Irish Taxation Institute

Educating, Developing & Representing

Irish Taxation Institute

Pre-Budget 2011 Submission

Encouraging Business Activity and Job Creation

October 2010

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Introduction

In framing our pre-Budget submission for 2011, the Irish Taxation Institute (ITI) is very aware of:

- The Government's need to achieve savings on current and capital expenditure in the order of at least €3bn, and
- The imperative of increasing activity in the economy and tackling unemployment.

These demands are likely to be with us for some years and, no doubt, will also feature in the Four Year Budgetary Plan, scheduled to be published by Government in early November 2010. It is against this backdrop that ITI recommends measures to Government across four key policy areas.

1. Income tax – ITI believes that marginal income tax rates need to be frozen at their current levels for the immediate future. They are already high by international standards and we believe that they have reached their "tipping point". Instead, targeted measures to increase income tax yield through base broadening alternatives should be implemented.
2. Private sector investment and job creation – ITI makes three suggestions as a contribution to this critical debate:
   - A targeted focus on pension sector investment in Irish businesses
   - Introduction of a clearly defined tax relief for private loan investment into SMEs
   - A new 50% contribution of social welfare payments to employers for new recruits
3. Attracting overseas talent – An extension is required to the Special Assignment Relief Programme (SARP), bringing share options into the regime and thereby creating a more competitive offering to mobile foreign executives.
4. Policy areas for reform – ITI is recommending:
   - Fundamental reform of the Irish Tax Appeals system to focus on better access to tax appeals for the public; and
   - The establishment of a National Business Forum to generate innovative discussion and speedy decision making on long term tax strategy for Ireland.

We are also making a number of additional recommendations for Budget 2011, which are listed in the Schedule to this submission.

1. Income Tax

The income tax system is now under considerable scrutiny, given the fiscal demands being faced by the economy. Three particular issues which we would highlight in this debate are as follows.

i) The income tax "tipping point"

The introduction of the income levy from 1 January, 2009 and the subsequent increase in income tax rates has seen the marginal rate of income tax (including income levy) rise to 47% which is the 8th highest rate in the EU[1]. When this is combined with PRSI and the Health Levy, the aggregate marginal rate rises to a potential 55%[2]. ITI is concerned that, at these levels, the taxation of income has now reached the "tipping point" and there is no economic benefit to Government in raising the top rates any higher. To do so, would act as a disincentive to work and entrepreneurship[3] and could result in skilled professionals and the wealthy moving to lower-tax jurisdictions.

In his Budget 2010 speech, the Minister recognised the progression of tax increases made in previous Budgets and stated that we have reached the limit in respect of the taxation of income. We agree with this assertion and believe that combined marginal tax rates cannot be raised further.

ii) Broadening the income tax base

Notwithstanding our high marginal rates, the tax yield from income tax and levies is low in Ireland when compared with most other OECD countries. This is particularly marked at the lower end of the income scale, especially when family allowances and supplements are taken into account[4]. Almost 50% (and rising) of income earners now pay no income tax at all and only 4% of earners pay over half of the income tax yield.

ITI has always supported the principle of a progressive income tax system, so that those who earn more pay more. However, it is not sustainable for half of our income earners to pay no income tax at all. We are in unprecedented economic times, with the need to find a minimum of €3bn in savings in Budget 2011. In these circumstances, ITI believes that we have no alternative but to broaden the income tax base to ensure that the burden is spread more evenly across the income earning population.

iii) Broadening the base through a property tax and/or water charges

There is much discussion at the moment about the possible introduction of an annual property tax and/or water charges. If such taxes were to be introduced, then there are certain key criteria that ITI would like to see applied:

1. Any property tax or water charges should be simple to understand and easy to administer.
2. They should be based on a person's ability to pay.

[1] KPMG's Individual Income Tax and Social Security Rate Survey, 2010
[2] The marginal rate of tax, PRSI and levies has increased from 46.5% in 2008 to 55% in 2010.
[3] The OECD has commented that the UK's top rate of income tax of 50% is substantially above the OECD average (40%) and is likely to adversely affect work initiatives and entrepreneurship.
[4] OECD Taxing wages 2008-2009.

3. Some credit should be available against property tax to recognise stamp duty paid and/or large mortgages.
4. The introduction of a property tax should be combined with a reform of stamp duty.

iv) The Universal Social Contribution (USC)

There are a number of important elements to consider in the introduction of the new USC, as announced by the Minister in Budget 2010:

- The introduction of the USC should not result in any further increase to the aggregate marginal rate of tax on income (see the comments above on the income tax tipping point).
- The definition of the new single tax base will be critical – the differing bases that exist at present for PRSI, the Health Levy and the Income Levy have caused considerable difficulty and complexity.
- Deductions in calculating the base such as pensions, capital allowances and share options will also be important and they become more significant, the higher the rate at which the USC is set.
- Clarity is needed as to whether the new USC is an income tax or a social security contribution. This is particularly important in addressing international aspects of the USC, including double taxation agreements and social security bi-lateral/totalisation agreements.
- The USC must be simple to administer.
- A sufficient lead in time must be provided to minimise administrative difficulties and to enable taxpayers put necessary systems in place.

2. Tax measures to encourage investment and assist indigenous business

Issues faced by Irish businesses seeking bank finance have been well documented of late[5]. To compound matters, Ireland has historically lagged behind other EU countries in respect of private equity investment, and in particular to the SME sector[6]. A targeted approach is required to "unlock" private sector capital and direct it into active Irish businesses. ITI has three suggestions that might assist with these efforts:

i) Greater Investment from Irish Pension Funds

Working capital credit is difficult to obtain at present, even for well established businesses with a robust balance sheet and a sound trading history. This proposal offers an alternative funding mechanism for established unquoted medium and large Irish corporates which meet these criteria (the "target group"). Under this proposal, Irish pension funds would be enabled (and possibly even required), to invest a minimum of

[5] Mazars review of Lending to SMEs (19 April 2010) indicated that one in five SMEs are not getting enough credit.
[6] At 0.155% of GDP in 2008 the level of private equity investment in Ireland lagged well behind the EU average- *Forfas/NCC Annual Competitiveness Report 2010.*

their asset allocation in the target group. Investment by Irish pension funds in our own indigenous businesses is currently minimal and this proposal aims to increase investment levels. Additional funds raised in this way could be used to enable the target group to continue or expand their operations.

It is proposed that a pension fund structure be established with the following characteristics:

1. Companies in the target group that wish to participate and apply for funding would be pooled together.
2. Expertise in identifying and managing the pool would be drawn from existing experts in private equity fund management.
3. The pension fund would be required to invest 5% of its resources in either unquoted Irish shares (ordinary or preference shares, as appropriate) or secure corporate bonds. Allocating 5% of pension fund assets in this way (say 1% p.a. for 5 years) would result in a total investment of €3.6.bn in shares or secure corporate debts. If the investment policy was restricted to defined contribution schemes, the total investment over 5 years would be €1.3bn.
4. The pension fund would receive its investment return in the form of dividend and/or redemption of its investment.
5. The structure of these loans and share investments would be standardised for efficiency of operation. The same documentation should be used as far as possible. This is also important to allow the investor to understand the mandate and parameters of the fund and the risks and return outlook.
6. The assumptions are that the fund would operate within the existing framework of regulations applicable to Life Assurance and Pensions (e.g. disclosure, accounting and reporting requirements). New and different obligations introduce cost to the administration and will undermine the viability of the venture.
7. The "prudent investor" principle would currently be a barrier to this proposal and would need to be amended to ensure that investments in the target group do not offend the principle.
8. This proposal could be introduced at no Exchequer cost. However, it would be important to maintain the marginal tax relief currently available to individual investors rather than the proposed lower rate of 33%[7], to ensure there is sufficient incentive for taxpayers to invest.

ii) Encouraging investment by individuals in active Irish businesses

Many family businesses may be reluctant to dilute share ownership but still have a pressing need to access capital for growth. Loan investment can meet this need for capital and can also provide more flexible options on exit, thereby offering a more attractive option for potential investors with cash. ITI propose that a tax relief for individuals making loan capital investments would encourage lending from the private sector into SME businesses. The proposed relief could have the following characteristics:

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[7] *National Pensions Framework,* paragraph 5.2: March 2010

- The relief could be limited to investment in SMEs - certain balance sheet/turnover thresholds could be imposed.
- There could be a minimum investment period of 3 to 5 years.
- To provide additional security for investors, the loan investment could be based on convertible loan stock, with conversion into share capital occurring only in the event of default.
- The relief could be targeted at active trading companies where potential for job creation is demonstrated.
- The relief could be based on a deduction for individuals from their total income and could be limited to the standard rate of income tax.
- To compete with other forms of investment, any interest return on these loan investments would be subject to income tax at DIRT rates.
- The administrative burden must be kept to a minimum to avoid some of the difficulties that have arisen under the current BES regime.
- The best way to estimate the potential Exchequer cost of this initiative is to look at the Business Expansion Scheme (BES) statistics. In 2009, €62.3m was invested in Irish companies at a cost of €25.6m to the Exchequer.
- If we are to introduce a meaningful incentive for investment, then it must be excluded from the High Earner's Restriction under Chapter 2A, Part 15, Taxes Consolidation Act (TCA) 1997.

iii) Labour Market Activation

The OECD has warned of a potential long-term unemployment problem in Ireland with rates of chronic joblessness possibly persisting well into the recovery[8]. It advises that job-search incentives need to be strengthened in order to avoid growing benefit dependency. The OECD recommends tax incentives and other subsidies for hiring, together with increased investment in training, particularly for low-skilled workers.

ITI proposes that Government introduce assistance for employers to encourage the recruitment of staff from the Live Register. If the employer recruits a person, who has been on the Live Register for at least six months, then the employer can claim 50% of that employee's basic social welfare payment to defray the cost of salary for a period of 12 months. The job would be a new full time position. The 50% allocation could be spread evenly over the year, or could be front loaded for the employer. The cost of this proposal would be approximately €5,200 per successful applicant but this cost would be more than outweighed by the social welfare and supplementary benefits savings achieved.

[8] OECD Employment Outlook, 2010

3. Foreign Direct Investment (FDI)

i) 12 ½% rate

Our 12.5% corporation tax rate has been a very successful element of our economic strategy for attracting FDI to Ireland. In recent times, the trend in Europe generally has been to reduce headline corporation tax rates[9] and we must strive to remain competitive as rival jurisdictions, both in Europe and beyond, continue to enhance their tax offering.

There has been recent speculation about the future of the 12 ½% rate. This speculation has the potential to create uncertainty amongst investors and the Minister's speedy moves to dispel this uncertainty was an important reassurance for everyone. ITI believes that it would be helpful for the Minister to reiterate the Government's commitment to the 12 ½% rate in the Four Year Budgetary Plan and in Budget 2011.

ii) Special Assignment Relief Programme (SARP)

A number of specific proposals on FDI are included in the Schedule to this submission. However, one issue in particular is causing significant concern amongst our membership.

Section 825B TCA 1997 (SARP regime) was introduced in Finance Act (No.2) 2008 and subsequently expanded in Finance Act 2010 with the aim of encouraging employers to relocate key individuals to Ireland. The relief applies to 'relevant emoluments' which requires that the emolument falls within the charge to tax under Schedule E and is one to which PAYE has been applied. Currently, share based remuneration is specifically excluded from the PAYE system[10]. This is a significant gap in the SARP regime as many multi-nationals use share options and other share based remuneration to reward their senior executives. ITI recommends that the definition of "relevant emoluments" under Section 825B TCA 1997, should be extended to include share-based remuneration.

The income levy is akin to an income tax for the purposes of relief under double tax agreements. However, in practice, it is not included as a tax for the purposes of relief under section 825B TCA 1997. This inconsistency creates a gap in the SARP regime and creates additional cost for the key employees we are trying to attract to Ireland and/or their employers. Clarification is required that the income levy is akin to income tax for the purposes of section 825B TCA 1997.

ITI has also made a number of other recommendations in the Schedule to this submission which are aimed at enhancing the offerings in our tax system to attract foreign investment.

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[9] European Commission – Taxation Trends in the European Union, 2010 edition.
[10] Section 985A(1A) TCA 1997

4. Strategic Policy Matters

4.1. Review of the Appeals System

In March 2008, ITI prepared a report on The Irish Appeals System, examining the rules and procedures governing Irish tax appeals. Work in the area of the Irish appeals system has also previously been carried out by the Law Reform Commission and through the deliberations of the Public Accounts Committee.

Irish taxpayers are entitled to a tax appeal system which they can avail of at a reasonable cost and before which they can represent themselves as a matter of course. The system must operate effectively and all decisions and procedural matters must be available to the public, in a fully transparent manner.

ITI does not believe that the existing system is meeting these policy objectives. We are seeking reform of the system and a new legislative basis for the operation of tax appeals, to be introduced without delay.

4.2 Establishment of a National Business Forum

All taxpayers deserve certainty regarding their tax affairs. Businesses, and in particular the international business sector, requires certainty in tax policy if they are to make investment decisions that benefit Ireland. The 2009 Commission on Taxation Report provided a welcome overview of our tax system and while many would not agree with some of the recommendations therein, it has provided a much-needed blue-print for reform of the Irish tax system. Clarity on the Government's intentions regarding the extent to which this Report will be implemented, would be welcome.

ITI also believes that a National Business Forum should be established to consider Ireland's medium to long-term tax strategy. This forum should involve representatives from all stakeholders including Revenue, Department of Finance, professional advisers and business representatives. This National Business Forum could follow the model previously set by the IFSC 'clearing house', which was instrumental in developing the very successful IFSC tax regime. Furthermore, any major changes to our tax regime should be subject to a comprehensive consultation process and sufficient advanced notice to enable taxpayers to adapt to the changes and to introduce new systems and/or procedures.

Additional Proposals by the Irish Taxation Institute

Assisting indigenous business

Funding issues

1. The close-company surcharge for professional services companies is inappropriate in the current economic climate in so far as it acts as a disincentive to business growth. ITI recommends that this surcharge should be abolished.
2. Professional Services Withholding Tax (PSWT) is contributing to cash flow difficulties for businesses at present. An exemption from PSWT should be available on production of a tax clearance certificate by a relevant service provider. A PSWT clearance system should also be introduced for non-resident service providers which are not liable to tax in Ireland.
3. Accelerated capital allowances could be introduced for SMEs investing in new plant and machinery with a value below €10,000. A targeted measure such as this would encourage capital spending to update expensive equipment for SMEs and would generate appending activity for the economy.
4. The BES application process requires simplification and streamlining. To encourage additional investment, BES should be excluded from the list of specified reliefs in Chapter 2A of Part 15, TCA 1997.

Job Creation Measures

5. Subject to a review for 2010, the Employer (PRSI) Incentive Scheme introduced in Budget 2010 should be extended for a further period of 12 months.

Other

6. An issue has come to our attention under the windfall tax legislation introduced under the National Assets Management Agency (NAMA) Act 2009. The issue arises where a company trading in land has taken a write down on the value of the land which is subsequently re-zoned. In these circumstances if the land is subsequently sold (or re-valued upward without being sold), the company can be liable to 80% tax on the profits due to rezoning even where the value of the land remains below the original cost. This anomalous treatment does not arise in a capital gains tax situation. ITI believes the 80% tax should only arise where there has been an overall profit on the transaction regardless of whether the transaction is trading or a capital gain.
7. The current preliminary tax regime for companies should be revised so that all companies are entitled to avail of the prior year basis. If the current system is retained, the larger companies should be entitled to base their preliminary tax liability on management accounts without fear of penalties. This recommendation is equally valid for FDI companies under the heading “Enhancing foreign direct investment” below.

Enhancing foreign direct investment

8. The 12.5% rate of corporate tax should be extended to dividends received from trading profits of all private companies, thereby extending coverage to non-treaty locations.
9. The effect of a PAYE exclusion order should be extended to include the income levy in circumstances where an employee is sent to work in a non DTA jurisdiction.
10. A public information campaign is needed to highlight the benefits of the R&D tax credit regime. As part of this campaign, regularly updated information should be published by Government on the types of activities qualifying for the credit.
11. The threshold on the amount of outsourced work that qualifies for the R&D tax credit should be increased to 25% over the life of a project.
12. Ireland is one of the few countries operating an incremental system of R&D credits. ITI recommends moving to full volume based system for R&D tax credits.
13. The period over which long life intangible assets may be written down for tax purposes under section 291A TCA 1997, should be reduced from 15 to 10 years.
14. A pooling system in respect of credits for foreign tax on royalty payments should be introduced.

IRISH TAXATION INSTITUTE

The Irish Taxation Institute is the leading organisation on tax education and practice in Ireland. It represents over 4,500 tax professionals and consultants who provide tax expertise and advice to thousands of businesses and individuals, while many advise professionally through senior roles within multinational companies, Government, Revenue, state bodies and the EU.

The Institute is the leader in tax education in Ireland for over 40 years and its School of Taxation is renowned for its standards of excellence and the outstanding quality of its graduates. Its AITI Registered Tax Consultant qualification is recognised in the EU and is the premier qualification in tax consultancy while the Institute's Tax Technician qualification is widely respected as the foundation to a tax administration career.

The Irish Taxation Institute's professional development programme ensures that members practice to the highest professional standards and that their tax expertise is underpinned by a comprehensive knowledge of the most up to date Irish and EU tax law.

The Institute is a respected authority on tax policy in Ireland, contributing to discussion and debate on the key issues around tax strategy and tax practice. A leading publisher of legal books and academic journals, the Institute is a respected voice on the role and impact of tax policies on the Irish economy.

The Institute works with members, Government and business to propose new policies and ideas on tax policy. Through its nationwide branch network and comprehensive committee structure, its members are actively involved in developing and advancing research on taxation, economic and social policy. Drawing on this expert team, the Irish Taxation Institute produces a comprehensive suite of taxation publications covering the full range of tax topics.

The Institute is governed by a Council made up of senior business executives and managed by a dynamic executive team.

For further information on the Irish Taxation Institute or to discuss the issues raised in this submission, please contact:

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