The Consultative Committee of Accountancy Bodies-Ireland

Chartered Accountants Ireland
The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Institute of Certified Public Accountants in Ireland

Pre Budget Submission 2011

Measures to boost confidence in the economy

October 2010

About CCAB-I

The Consultative Committee of Accountancy Bodies – Ireland is the representative committee for the main accountancy bodies in Ireland. It comprises Chartered Accountants Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland, and the Chartered Institute of Management Accountants.

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Executive Summary

CCAB-I, in this submission, recommends:

- No increase to marginal income tax rates (Page 3)
- The linking of Public Service efficiencies with the timing of any tax increases (Page 5)
- Schemes to generate funding for Irish Business, based on loan capital (Page 6)
- Incentives for world class executives to work and pay tax in Ireland as per the French "Impatriate" model (Page 9)
- Changes to Social Welfare and Tax incentives to support job growth (Page 12)

Introduction

This pre-Budget submission is framed in the recognition that Ireland has an Exchequer Deficit to the tune of €18bn which needs to be bridged. As public commentators CCAB-I has responded responsibly in the wake of the economic downturn, being among the first to call for a supplementary Budget in 2009. We consistently defend Ireland's tax record abroad and actively canvass for Ireland's fiscal interests.

In common with most analysts, we note that the tax revenues have stabilised during 2010 but without much sign of an upturn. While the tax receipts more or less meet forecast figures, the most important comparisons remain those against prior years. We are keenly aware that overall in 2010 Revenue will collect €2bn less than they did last year.

The first sign of a domestic pickup from the tax receipts will be from the VAT figures. Stronger VAT figures will not only reflect stronger consumer demand, but also some recovery of business margins. It is too soon to discern anything more than a glimmer of hope here.

Taxes and Expenditure

Income Tax Marginal Rates

All the indications are that increases in Income Tax rates could be counterproductive. The cumulative result of increases over the last three Budgets in contributions and levies on personal income is marginal rates of taxes on income of up to 55% for the self employed, and of 50% for employees earning over €75,000. A change in the earning circumstances of such individuals will result in significant changes to the tax yield. These earning circumstances are especially vulnerable in a recession.

The full negative impact of an increase in marginal tax rates is only seen in the tax years following the first full year of implementation. This is because it takes individual

taxpayers time to respond, through the relocation of investments and labour or the non-release of dividends, bonuses and the like out of businesses. This is the pragmatic argument against increases.

But equally, it seems to us there can be no economic or social justification for increasing the marginal rates of income tax.

Those earning over €75,000 per annum contribute two thirds of all the income tax collected. This is a dangerous degree of reliance on one economic sector. In fact it is comparable to the reliance placed on the yield from transaction taxes prior to the collapse of the property market. We cannot jeopardise the provision of costly social services by relying too heavily on any one sector for the bulk of the funding.

The expansion of Income Tax credits and the widening of bands in our income tax system has created two “sweet spots”. Those earning up to €700 per week pay almost nothing, those earning up to €1,400 per week remain below the marginal rate of tax. These are huge amounts compared to what social welfare recipients receive weekly. Yet taxpayers within these categories – almost 90% of all earners – contribute very little.

We estimate that if all income tax payers paid an additional €25 per week through a reduction in tax credits, this would yield €1bn for the Exchequer.

If the Government does decide to take more money out of the Economy through Income Tax, increasing the rates is not the way to do it as this will affect only those on €75,000 or more – currently just 10% of the taxpaying population and falling.

Expenditure

Increasing taxes is at best only part of the solution to bridging the deficit. As a nation we can sometimes remain profligate and thoughtless when it comes to public service provision, both on small and on large issues.

The Public Service Agreement 2010-2014 (the "Croke Park Agreement") is long since signed and ratified, but there is little public evidence of its implementation. We need to see the promised employment controls, the unified public service labour market and the rationalisation and restructuring which will lead to greater efficiencies.

As any Budget tax increases will take effect by 1 January, hard evidence of real savings under the Croke Park Agreement must also be available by reference to that date. A link must be created between the raising and consumption of tax revenue.

Other Tax Measures

It remains the case that tax drives business behaviour. The positive measures introduced in Finance Acts 2009 (in relation to Intellectual Property) and 2010 (in relation to cross border issues) are flowing through already in attracting and retaining Foreign Direct Investment. The role of FDI is more crucial than ever before in managing our balance of payments.

Equally, there remain tax expenditures and compliance requirements on the Statute Books which are ineffective, spent or mistargeted. Increasing tax complexity without removing unnecessary requirements damages our competitive position. Paragraph 10 of the Croke Park Agreement commits to "reduce information demands on the citizens and business."

The value of our 12.5% rate of Corporation Tax in attracting and retaining Foreign Direct Investment cannot be overstated. An adjustment to this rate might yield short term gains, but at the expense of our reputation as an excellent environment for multinational companies seeking a European base. CCAB-I notes and encourages the Minister's continued commitment to retaining the 12.5% rate of Corporation Tax.

Tax Relief for Funding Businesses

There can be no doubt that there is a gap in the market at present regarding the funding of Irish Business, and in particular the Small to Medium Enterprises sector.

There is an underlying problem with targeting small business with any form of relief. All businesses start small. Further, of the number of SMEs in operation already in this country, only a proportion will be significant in terms of future jobs and growth opportunities. If an incentive scheme has too many conditions or restrictions imposed on it, the number of businesses which will benefit and ultimately make a real difference within their local (or eventually within the national) economy is too small.

A proper funding mechanism should not discriminate between large and small enterprise. However, there must be an emphasis on manufacture and trading, and any incentivised funding scheme should only address the needs of companies subject to taxation at 12.5%.

The Business Expansion Scheme, while in existence for over twenty years, has suffered from this over-targeting. It is available only to those companies which "manufacture", and the conditions are stringent. In 2008, only 461 investors made BES type investments. The figure for the related relief, Seed Capital, was even worse, attracting just over 60 investors. This volume of investment is not adequate.

In order to ensure adequate access for Irish business to capital, it is now necessary to consider an alternative mechanism to the BES. Capital is available, but a large volume of capital is held by Irish citizens in low risk, low interest bearing investments. We need to get this money into the wider economy.

Whatever incentive route is taken, lessons need to be learned from the Special Savings Investment Account mechanism. The SSIA was the most successful tax incentivised

scheme ever operated in this country, ironically designed at least in part to take money out of the economy. SSIAs had the characteristics of being open to everyone, of operating independently of the investment target, and of requiring a long term and regular commitment on the part of the investor. We need to apply these successful characteristics to any new funding model which will put money into the economy.

We offer two suggestions towards this, one based on the creation of a special loan instrument and the other on an Investment Company vehicle.

Private Investor Loan Instrument

The purpose behind such an instrument would be to create a risk investment option for private investors, allowing them to place funds in private companies. Unlike the BES, the vehicle would be a loan, rather than a shareholding. This is to address one of the main drawbacks of the BES as currently formulated, which is the lack of an exit mechanism.

Moneys would be invested through the loan instrument issued by a trading company for a period of not more than five years. The investment would be interest bearing at a rate specified on the instrument, and the interest would be assessable in the investor's hands and subject to withholding tax at the prevailing DIRT rate. Interest payments would be deductible in the company's hands and where the instrument is held by a participator in the company, the close company provisions would not apply to the interest payment.

A suitable minimum investment would be €10,000, and a maximum individual investment is €250,000. The individual would have no access to the funds over the five year period. At the end of the five year period, the loan would be repaid in full, along with a 25% bonus to justify the risk involved in the original investment. The bonus would be tax free in the investor's hands.

The risk for the taxpayer is that the loan amount might not be repaid in part or in full at the end of the five year period through a deficiency in shareholders funds. The company

might also fail, or go into liquidation before the five year period expires. Where that is the case, the taxpayer would be entitled at that point to treat the amount originally invested as a Case I loss for the year of assessment in which it crystallises.

This suggestion also differs from BES because Exchequer exposure is limited to instances where there is business failure, back-ended to the time the business fails or the loan falls due for repayment, whichever is the latter. From the investor's point of view, the return on the investment is taxed as if it were deposit interest. The investment would be expected to attract a higher rate of interest than available on deposit accounts, along with the prospect of a bonus at the end of the term.

Business Investment Company

Under this proposal, individual depositors could invest funds by way of annual lump sum, which would attract a "top-up" tax credit at the standard rate into a Business Investment Company (BIC). BICs could only be administered by commercial lenders. The BIC would make funds available to lend to suitable businesses, on commercial terms, subject to three restrictions:

- No more than 5% of its funds on hand would be lent to any one company or group of companies
- No more than 50% of any one loan to a company could be secured on real property – the idea here is that the BIC would primarily be a source of working capital
- Funds could not be advanced for any period longer than five years

Annual returns on investment in the BIC would be treated in the investors' hands as deposit interest, subject to DIRT. At the fifth anniversary of each initial investment, the initial investment along with the tax credit top up would be refunded, net of any losses arising through bad debts averaged across the BIC by reference to the investment in the base year. It would then be open to the investor to reinvest that amount as a lump sum

into the BIC, attracting a tax credit as before. The overall scheme would close after ten years, at the end of which time the BICs would be closed down.

The BIC itself would be within the charge to corporation tax on surpluses from its lending activities. No rate of return to investors need be set, as attractive returns would be necessary to ensure that investors continued to deposit funds into the BIC.

Securing Expertise - A successful Impatriate Regime

Long term Foreign Direct Investment involves the re-location of the key executives and decision makers to Ireland. When the top executive is working on the ground in Ireland then he/she is more likely to make long term commitments to building business resources in Ireland such as job creation, infrastructural investment and marketing Ireland as a key place of business.

In recent years we have remodelled mechanisms which worked very well in encouraging the decision makers to locate in Ireland, but with mixed results. The existing incentive regime is uncompetitive with other jurisdictions because:

- Relief is restricted to 50% of an excess, rather than the full amount, of earnings
- Share incentive schemes are not recognised
- Relief is on a refund basis

While the existing arrangement might be attractive for an individual, in practice, multinational assignments are arranged on a “hypo tax” basis, where a net sum is agreed by way of remuneration, and then worked back, depending on the country where he or she is based, to arrive at the taxable gross amount. Unfortunately this leaves us as a poor comparison to other jurisdictions.

The French "Impatriate" Model

We have in the past advocated an approach similar to the French Impatriate model, and put it forward for consideration again. This "impatriate regime" is aimed at managers and employers sent to work in France by a non-French employer to perform a professional activity for a limited period of time. The impatriate must take up French tax residence and not have been a French tax resident during the five-year period preceding the start of his duty in France. The tax incentive takes the form of a partial exemption from income tax for the portion of the impatriate's salary compensating him/her for the transfer to France or an exemption on 30% of the global remuneration of the impatriate.

Rewarding Innovation

It remains important to recognise the input and involvement of employees who contribute to the nation's bank of Intellectual Property. While we have a Patent Dividend regime, it requires refinement. We recommend that the current regime should be maintained. In addition, any dividends paid to shareholders directly involved in the innovation process. should be subject to a 12.5% withholding tax rate, with that tax constituting the final liability.

This approach will be attractive in the commercial environment where the remuneration for an innovator and their team can be directly linked to the commercial return being made from their underlying work. However it would not be sufficient to implement this measure on its own, as this would be to the detriment of innovation within the public, and in particular, the university sector.

Rebasing of R&D Relief

Great progress has already been made in developing a credible R&D regime for companies.

Currently the R&D credit is a function of increases in expenditure using 2003 as the base year of comparison. While the incremental approach was a fair means of encouraging year on year increased R&D expenditure, it is not appropriate in a recession. This is as much a factor of reduced costs as reduced R&D activity within the sector, leading to reduced expenditure.

We suggest that a volume based approach be introduced, if only for a limited period to address the current economic downturn to ensure that a company's competing resources are tax efficiently dedicated to R&D expenditure. If the volume based approach is not deemed desirable in the long term, a short term base of 2003 volume less 25% is required over the next few years. This suggestion will be of particular assistance to those companies which have invested in Ireland over many years.

Relief for Pensions Contributions

There is much merit in many of the proposals within the National Pensions Framework published in March of this year. It is extremely important that the Framework be taken on in its entirety, rather than cherry picking the revenue raising or revenue saving proposals for implementation without reference to the broader picture. A pension policy should be viewed as an approach to spreading the income earned (and the tax paid) over the lifetime of the worker, rather than merely over his or her working career.

The "Big Ticket" item in this regard is the proposal to set tax relief for the individual contributor at 33% irrespective of their marginal rate of tax[1]. There may be a temptation to implement this change as a measure to reduce tax expenditures while disregarding other elements of the framework. This would not lead to better pension provision by citizens.

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[1] As described at Sections 4.2.1 and 5.2 of the National Pensions Framework published 3 March 2010.

Parameters for a property tax

CCAB-I notes the proposals in the Programme for Government and in the report of the Commission on Taxation in regard to a property tax. We also note the success, at least from the perspective of local authorities, of the non Principal Private Residence levy.

We agree with the notion that it is better to have a reliable and recurring source of exchequer funding rather than one which is driven by property transactions, as Stamp Duty is. For coherence, the introduction of a property tax needs to be matched with the phasing out altogether of Stamp Duty on principal private residences. Stamp Duty on principal private residences is by now largely an urban phenomenon. There is merit from the point of view of the National Spatial Strategy in not discouraging investment in residential property outside our major towns and cities.

At its heart, a Property Tax is merely a means of determining who should pay more income tax, as a property tax on the principal private residence must be funded from disposable income. Accordingly, any property tax which does not reflect genuine inability to pay would be totally inappropriate. Equally, considerations as to house size, site valuation and the like would seem to be spurious. Once the fundamental criterion, the ownership of a property, is established, the key determinant for an equitable tax would seem to us to be disposable income.

Reform of Social Welfare Benefits for the Unemployed

We feel that the use of the tax and social welfare system to “create” jobs is misguided. Jobs can only be created through demand for products and services. While any form of tax relief is welcome, the uptake of the reliefs which are currently available suggest that scarce resources might be better deployed elsewhere.

The Revenue Job Assist Scheme only benefited 360 people in 2006[2] at a cost of €300,000. We understand that this year's Employer Job (PRSI) Incentive scheme has thus far attracted applications in respect of 1,053 employees. With respect to both initiatives, with unemployment heading for 460,000 people, they are more of a distraction than a solution.

Perhaps of more benefit is the exemption from tax of the unemployment benefit of systematic short term workers. In 2009, this assisted nearly 16,000 people at a cost of €14.9m. An extension of this relief to recipients of Jobseeker's Allowance and Jobseeker's Benefit for the first year of their return to full time employment would be far more effective. It would reduce the payroll cost to employers of filling vacant jobs in the first year, rather than forcing employers to create jobs for which demand might not already be there.

For those formerly in employment, and becoming self employed, this level of enterprise could be rewarded by continuing to pay Jobseeker's Allowance or Jobseeker's Benefit for the first year of self employment, but making the benefit taxable.

[2] The last year for which we have reliable data – the figure might be higher now