate with our need to stimulate growth in the Irish entrepreneurial landscape. A similar relief would reward commercial longevity, signal Ireland as an excellent place to operate as an entrepreneur and arouse direct domestic investment, which should ignite future domestic employment.

On introducing CGT tapered relief, the then Minister for Finance provided as follows:

"Section 4 [The relevant amending section] proposes a further fundamental change in the rate structure of capital gains tax. The new structure is based on the principle that the rate of tax should be related to the length of time for which an asset is held between acquisition and disposal.

A basic aim of any capital gains tax should be, I believe, to discriminate between the speculator and the genuine entrepreneur or businessman or farmer. Equity clearly demands that investment and hard work should not be penalised while economic logic demands that a capital tax should not act as a disincentive to economic activity. A man who builds up a business over 15 or 20 years, putting time, effort and money into its improvement and expansion, should not be taxed on the same basis as somebody who simply buys and sells an asset within a short time, relying solely on market forces to increase the value of the asset in question."

In our view, one way of making this important distinction in the CGT code would be to have the rate of tax depend on the period of ownership. The length of ownership should be regarded, in general, as an indicator as to whether the owner acquired the asset as a genuine non-speculative investment or whether he acquired it merely in the hope of disposing of it to achieve a short-term gain as soon as market forces were favourable.

Therefore, with this policy objective in mind of rewarding the *'genuine entrepreneur, businessman or farmer'*, we should look to the approach adopted in the 1970s and should introduce a 'fundamental change' in our capital gains tax rate structure for entrepreneurs that encourages a strong entrepreneurial spirit in our domestic economy that is aligned to economic success. So let's reward the person 'who builds up a business over 15 or 20 years, putting time, effort and money into its improvement and expansion'. Many of Ireland's greatest commercial success stories came from such entrepreneurial endeavour, so let's cultivate an entrepreneurial landscape where such success stories can continue to be nurtured.

In our view, the design of such a tapering relief should encourage long-term ownership, which could be achieved by providing for the CGT rate to be reduced over time depending on the period of ownership/active involvement as follows:

Period of ownership	CGT rate applicable
0-5 years	33%
5-10 years and a full-time working director for 5 years	16.5%
10+ years: working director for 10 years and a full-time working director for 5 years	8.25%

In addition, 100 per cent rollover relief should be allowed for persons who exit the business earlier but who then re-invest 75 per cent of the proceeds in another company.

The introduction of such a CGT tapering relief should not require EU State aid approval on the same basis as applies for the UK Entrepreneurs' Relief and as set out in further detail in **Appendix I**.

6.2 Alternative to the CGT Tapering Relief proposal

As an alternative to our recommendation in **6.1** above, a relief modelled on the UK's Entrepreneurs' Relief could be introduced which would both increase Ireland's competitiveness as a location for entrepreneurship and would also better align Irish tax policy relevant to entrepreneurs to the strategic objectives identified in the 2014 National Policy Statement on Entrepreneurship in Ireland as above.

Clearly such CGT reform would need to be compliant with the EU State Aid rules and, in our view, such CGT reform for individual entrepreneurs should not be considered State Aid under EU Law. Our analysis in this regard is set out in **Appendix I,** for completeness. It should be noted at the outset that we understand that the UK Government did not obtain EU State Aid approval when initially introducing CGT Entrepreneurs' Relief in 2008 which further supports our view. We have included the HMRC manuals dealing with Entrepreneurs' Relief in the UK in **Appendix II** for ease of reference.

7.0 Question 7

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

As above, we are recommending that Section 597A of the Taxes Consolidation Act 1997 be abolished and replaced with a new CGT relief for individual entrepreneurs either based on some form of tapered relief as was in place in Ireland previously or the UK's Entrepreneurs Relief. Such changes are aligned to the strategic objectives identified in the 2014 National Policy Statement on Entrepreneurship in Ireland and would give Ireland a competitive offering for entrepreneurs. The result of this would be an increase in enterprise and employment that would further strengthen our economic growth in the medium term.

Currently, there is little or no incentive for Irish entrepreneurs to grow a business over a number of years with a view to sale upon retirement. It is accepted that retirement relief provided for in Sections 598, 598A and 599 of the Taxes Consolidation Act 1997 is a useful relief, but the €750,000 lifetime threshold is too low in comparison to Ireland's competitors, which is evidenced by a simple comparison of this threshold with the £10 million threshold in the UK for entrepreneurs.

The ineffectiveness of the Irish CGT landscape for entrepreneurs as things stand can be demonstrated by comparing the overall effective tax rates suffered by entrepreneurs in Ireland and the UK, taking account of corporation tax suffered on the profits generated at a company level prior to the realisation of the gain, which is subject to CGT at the level of the shareholder.

	UK TradeCo	*UK InvestCo*	*Irish TradeCo*	*Irish InvestCo*
Accumulated profits	€10,000,000	€10,000,000	€10,000,000	€10,000,000
Corporation tax payable	€2,000,000*	€2,000,000*	€1,250,000**	€2,500,000***
Accumulated after tax profits	€8,000,000	€8,000,000	€8,750,000	€7,500,000
Gain	€8,000,000	€8,000,000	€8,750,000	€7,500,000
CGT payable	€800,000****	€800,000****	€2,887,500	€2,475,000
Total tax payable	**€2,800,000**	**€2,800,000**	**€4,137,500**	**€4,975,000**
Effective tax rate	**28%**	**28%**	**41.375%**	**49.75%**

**20% rate of corporation tax in UK*

***12.5% rate of corporation tax applicable in Ireland on trading profits*

****25% rate of corporation tax applicable in Ireland on passive income*

*****Assumed that Entrepreneurs' Relief available in UK to grant 10% CGT rate*

As is demonstrated by the above simple comparison, Irish tax policy in the area of CGT for entrepreneurs does not currently provide a sufficient level of reward for successful entrepreneurs that have built up a successful business. Action is needed to revamp Irish tax policy in this area in order that entrepreneurs continue to look to Ireland as the location for their business ventures rather than considering other possible locations with a tax system for entrepreneurs that recognises the value of entrepreneurship in those economies through the use of tax policy to reward same. In a time of unprecedented change in the international tax landscape, Ireland must seek to compete with other jurisdictions in all possible areas, such as the Irish CGT landscape for entrepreneurs, in order that we can continue to attract the level and quality of entrepreneurship that has played an important role over the years in developing Ireland's strong reputation as an excellent place to do business.

8.0 Question 8

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:

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 in 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?**

8.1 Overview

A detailed review in relation to Section 486C of the Taxes Consolidation Act 1997, which provides relief from corporation tax for certain start-up companies based on the quantum of payroll costs incurred by those companies, is most welcome and is aligned with the Government's stated intention to improve Irish tax policy in areas affecting entrepreneurship.

In designing a tax relief targeted at start-up companies, and indeed in reviewing the effectiveness of same, a comprehensive understanding of the commercial difficulties facing start-up companies must be obtained.

The vast majority of start-up companies are loss making for the first two to three years (depending on the industry), given the initial investment required and the time it typically takes to build up a sufficient level of market share in the company's chosen market to make the company profitable. Cash flow is the single biggest concern for start-up companies in Ireland in respect of which this relief is targeted. This may not be the case where a sole trader has made a decision to incorporate their sole trade business, but in any case such a company would not qualify for relief under Section 486C of the Taxes Consolidation Act 1997, given the requirement that the business cannot previously have been carried on by any other person.

In our view, while Section 486C of the Taxes Consolidation Act 1997 can be a useful relief for certain companies that do generate trading profits during the start-up period, and indeed the carry-forward provisions are beneficial to companies that manage to endure the loss-making period despite any effective targeted tax relief to alleviate the burden of same and become profitable, if the aim of the relief is to take some of the burden off of start-up companies during the start-up phase, which we understand it to be, then the relief is unfit for purpose. For loss-making start-up companies, no relief becomes available until such time as the company becomes profitable, which may not happen if the appropriate supports are not in place during the start-up phase.

We have a number of recommendations as to how Section 486C of the Taxes Consolidation Act 1997 could be revamped to make the relief relevant to the commercial realities faced by start-up companies in Ireland, which we have set out in further detail below.

8.2 Recommendations

Further to the above, we outline our recommendations below.

8.2.1 Refundable start-up credit

As mentioned above, giving relief from corporation tax is of little benefit to start-up companies that are loss making, as the benefit of such relief would only get realised if and when those companies become profitable. However, if the cash value of the relief could be realised by the start-up companies concerned via some form of refundable start-up company credit, then this would greatly enhance the effectiveness of the relief and make it more relevant to dealing with the commercial difficulties (which to a large extent revolve around cash flow) faced by start-up companies.

There is a precedent for such a form of refundable tax credit in the R&D legislation and we would propose that the refundable start-up credit could be claimed in the company's corporation tax return each year.

8.2.2 Better utilisation of start-up losses

Typically, taking the situation of a single start-up company rather than a group of companies including a start-up company, where the start-up company incurs losses during the start-up phase relief does not become available until that company becomes profitable. Had the business been operated as a sole trade, relief for the losses would have been available against the individual's (and their spouse's, if applicable) total income at their marginal rates of income tax.

With a tax policy objective in mind of maximising the funds available for re-investment in the company, we would recommend that a mechanism be introduced whereby, by election, start-up companies could be treated as transparent for tax purposes for the first three years on the condition that: the cash benefit realised through the utilisation of losses generated, relief for which is claimed by the shareholders against their gross income at their marginal rates, be re-invested in the company to fund future growth. The election would last for the first three years, with the option to cancel the election to be treated as transparent upon payment of a penalty.

This mechanism creates a channel whereby start-up companies can realise a cash benefit for their losses to ease the cash-flow burden during the start-up phase and, in our view, should be given consideration. The penalty mechanism is needed to avoid potential abuse.

8.2.3 Reduced VAT rate for start-up supplies

Once again with the cash-flow concerns of start-up companies in mind, we would recommend that some form of reduced rate for start-up supplies be introduced which would result in improved cash flow for start-up companies as the net VAT cost, taking account of input credits available, would be reduced and cash-flow benefits would be realised in real time by the start-up companies concerned.

A similar approach was adopted for the tourism industry with the introduction of the 9 per cent rate of VAT to supplies in that sector, which has had great success in facilitating taxable persons operating in that industry.

In our view, a similar rate reduction could be considered for start-up companies during the start-up phase to alleviate some of the cash-flow concerns that are likely to arise during that period.

8.2.4 Refund of Employers' PRSI paid

One further recommendation that could be considered would be to allow start-up companies to apply for a refund of 50 per cent of employers' PRSI paid in the first three years, or to simply reduce the employers' PRSI payable by start-up companies during this period by 50 per cent so that the cash benefit can be realised in real time.

This recommendation follows the theme of each of the other recommendations, which is to alleviate the cash-flow difficulties experienced by start-up companies. This is precisely where a relief for start-up companies should be targeted if it is to be fit for purpose and relevant.

8.3 Comments on review criteria outlined in public consultation document

For completeness, we set out below some comments on the review criteria identified by the Department of Finance, which we understand will form the basis of the review of Section 486C of the Taxes Consolidation Act 1997:

Review criterion	Comments
A. Has the relief led to an increase in employment and economic activity?	Perhaps, along with a range of other factors, such as the recovering Irish economy.
B. How many jobs have been supported by this relief?	We have no visibility in relation to this criterion.
C. What types of companies are using the relief?	Indigenous Irish companies, but also subsidiaries of multinational companies.
D. What has been the impact of the carry-forward provisions introduced in Finance Act 2013?	Loss-making start-up companies can avail of the relief if they endure the start-up, loss-making period experienced by many start-up companies.
E. What role does the relief play in decisions by start-up businesses on whether or not to incorporate?	Arguably, the relief as currently structured plays an insignificant role given the absence of any benefit for start-up, loss-making companies during the difficult start-up phase.
F. Are there specific elements of 486C that should be considered as part of the review?	Please refer to **section 8.2** above.

8.4 Conclusion

We welcome the detailed review to be undertaken by the Department of Finance regarding the effectiveness of Section 486C of the Taxes Consolidation Act 1997.

In our view, the relief is not currently fit for purpose and we have set out above our recommendations as to how the relief could be made more relevant to start-up companies.

The focus must be on cash-flow benefits, since cash is the single biggest concern of the majority of start-up companies being targeted by this relief. Relief that is triggered only at a time when the relevant companies become profitable is ineffective in supporting start-up companies and therefore Section 486C of the Taxes Consolidation Act 1997 needs to be revamped. We are confident that the Department of Finance will appreciate the benefits of such an outcome for improving Ireland's competitiveness as a place to create and expand a business.

Appendix I - Application of EU State Aid rules to the possible introduction of a "UK Entrepreneurs' Relief"-type CGT relief in Ireland

A. Background and Introduction

The purpose of this analysis is to set out, briefly, the application of the EU State Aid rules, particularly in the context of CGT reform for individual entrepreneurs, which currently forms part of this public consultation.

B. Meaning of State Aid

Article 107(1) of the *Treaty on the Functioning of the European Union* (TFEU) defines the concept of a State Aid under EU law. It provides:

"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

In order for a measure to fall within the above definition of State Aid the measure must satisfy all of the following criteria:

- There must be aid in the sense of an economic advantage
- The advantage must be granted directly or indirectly through State resources and must be imputable to the State
- The measure must favour certain undertakings or the production of certain goods and
- The measure must be liable to distort competition and affect trade between Member States.

These criteria and their application to a UK Entrepreneurs' Relief-type CGT measure are considered in further detail below.

B1. Economic advantage

Two questions arise under this heading. Firstly, the types of entities that can be regarded as benefitting from State Aid and, secondly, whether an economic advantage exists.

Dealing first with the beneficiary of aid, Article 107(1) TFEU by its terms applies only to benefits or advantages granted to *"undertakings"*, which according to settled case-law in the field of competition law, covers any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed (Case C-41/90 *Hófner and Elser* [1991] ECR I-1979, paragraph 21, and joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK Bundesverband and Others* [2004] ECR I-2493, paragraph 46).

The mere fact of holding shares, even a controlling shareholding, is insufficient to characterise the shareholder as an *"undertaking"* carrying on an economic activity, if it gives rise simply to the normal rights of a shareholder, such as the right to receive dividends.

On the other hand, a controlling shareholder which is involved directly or indirectly in the management of the company must be regarded as participating in the economic activity carried on by the controlled

undertaking, and may therefore itself also be regarded as an undertaking within Article 107(1) TFEU. This principle was outlined in *Case C-222-04*[12], where the court stated that:

"an entity which, owning controlling shareholdings in a company, actually exercises that control by involving itself directly or indirectly in the management thereof must be regarded as taking part in the economic activity carried on by the controlled undertaking. It must therefore itself, in that respect, be regarded as an undertaking within the meaning of Article 87(1) EC".

The facts of this case concerned a banking foundation with organic and functional links with the banking companies in respect of which the banking foundation had acquired control. This fact pattern could be likened to the situation of an individual majority shareholder in a company who is also actively involved in the management and control of the company. Therefore, in performing the analysis of whether State Aid exists in the case of a CGT relief to individual entrepreneurs, it must be assumed that a majority individual shareholder engaged in the management and control of the controlled undertaking can be considered to be an undertaking in their own right for the purposes of the EU State Aid rules.

The second question that needs to be considered under this heading is whether an economic advantage exists. To constitute an advantage that falls within Article 107(1) TFEU, the measure must lead to an improvement in the economic and/or financial position **of the undertaking**. To reiterate here, the individual is considered to be an undertaking for the purposes of the EU State Aid rules purely by virtue of their majority shareholding in an entity carrying on an economic activity in respect of which they participate in the active management of same. The granting of the CGT relief to the individual shareholder in this situation does not result in an improvement in the economic and/or financial position **of the undertaking** itself. This is because the relief is only triggered upon the cessation of the individual's involvement in the economic activity that would likewise mark the cessation of an undertaking connected with the individual beneficiary of the tax relief under review for the purposes of the EU State Aid rules. Therefore, no economic advantage should be considered to accrue **to the undertaking** represented by the individual's previous majority shareholding and by their active management and control of the company performing the economic activity. The individuals claiming the relief are claiming such relief in their capacity as individuals, rather than in any capacity connected with an economic activity or enterprise being carried out by the individuals concerned and, therefore, should be outside the remit of the EU State Aid rules.

In summary, therefore, in our view the introduction of a CGT relief similar to the UK Entrepreneurs' relief does not result in any economic advantage under the EU State Aid rules.

<u>B2. State resources and imputability</u>

In order for a measure to constitute State Aid under Article 107(1) TFEU it is necessary to show both that the measure involves State resources, whether directly or indirectly, and that it is imputable to the State.

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[12] **http://curia.europa.eu/juris/showPdf.jsf;jsessionid=9ea7d2dc30dd14ff922999ed4bd28700e39cef4f0461.e34KaxiLc3qMb40Rch0SaxuQbh10?text=&docid=57282&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=102357**

Dealing with these two conditions in turn, the principle of forgoing revenue that a reduction in the CGT rate on a disposal of certain shareholdings by entrepreneurs would involve inevitably results in a reduction of State resources and, therefore, this leg of the test would be satisfied.

Regarding the imputability test, it should be noted that legislative power is one of the constitutional powers of the State and, therefore, aid resulting from legislative measures, such as would be the case with the introduction of a CGT entrepreneurs' relief in Ireland, would be regarded as imputable to the State.

In summary, therefore, in our view the introduction of a CGT relief similar to the UK Entrepreneurs' relief does involve State resources and is imputable to the State.

B3. Selectivity

In order to constitute aid, a State measure must favour 'certain undertakings or the production of certain goods'. There is a vast amount of material available on the topic of selectivity to determine whether a measure is selective in nature, which can often be a difficult question to answer; however, in this case, as the proposed CGT relief would be targeted at share disposals in SMEs by the entrepreneurs, it is clearly selective in nature.

In summary, therefore, in our view the introduction of a CGT relief similar to the UK Entrepreneurs' relief does involve selectivity.

B4. Distortion of competition and effect on trade

The final requirement under Article 107(1) TFEU is that the measure should be liable to distort competition and affect trade between Member States. The effect of the measure in question on competition and trade cannot simply be assumed from the circumstances, at least involving cases involving individual aid as is the case here. This principle was confirmed in *Case C-254/00*[13] where it was stated:

"With regard to individual aid, the Community judicature will ascertain whether the statement of reasons for the contested decision is based on specific elements in order to establish that the measure under consideration is likely to affect trade between the Member States and competition, such as the size of the recipient undertaking, its exports and the amount of the aid…It requires a specific economic analysis of the market by the Commission".

There is undoubtedly a distortion of competition and trade where the beneficiary undertaking is carrying on a cross-border activity or where the sector affected by the aid is characterised by a substantial level of trade between Member States. In considering this requirement, it is sufficient to show that the relevant markets are open to international competition and that the aid may therefore distort competition at the expense of economic operators who might come from other Member States.

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[13] **http://curia.europa.eu/juris/showPdf.jsf?text=&docid=46272&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=19189**

Turning now to an analysis of the application of this requirement to the potential introduction of a CGT relief for individual entrepreneurs in Ireland modelled on the UK's Entrepreneurs' Relief. The relief would be granted to Irish tax-resident individuals only at a time when they are ceasing their connection with the undertaking carrying on the economic activity and it follows, therefore, that there should not be any distortion of competition or intra-EU trade. The economic activity will continue to be carried on as was the case before, with no direct or indirect benefit attributable to the company carrying on that activity by virtue of a CGT relief being triggered at the shareholder level. The relief would be available on disposals of shares in companies resident for tax purposes in Ireland and elsewhere. For the reasons set out above, the occurrence of the exit through sale by entrepreneurs from companies carrying on an economic activity with such entrepreneurs being the beneficiaries of the CGT relief under review should not, in our view, result in any distortion of competition or intra-EU trade.

In summary, therefore, in our view the introduction of a CGT relief similar to the UK Entrepreneurs' relief should not involve any distortion of competition or intra-EU trade.

C. Conclusion

As set out above, in determining whether the introduction of a CGT relief for individual entrepreneurs (similar to the Entrepreneurs' Relief in the UK) could constitute State aid, it is necessary to show that all four of the following requirements are met:

- There must be aid in the sense of an economic advantage
- The advantage must be granted directly or indirectly through State resources and must be imputable to the State
- The measure must favour certain undertakings or the production of certain goods, and
- The measure must be liable to distort competition and affect trade between Member States.

While we consider the CGT relief to be granted through State resources, to be imputable to the State and to be selective in nature, we do not consider any economic advantage to accrue to *an undertaking*; nor do we consider the CGT relief to result in the distortion of competition or intra-EU trade. Therefore, on this basis the CGT relief being proposed should not be regarded as EU State Aid.

Appendix II – HMRC manuals of Entrepreneurs' Relief in the UK

The HMRC manuals on Entrepreneurs' Relief in the UK can be accessed here:

https://www.gov.uk/government/publications/entrepreneurs-relief-hs275-self-assessment-helpsheet/hs275-entrepreneurs-relief-2015

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