JULY 2015

SUBMISSION TO: PUBLIC CONSULTATION ON TAX AND ENTREPRENEURSHIP

FIANNA FÁIL
THE REPUBLICAN PARTY

Michael McGrath T.D.
SPOKESPERSON ON FINANCE

Introduction

Ireland is acknowledged as a world leader in attracting foreign direct investment. No country can match what we have achieved over many decades. 175,000 people are employed by multinationals and the sector rightly commands significant attention in political debate. By contrast we give far less prominence to the role of Irish entrepreneurs in the economy despite the enormous potential for risk takers with new ideas to lead Ireland's recovery.

There is a risk associated with equating self-employment and SMEs with entrepreneurship. While there is considerable overlap between the two areas, Fianna Fáil believes that in order to maximise the potential of both sectors they need to be treated as distinct policy streams.

While self-employment can be quite easily measured, entrepreneurship is more difficult to quantify. An entrepreneur in simple terms is someone who takes a new idea and turns it in to a business success. The entrepreneur is the person who spots a gap in the market and develops a product or service to fulfil the unmet need. They are a disruptive force in the economy challenging the “business as usual” approach that may be taken by others.

There is no shortage of individuals with good ideas for products and services that people would be willing to purchase, but often the obstacles in their way prove too great. Setting up your own business is a daunting undertaking, negotiating a minefield of regulatory and financial hurdles.

There are many factors that may hold an entrepreneur. Lack of access to finance is an obvious one which may prevent a business from getting off the ground. This lack of finance is often associated with the perceived riskiness of new ventures. Banks may be unwilling to lend to entrepreneurs at reasonable rates, or even at all.

In this context, the tax system can be a very important mechanism to give investors an increased return for the level of risk they have taken on. It opens up a range of new sources of funds for entrepreneurs and, combined with advances in technology, can facilitate funding which would not otherwise be available to firms.

We firmly support the use of taxation-based incentives to both encourage entrepreneurs to take the risk of setting up a new venture and facilitate those who wish to act as investors, and we believe that such incentives can deliver good value to the taxpayer.

Michael McGrath T.D.
Fianna Fáil Spokesperson on Finance

Barriers to enterprise in the current taxation system

1. Income tax

Insofar as possible, the tax system should treat people in an equitable manner. Self-employed people lose under the current regime because, while they receive the personal tax credit, they cannot claim the PAYE allowance, both of which are currently worth €1,650 per annum.

This has a particularly stark impact at lower levels of income. For example a self-employed single person on an income of €15,000 pays almost 8 times as much tax and PRSI as an employee on the same income. There is a strong case for addressing the unfair treatment of self-employed taxpayers, particularly those with lower incomes. This should be done by means of an earned income tax credit as suggested by the Commission on Taxation.

2. PRSI

PRSI is regarded as equivalent to an income tax by self-employed people due to the tenuous link between benefits derived and the amount paid. It operates as a significant barrier to people setting up their own business.

The self-employed currently pay Class S PRSI at a rate of 4%. This entitles them to a reduced range of benefits when compared to PAYE workers. To be eligible for Jobseekers Assistance, a self-employed person must undergo a means test. This can be time consuming with waiting periods of up to eight months. Inaccurate media reports have led some people to believe that they are entitled to nothing because they have no automatic entitlement to Jobseekers Benefit. This has caused unnecessary confusion among the self-employed.

Furthermore, self-employed persons have no entitlement to an invalidity pension and occupational injuries benefits, which employees can avail of from contributing made at the PRSI Class A rate. Currently, Class S PRSI contributions do not count towards social insurance contributions required for eligibility under schemes such as jobseeker's benefit, illness benefit and invalidity pension.

Extending social welfare protection to self-employed people achieves a measure of social equality. In addition, it reduces the risk for those entrepreneurs who wish to start up their own businesses by providing a safety net.

To facilitate this, we propose to allow the self-employed to opt into PRSI Class A. They would pay an extra 4% PRSI under Class A, in addition to their existing Class S contribution. The same terms and conditions would then apply for the unemployed self-employed as they do for the unemployed PAYE employee.

3. Commercial Rates

Commercial rates paid by entrepreneurs to local authorities should be predictable, but also, more importantly, they must be proportionate and fair. Rates place a disproportionate burden on small businesses;, business rates are the third biggest expense for smaller companies, after rent and wages.

For entrepreneurs hoping to set up new businesses the burden of rates can render their goals financially impossible. It is imperative that the government and local authorities work together to establish a revamped system that creates breathing space for retailers in financial difficulty, incentivises new businesses to set up in towns and forms a sustainable base for local authority finances.

Local authorities should use new discretionary powers to give business rate concessions to new local businesses. In addition, we would introduce an inability to pay clause in the commercial rates system to assist struggling businesses, and delete the subsequent occupier clause to encourage greater take-up of vacant spaces.

Regular revaluations would help make the system more responsive to economic conditions. It may impose a cost on the Valuations Office but ultimately would make sound economic sense.

Effectiveness of current incentives

20,000 people established new businesses in Ireland in 2014. However, not all of these can be classified as entrepreneurs in the true sense. In fact, the aspiration to become an entrepreneur here remains low according to the Global Entrepreneurship Monitor report.

Current tax incentives certainly contribute to supporting new enterprises but the balance of public policy remains tilted towards foreign direct investment.

It will take a deep rooted reform of current tax incentives to change this. In addition, there is a need to actively market the measures that are currently in place so as to ensure that potential beneficiaries are fully aware of their presence.

Proposals to assist start up enterprises:

There is a vibrant emerging start-up scene in Ireland with start-up weekends, bootcamps and incubators, particularly in the technology sector. Fianna Fáil wants to nurture and expand this activity to other high-potential enterprises. The energy and drive present in this sector has great potential to generate future economic growth.

Our aim would be to open the start-up investment landscape to smaller investors, spread knowledge of and involvement in the technology start-up market more widely and begin to solidify Ireland's position as a world leading start-up location.

We propose the following enhancements of current tax incentives for enterprise together with the roll out of new incentives:

1. Reform Capital Gains Tax relief for entrepreneurs

There is a globally competitive market for start-up enterprises. Currently relief from Capital Gains Tax for entrepreneurs works by offering relief to individuals who have recently paid Capital Gains Tax (CGT) and subsequently invest in a new business, before selling that new interest no earlier than three years after the investment date.

The CGT due on this sale is reduced by the lower of either the CGT paid on the original disposal or by half of the CGT due on the new sale. If the second venture succeeds and the entrepreneur can make a successful exit the absolute best case scenario is that their overall effective CGT rate across the two investments drops to 22 per cent.

We believe this is excessively restrictive and the fact that the second company must be involved in an activity "not previously carried on" by the entrepreneur or an associate dilutes the incentive even further.

We propose a more general relief from CGT for entrepreneurial investors regardless of whether they invested in a new business. This would create a clear distinction between enterprise and passive investment. It would involve a lower rate of 15% CGT rate applying for people who establish and subsequently sell their own business. This would be limited to relief on the first €5m of chargeable gains.

We would also allow the relief to be made available to so-called angel investors, who provide capital for new businesses without taking on executive roles. As it stands the measure is aimed only at the owner/manager, who "is required to devote substantially the whole of his or her time to the service of the company in a managerial or technical capacity".

Investing at this level is an incredibly brave decision. Angel investors will typically provide more than just upfront capital and will very often mentor and guide the entrepreneur in their venture. This type of support is vital to assisting a company in realising its potential. Angel investors should also be regarded as part of the "team" when Entrepreneurs' Relief is calculated.

2. Incentivise crowdfunding of SMEs

Crowdfunding of SME loans is a rapidly growing sector across the EU and US. Already a number of platforms are operating in Ireland. Given the weakening of bank's traditional role as a business lender and given the low deposit rates available for savers there is a natural synergy in an approach that links small-scale investors to SMEs in need of finance. It also leverages the wisdom of crowds, which are often very accurate predictors of outcomes when people's own money is on the line.

As with all investments there is risk, but experiences with crowdfunding to date have been largely positive and as investors can research and even visit a business looking for funding they can get a feel for it and feel engaged with their investment choice. Nevertheless diversification is desirable.

Fianna Fáil wants to make Ireland an exemplar of business innovation and growth. Currently the interest on crowdfunding loans is subject to income tax, USC and PRSI as unearned income. This compares to DIRT (and potentially PRSI) on the (low) interest earned if an investor left their money in the bank.

To incentivise crowdfunding, we propose waiving the PRSI and USC on the interest on any such investment up to €20k. The interest earned would also be subject to tax at the standard rate of 20% rather than the investor's marginal rate.

Investors would be required to invest in a minimum of three loans to qualify for the tax incentive, in order to ensure they have achieved diversification. On the other side of the investment, for a SME to qualify it must meet the Revenue definition of 'a small company' (<50 staff; <€10m turnover).

By offering such incentives we aim to expand this sector in Ireland and encourage more crowdfunding platforms to set up here.

3. Provide progressive relief from Employers' PRSI

Within the existing €1bn budget for job support, we believe resources should be reallocated to support a progressive relief from Employer PRSI. This should be linked to growth in employee headcount. The Government has previously acknowledged the issue of Employer's PRSI by deploying the reduced PRSI rate between 2011 and 2013.

When an entrepreneur makes their first hire, they are taking a huge risk. This is a vital moment in a company's development with the entrepreneur being forced to take on board significant personal, financial and regulatory burdens.

The state should seek to reduce the upfront financial burden of taking on first employees. We need a scheme that focuses on early stage companies and rewards growth by offering exemptions from and reductions in Employers' PRSI relative to the number of staff employed or the company's wage bill. For example, the first additional employee taken on should be exempt from Employers' PRSI for a period of 2 years and the next 5 employees subject to a reduction of 50% on the first €50,000 of salary.

4. Enhance the Employment and Investment Incentive scheme

The announcement that the Employment and Investment Incentive scheme is being extended to 2020 is on the face of it welcome. However, it had never actually been indicated that the scheme would expire at a particular date. By putting in place an end date the government may inadvertently create doubt about the attractiveness of the scheme.

The current scheme could be made more attractive by allowing full tax relief when the investment is made in a start-up company would facilitate raising capital for SMEs.

5. Support Family Business Succession

CGT retirement relief has seen significant restrictions imposed on the value that can transfer tax free from one generation to the next if the individual is aged 66 or older. The age limits do not reflect the reality that business owners will often need to retain ownership of their businesses until over 65 in order to ensure that the next generation has acquired the necessary experience and maturity to take on the business. In addition over the last number of years many business owners have been forced to retain their businesses in order to keep them viable through the recession. In many instances there was no functioning market for the sale of businesses in the period 2008 – 2014 (and arguably there continues to be no functioning market in many geographical areas or business sectors).

We therefore propose that the 66 age limit in the above cases is raised to 72 to reflect the balance between encouraging business owners to pass on their business and the reality of the business environment over the last number of years.

In relation to the monetary limit placed on relief available on transfers we would argue that these are causing many business owners to retain ownership of assets until death as no CGT charge applies on assets so passing.

We therefore recommend an increase in the limits set out above as follows:

Assets transferred to Children	
Transferor 55 - 72	no limit
73 +	€6 million
Assets transferred to others	
Transferor 55 - 72	€1,500,000
Transferor 73+	€1,000,000

6. Encourage additional Research and Development expenditure

We have an excellent research and development base in Ireland from which to make further progress. Two thirds of Ireland's R&D is in the private sector, creating new product and service innovations.

We welcome the recent changes to the R&D tax credit regime which broadens the range of companies to which the credit is available. However the regime is still perceived as too cumbersome for entrepreneurs. The documentation requirement for R&D claims below €50,000 should be simplified to support entrepreneurs.

Where a company has produced audited accounts that it should have an R&D credit of up to €50,000 automatically refunded (subject to future audit). Many companies which are filing claims are currently going through an onerous process before getting the refund they are entitled to.

To help attract additional mobile R&D investment into Ireland, a pre-approval mechanism should be put in place to enable firms to agree in advance the percentage of an R&D grant-aided project that qualifies for the tax credit.
We propose a specialist dedicated unit be established within Revenue to deal with specific R&D tax matters, as well as handling technical appeals in a more streamlined manner. In addition we should broaden the relief to enable loss-making companies pass on the benefit of their R&D credits to their key research staff.

Conclusion

Ireland can benefit significantly from unleashing the talent of entrepreneurs. In this context tax policy has the potential to be a significant engine of growth in the Irish economy.

The proposals outlined in this submission seek underpin the strengths that exist within our current tax regime and enhance it further to ensure we realise this goal. They are designed to assist starts-ups in raising necessary and reward risk takers who succeed in building a successful business. A well-defined social protection safety net can also play a vital role. In addition we believe that incentivising research and development will also add to the productive capacity of the economy.

Michael McGrath T.D.

SPOKESPERSON ON FINANCE

Dáil Éireann, Leinster House, Kildare Street, Dublin 2.
Constituency Office, Main Street, Carrigaline, Co. Cork.
✆ 021-4376699 🖷 021-4834252
✉ michael.mcgrath@oireachtas.ie
/michael.mcgrath.1614 @DeputyMcGrathTD

FIANNA FÁIL
THE REPUBLICAN PARTY