Irish Tax Institute

Leaders in Tax

A Tax Strategy for Irish Companies and Irish Exports

Irish Tax Institute Report

September 2011

Irish Tax Institute

Leaders in Tax

A Tax Strategy for Irish Companies and Irish Exports
Irish Tax Institute Report

Table of Contents — Page

1. Irish Tax Institute 3
2. Executive Summary 4
3. 20 Interesting Statistics 10
4. Comprehensive list of Institute proposals 12
5. Why Focus on Irish Indigenous Companies? 16
6. Research Methodology 20
7. Key Research Findings 22
    - 7.1 Current tax system – positive foundations 22
    - 7.2 Certainty 23
    - 7.3 Exporting and expanding to new markets 24
    - 7.4 Developing a generation of invention 26
    - 7.5 Marginal income tax rates 34
    - 7.6 Simplification 37

Appendix I Double Taxation Treaties 39
Appendix II CSO External Trade Statistics 42
Appendix III Tax Simplification: International Initiatives 44

1. Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Registered Tax Consultants and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses, multinationals and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Registered Tax Consultant qualification is the gold standard in tax education and is renowned for its professional rigour and depth. The Institute also continues to promote the highest standards throughout the careers of Registered Tax Consultants through our expert-led professional development programme.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of our members, we play an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

2. Executive Summary

Why focus on Irish Indigenous Companies

With at least 85% of Ireland's total exports now coming from foreign owned companies, it is time to place a sharp and immediate focus on what is happening in Ireland's indigenous sector and what strategies must be employed to drive the growth and expansion of Irish-owned companies.

The forthcoming Budget and the publication of a new Government 3 Year Plan provide Ireland with the opportunity to develop ambitious tax policies that are aimed at creating a solid indigenous sector and a confident new Irish entrepreneurial culture.

The Research – Irish Indigenous Companies tell their story

This summer, the Institute undertook an extensive and original piece of research to identify the key tax issues facing indigenous Irish businesses as they seek to find new export opportunities and grow their revenue in a challenging economic environment.

This report conveys the views and concerns of the Irish businesses who participated in our research programme. The combined evidence received from businesses directly, and from tax practitioner members who sought the views of their clients represented over 100 indigenous Irish businesses.

The scope of the research was wide and encompassed a variety of industries including food and drink, construction and engineering, packaging, medical devices and software development.

Ireland's Indigenous Sector – The Facts

Enterprise Ireland's (EI) most recent annual report shows that Irish companies achieved €14bn export sales in 2010 and that EI's client companies support (directly or indirectly) over 300,000 Irish jobs (137,241 directly employed).

But despite strong performances in some sectors, recent reports indicate that less entrepreneurial activity is happening in Ireland over the past 4 years. The Global Entrepreneurship Monitor (GEM) 2010[1] report for Ireland shows a reduction in the population of entrepreneurs in this country. It estimates that 800 people set up a new business in Ireland each month in 2010 compared to 2,800 people per month during 2008.

---

[1] *Entrepreneurship in Ireland 2010* – Global Entrepreneurship Monitor, May 2011

Ireland's star performers are exporters

As recognised in the Programme for Government, Ireland's economic recovery must be export-led and there is certainly potential for the indigenous sector to grow its export sales.

The star performers of the Irish Stock Exchange and the most successful of the privately owned Irish corporations provide compelling evidence in the argument for developing a strong indigenous sector.

Our most impressive companies have built their success on export markets and strong international sales.

The UK has recognised the benefits to be gained from identifying the star performers of their economy. The Department for Business, Innovation and Skills reports[2] that 6% of UK businesses with the highest growth rates were responsible for over half of the new jobs created by existing businesses between 2002 and 2008. Small and medium sized businesses provide nearly 60% of jobs in the UK and account for 50% of GDP.

Indigenous Companies Globally – The backbone of strong economies

Strong indigenous exporting sectors are the backbone of individual economies across the world, providing them with a stable employment base and enhancing their resilience.

Many countries have introduced important tax measures to deliberately drive innovation; entrepreneurial thinking and globally-focused sales strategies. Their business administrative systems have also been designed to encourage their entrepreneurs and to dismantle obstacles that would hinder export companies and indigenous businesses in their economy.

Indigenous businesses are not characterised by the same volatility which can be a feature of Foreign Direct Investment (FDI). They tend to grow more organically and become more embedded in the domestic economy.

***German* Mittelstand**

In Germany, the small and medium-sized enterprise sector is widely credited with ensuring the resilience of the German economy.

This sector is known as the *Mittelstand*, and it forms the backbone of the German economy. A special report by Businessweek magazine[3] stated that the sector is

---

[2] *Backing Small Business* – Department for Business, Innovation & Skills, November 2010

[3] *Germany's Mittelstand Still Thrives* – Businessweek, 30 September 2010

comprised of more than 3 million enterprises; it employs more than 70% of German workers and accounts for approximately half of German GDP. The Financial Times[4] identified a number of key elements which have contributed to the success of the sector:

> *"Mittelstand companies……have a seemingly simple recipe: a mixture of financial prudence, engineering spirit, long-standing internationalisation and a strategy to hold on to highly skilled workers. The overriding element of their market success is a focus on exports and highly advanced market niches."*

The sector is also sustained by a domestic environment which is supportive of its development. Germany's vocational education approach and its apprenticeship system ensures that companies have ready access to workers. Businessweek noted that Mittelstand companies take on 83% of all apprentices in Germany, more than their share of overall employment.

The example of Germany is one which Ireland might want to emulate, and the development of an Irish *Mittelstand* should be a long-term aspiration in order to insulate the economy to the greatest possible extent from future external shocks.

The 5 Core Findings and Recommendations from Irish Indigenous Businesses

1. Bring Certainty to our Tax Policy

- Tax certainty, more than any other individual tax issue, was the overwhelming concern of every single Irish business with whom we spoke. It is vital that the Government publishes a definitive tax strategy for the next three years in order to allay the fears of investors, businesses and job creators.

- There can be no scope for retrospective decisions in our tax policy. Confidence is the bedrock of investment decisions, and any uncertainty or unexpected change of direction in tax policy can damage hard won confidence. (e.g. recent policy changes on the application of PRSI to share awards).

- The Institute welcomes recognition by the Minister for Finance that certainty is important and that a 3 Year Plan, which will include tax decisions, is soon to be published.

2. New tax measures to drive sales and expansion into export markets

- A tax measure should be introduced to encourage employees to travel abroad to drive exports for Irish companies. Appendix II below demonstrates that there is huge

[4] *The German drive to globalise* – FT.com, 31 May 2011

potential to be gained by Irish businesses exploring new markets beyond the EU and some encouragement for key sales staff to take these steps would bring rewards for the Exchequer in terms of increased sales and tax revenues at home.

- Again, as part of a strategy to encourage and support businesses to expand into new markets, the Institute is proposing a relief for sales and marketing costs. Ideally the relief would operate to reduce PRSI costs or as an offset against PAYE.

- First time exporters can often feel daunted by the complexity of overseas VAT rules. It would be useful to provide an information campaign for them on the common VAT issues that arise when they first begin to sell overseas. The Institute would be happy to assist State Agencies with such a project.

- There is a very real acceptance that some of the highest unemployment levels in Ireland are amongst those who were employed in the engineering, architecture and construction sectors in recent years. The need to earn a living overseas often forces these workers to work in countries with which Ireland does not have tax treaties (e.g. South American and African countries). At the moment, these workers are suffering double taxation. This issue needs to be addressed in Irish tax legislation.

3. Advance the critical tax measures that drive invention and innovation in ` competing economies internationally

(a) Research and Development (R&D)

- R&D is at the heart of innovation and those who have been most successful in export markets have been the leading innovators in their field. Businesses expressed a strong view on the need for a volume based R&D scheme as is the case in many competing countries.

- With only 18% of Irish companies claiming the R&D tax credit, there is a compelling case for the introduction of a high-profile education campaign across all sectors of Irish business.

- For those who do claim the R&D relief in Ireland it is a very long and complex process. The UK has a voluntary advance assurance procedure for smaller companies and new start-ups whereby those companies could obtain certainty about whether their projects will qualify for the R&D credit at an early stage. We should consider such a system to address the high cost of making an R&D claim at the moment in Ireland.

- If Ireland is to drive innovation and create a new generation of entrepreneurs who invest in R&D, the claims process must be simplified:

- Review the documentation requirements.
- Implement the commitment in the Programme for Government and introduce a procedure whereby companies in receipt of a Research, Technology & Innovation (RTI) grant will be automatically deemed entitled to the R&D tax credit.
- Introduce a procedure whereby the taxpayer could make a financial contribution to expedite the claim.
- Ensure that there is ease of access to appropriate and timely advice for taxpayers.

(b) IP (Intellectual Property)

- A good system for developing and commercialising IP goes hand in hand with a good R&D policy. Our research has found that the best way for Ireland to become a competitive location for the development and use of IP is through the establishment of a "patent box" regime, which exists in other countries such as The Netherlands, Luxembourg and Belgium but not here (detailed below). The introduction of a "patent box" is also being given strong consideration in the UK at present.

- If a "patent box" system is not attainable in the short term, then an alternative would be to remove the 10-year claw-back period and to ensure that the asset would continue to qualify for capital allowances for as long as it remains valuable in the business.

(c) Injecting money into indigenous companies

- The announcement of the Employment and Investment Incentive Scheme (EIIS) in Budget 2011 was welcome and we urgently await EU approval of the scheme. It is vital that the relief will be well explained to businesses by government, and a simple claims procedure should be adopted if it is to be effective.

- The UK operates "Enterprise Management Incentives" (EMI) which are share options schemes with tax advantages. 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"*[5]. It may be worth considering such a proposal in Ireland.

(d) Rewarding the key employees who drive invention in Irish businesses

- The exceptional and highly talented employees who are leading innovation within Irish companies must be encouraged to remain in Ireland if we are to truly create the

[5] *Enterprise Management Incentives* – HMRC website

innovators of the future in the Irish economy. There is currently a gap in the innovation agenda, with no facility whereby employees engaged in innovative activity are encouraged to do this work. An initiative would be welcomed to fill this gap. It should be targeted and focussed and could be subject to certain conditions. For example, a cap could be imposed on the income that qualifies.

(e) Any reform of capital taxes must not damage business growth

- Any reform of capital gains tax and capital acquisitions tax must be fully thought out before being implemented and it must take into account the impact on business growth and family succession. Our priority at present is to create and retain Irish jobs and our capital taxes policy must reflect this overall strategic imperative.

4. No scope for any further increases to marginal income tax rates

- Marginal tax rates should not be increased beyond their current levels, which are already very high by international standards. A statement of commitment to income tax rate stability is necessary as part of an overall government message on certainty. Ireland has already reached a tipping point on marginal tax rates and any increase would severely damage our international competitiveness.

- The differential in the marginal tax rate between the employed and the self-employed should be eliminated. The current position is inequitable and is not supportive of a domestic entrepreneurial culture.

5. A new Tax Simplification Strategy must be introduced for fledgling entrepreneurs

- New businesses should be able to avail of a "one-stop-shop" service to help support them with tax and other business issues. Ireland is one of only 9 EU countries which have not yet implemented a "one-stop-shop" procedure for starting up a new company[6]. This service would pay for itself and it would be a more efficient way of providing help that currently comes from a number of separate agencies (e.g. Revenue, Enterprise Boards, etc.).

- A new simple micro-tax for fledgling entrepreneurs should be introduced, as proposed by the Irish Tax Institute last year and proposed in the Programme for Government. This is currently under consideration in the UK and has already been introduced in South Africa. Simplification measures have also been introduced by other economies including New Zealand, Hungary, the Netherlands and Australia.

---

[6] European Commission website - Start-up procedures under the Lisbon Agenda for Growth and Jobs. Actions in 2010

3. 20 Interesting Statistics

(Sources all contained in this report)

Contribution of Indigenous Sector and Importance of SMEs

1. Enterprise Ireland client companies support (directly or indirectly) over 300,000 Irish jobs (137,241 directly employed) and spend an estimated €19 billion per annum in the Irish economy.
2. 800 people set up a new business in Ireland each month in 2010, down from 2,800 people per month during 2008.
3. SMEs are a significant feature in the Irish economy, accounting for an estimated 53% of total employment (Q3 2010).
4. More than 99% of all European business are SMEs.
5. At least 85% of Irish exports are from foreign-owned companies.
6. 60% of Ireland's total exports are currently to EU countries, with 13% to the UK alone.
7. Ireland is one of only 9 EU countries which have not yet implemented a "one-stop-shop" procedure for starting up a new company.

Influence of "Top Performers"

8. 71% of the "best managed" Irish companies plan to recruit additional staff this year.
9. 6% of UK businesses with the highest growth rates were responsible for half of the new jobs created by existing businesses between 2002 and 2008.
10. Small and medium sized businesses provide nearly 60% of jobs in the UK and account for 50% of GDP.

Income Tax Burden

11. The marginal income tax rate for the self-employed has increased from 46.5% in 2008 to 55% in 2011.
12. For a single person with no children in 2010, only Germany and Belgium have higher marginal income tax rates than Ireland. 31 countries had lower marginal rates than Ireland in 2010. This sector is typically highly educated and well-placed to drive economic recovery, but, crucially, also tends to be highly mobile.

Innovation

13. Ireland is the only one of 26 countries surveyed on R&D which operates an across-the-board "base year" system in respect of the R&D tax credit.
14. Only 18% of the companies surveyed in a recent study have claimed the R&D tax credit.

Key Irish Tax Policy successes

15. The reduction of the corporation tax rate to 12.5% in 2003 has had a significant long-run impact on the business and financial services sector.
16. Ireland ranks ninth in the world (and first in the Eurozone) in the World Bank's rankings on the ease of doing business.
17. Ireland now has tax treaties in effect with countries which, in aggregate, account for over 80% of world GDP.

The German Example

18. The German SME sector, known as the *Mittelstand,* comprises more than 3 million enterprises; it employs more than 70% of German workers, takes on more than 83% of all apprentices, and accounts for approximately half of German GDP.
19. 79% of all businesses in Germany are family-owned and 78% of German family businesses will stay within the family.
20. The 50 largest German family businesses outperformed the DAX24 by on average 6.8 % for the period 2003-2008.

4. Comprehensive list of Institute proposals

This section of the report provides readers with a full list of all recommendations contained in the report. The recommendations have been categorised under 5 main themes.

1. Certainty

- A well-thought-out and clearly-communicated tax strategy for the medium term would help allay the fears expressed to us by business and assist in planning and investment decisions.

- It is important that tax policy decisions taken do not have retrospective effect and are not subsequently changed once they are made (for example, the application of PRSI to share awards).

- The Institute welcomes recent comments by the Minister for Finance that certainty will be provided in the Government's 3 Year Plan.

2. Exporting and expanding to new markets

- Introduce an initiative to support employees who take the difficult decision to travel abroad for their Irish companies. These are companies which are seeking new customers and working to expand. Appendix II below demonstrates that there is huge potential to be gained by Irish businesses exploring new markets beyond the EU and some encouragement for key sales staff to take these steps would bring rewards for the Exchequer in terms of increased sales and tax revenues at home.

- Again, as part of a strategy to encourage and support businesses to expand into new markets, the Institute is proposing a relief for sales and marketing costs. Ideally the relief would operate "above the line", to reduce PRSI costs or as an offset against PAYE. As noted above, this type of assistance for business is more valuable than a deduction against corporation tax, at a time when many businesses have trading losses.

- First time exporters can often feel daunted by the complexity of overseas VAT rules. It would be useful to provide an information leaflet for them on the common VAT issues that arise for SMEs when they first begin to sell overseas. The Institute would be happy to work with State Agencies on such a project.

3. Developing a generation of invention

(a) R&D

- The strong preference of our respondents was that a volume basis be introduced for the R&D tax credit. However, if it is felt that this is not feasible then an alternative suggestion might be to restate the 2003 threshold by reference to deflation. Another option may be to take a project-based approach, whereby a volume basis would be available in respect of new projects undertaken which are significantly different to the research and development activity being undertaken by the company in 2003.

- The R&D claims process must be simplified:

  - Review the documentation requirements.
  - Implement the commitment in the Programme for Government and introduce a procedure whereby companies in receipt of an RTI grant will be automatically deemed entitled to the R&D tax credit.
  - Introduce a procedure whereby the taxpayer could make a financial contribution to expedite the claim.
  - Ensure that there is ease of access for taxpayers to officials who can provide appropriate and timely advice.

- A targeted publicity campaign, focusing on the wide-ranging applicability of the credit should be launched in order to encourage uptake. In this regard, the Institute notes the approach of HMRC in Northern Ireland in this area[7] and the success of the Revenue Commissioners here in promoting and managing the BES scheme.

(b) IP (Intellectual Property)

- Our research has found that the best way to become a competitive location for the development and use of IP is through the establishment of a "patent box" regime, as exists in other countries (detailed below).

- If a "patent box" regime is not attainable in the short term, then an alternative would be to remove the 10-year claw-back period and to ensure that the asset would continue to qualify for capital allowances for as long as it remains valuable in the business.

(c) Investment in indigenous companies

- The announcement of the EIIS scheme in Budget 2011 was welcome and we urgently await EU approval of the scheme. The legislation underpinning the relief is even more complex than the predecessor BES regime and the hope is that the relief will be

---

[7] *Your Research Our Support – Research and Development Tax Relief in Northern Ireland* - HMRC

well explained to businesses by government and a simple claims procedure will be adopted.

- The UK operates "Enterprise Management Incentives" (EMI) which are tax advantaged share options "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"[8]. It may be worth considering such a proposal in Ireland.

(d) Rewarding invention

- There is currently a gap in the innovation agenda, with no facility whereby employees engaged in innovative activity are encouraged to do this work. An initiative would be welcomed to fill this gap. It should be targeted and focussed and could be subject to certain conditions. Possibly there could be a cap on the income that qualifies.

(e) Capital taxes

- Any reform of CGT and CAT must be fully thought out before being implemented and it must take into account the impact on business growth and family succession. Our priority at present is to create and retain Irish jobs and our capital taxes policy must reflect this overall strategic imperative.

4. Marginal income tax rates

- Marginal tax rates should not be increased beyond their current levels, which are already very high by international standards. A statement of commitment to income tax rate stability would be welcome as part of an overall government message on certainty. This would help allay concerns over competitiveness.

- The differential in the marginal tax rate between the employed and the self-employed should be eliminated. The current position is inequitable and is not supportive of a domestic entrepreneurial culture.

- PRSI continues to be a major cost for business and all efforts must be made to try and minimise this cost, within the boundaries of our current economic constraints. Positive steps were taken in the Jobs Initiative to temporarily reduce employer PRSI for employees earning up to €365 per week. Feedback from business was that the scheme would be worth expanding, as it has worked well. They would also welcome an increase in the earnings limit to €450.

---

[8] *Enterprise Management Incentives* – HMRC website

5. Simplification

- New businesses should be able to avail of a “one-stop-shop” service to help support them with tax and other business issues. Ireland is one of only 9 EU countries which have not yet implemented a “one-stop-shop” procedure for starting up a new company[9]. This service would pay for itself and it would be a more efficient way of providing help that currently comes from a number of separate agencies e.g. Revenue, Enterprise Boards, etc.

- Consideration should be given to a simple micro-tax for the smallest of businesses, as proposed in the Programme for Government. This is currently under consideration in the UK.

- Simplification of administrative procedures should be prioritised for claiming tax reliefs that are of critical cash flow importance to business e.g. the R&D tax credit and the new Employment and Investment Incentive (see below).

---

[9] European Commission website - Start-up procedures under the Lisbon Agenda for Growth and Jobs. Actions in 2010

5. Why Focus on Irish Indigenous Companies?

Their contribution to the Irish economy

Enterprise Ireland's Annual Report for 2010 shows that Irish companies achieved €14bn export sales in 2010. The report also states that Enterprise Ireland client companies support (directly or indirectly) over 300,000 Irish jobs (137,241 directly employed) and spend an estimated €19 billion per annum in the Irish economy.

The evidence shows that profits generated by Irish companies are being re-circulated in the domestic economy. Forfás[10] reported that, for 2009, total direct expenditure in the Irish economy (on payroll costs, Irish raw materials and Irish services) by Irish companies was €18.8bn. This gives rise to a "virtuous circle" effect, whereby economic success becomes self-sustaining.

Supporting Ireland's Entrepreneurs

Entrepreneurs run Ireland's indigenous businesses and they need our support and encouragement.

A Global Entrepreneurship Monitor (GEM) 2010 report[11] for Ireland notes that 77% of early stage entrepreneurs in Ireland have created, or expect to create, some jobs within five years. One in seven (14%) anticipates employing more than twenty or more people within five years. In the GEM Global Report 2010, Ireland is ranked highest of all of the "innovation-driven" economies in terms of innovation among early stage entrepreneurs for the period 2008 to 2010.

However, the GEM 2010 report for Ireland also shows a reduction in the population of entrepreneurs in this country. The report estimates that 800 people set up a new business in Ireland each month in 2010, down from 2,800 people per month during 2008.

Importance of the SME sector

Small and medium sized enterprises (SMEs) are an important sector of indigenous business and they have a huge role to play. The Central Bank[12] has stated that:

> *"Small and medium sized enterprises (SMEs) are a significant feature in the Irish economy, accounting for an estimated 53 per cent of total employment (Q3 2010). Indigenous firms are also more likely to be found in the SME*

---

[10] *Annual Business Survey of Economic Impact 2009* - Forfás

[11] *Entrepreneurship in Ireland 2010* – Global Entrepreneurship Monitor, May 2011

[12] *Lending to Irish Small and Medium Sized Enterprises: Q1-Q3 2010* – Central Bank of Ireland

category, implying they are an important source of retained earnings domestically."

The European Commission estimates that more than 99% of all European business are SMEs. The Commission estimates that SMEs provide two out of every three private sector jobs across the EU and contribute to more than half of the total value-added created by businesses in the EU. It is also estimated that nine out of ten SMEs are micro-enterprises, with fewer than 10 employees.

Potential to increase exports and jobs

As recognised in the Programme for Government, Ireland's economic recovery must be export-led and there is certainly potential for the indigenous sector to grow its export sales. The *Trading and Investing in a Smart Economy* Report[13] notes that at least 85% of Irish exports are from foreign-owned companies.

However, the Irish Exporters Association's annual report of the Top 250 Exporting Companies in Ireland for 2011 shows that exports in the food and drink sector, in which Irish-owned companies are more dominant than foreign multinationals, are growing. The report notes that the food and drink sector, which is highly labour-intensive, accounts for approximately half of all exports from indigenous owned firms.

The stability that can be gained from a strong indigenous sector

Indigenous businesses are not characterised by the same volatility which can be a feature of FDI, as they tend to grow more organically and become more embedded in the local economy. While the immediate impact in terms of an employment boost may not be as great with a home-grown start-up business, this can be outweighed by the growth potential of such enterprises and the entrepreneurial culture which their success can engender.

German Mittelstand

At the same time as we work to remain attractive for FDI, we must be building our own indigenous Irish sector and working to achieve scale and critical mass.

The German small and medium-sized enterprise sector is widely credited with ensuring the resilience of the German economy.

This sector is known as the *Mittelstand,* and it forms the backbone of the German economy. A special report by Businessweek magazine[14] stated that the sector is

---

[13] *Trading and Investing in a Smart Economy* – Department of Enterprise, Trade and Innovation, 2010

[14] *Germany's Mittelstand Still Thrives* – Businessweek, 30 September 2010

comprised of more than 3 million enterprises; it employs more than 70% of German workers and accounts for approximately half of German GDP. The Financial Times[15] identified a number of key elements which have contributed to the success of the sector:

> *"Mittelstand companies, often family-run, have a seemingly simple recipe: a mixture of financial prudence, engineering spirit, long-standing internationalisation and a strategy to hold on to highly skilled workers. The overriding element of their market success is a focus on exports and highly advanced market niches."*

Many of the *Mittelstand* companies are family-owned. A 2008 study by the Family Business Network[16], an international network run by family businesses, found that 79% of all businesses in Germany are family-owned. Family businesses employ approximately 44% of the German workforce. The sector is also characterised by a high degree of continuity between generations. The Family Business Network found that 78% of German family businesses will stay within the family. A report published by the European Commission in 2008[17] noted that the 50 largest German family businesses outperformed the DAX24 by on average 6.8 % for the period 2003-2008. Major German companies which began life as family companies include BMW, Merck and Porsche.

The close relationship between the *Mittelstand* companies and their workforce and local communities has also been identified as a major factor in their success. During the downturn, a government programme called *Kurzarbeit* subsidised companies which retained their staff but cut working hours.

The sector is also sustained by a domestic environment which is supportive of its development. Germany's vocational education approach and its apprenticeship system ensure that companies have ready access to workers; Businessweek noted that *Mittelstand* companies take on 83% of all apprentices in Germany, more than their share of overall employment. The Economist[18] describes the development of local eco-systems:

> *"German universities work hand in glove with researchers at local firms. Suppliers cluster round big manufacturers. Owner-managers rub shoulders with workers."*

---

[15] *The German drive to globalise* – FT.com, 31 May 2011

[16] *Family Business International Monitor* – FBN International, April 2008

[17] *Overview of Family Business Relevant Issues* – European Commission, 2008

[18] *Germany's Mittelstand – Beating China* – The Economist, 30 July 2011

The Washington Post highlights[19] that the sector also benefits from a network of municipally owned savings banks. The chief economist for the German national organisation of savings banks is quoted as saying:

> *"Over the past decade, banking largely became a self-fulfilling activity…But our banks are restricted to doing business in their regions; they have to concentrate on the real economy."*

Many of the *Mittelstand* companies operate in niche markets and produce specialised products. They often have a long-term orientation[20] and a focus on developing sustainable relationships with key stakeholders.

The example of Germany is one which Ireland might want to emulate, and the development of an Irish *Mittelstand* should be a long-term aspiration in order to insulate the economy to the greatest possible extent from future external shocks.

Benefits from identifying Irish "star performers"

Within the indigenous sector it is also important to recognise the potential "star" fledgling companies which might ultimately develop into one of our leading plcs, and ensure that they receive every support and encouragement possible.

Deloitte recently carried out a survey of Irish companies who have been recognised as "Best Managed" by the firm's Awards programme over the past three years. The survey found that 71% of those companies (which together have total revenues of €6.9 billion and employ over 18,800 people) plan to recruit additional staff this year. Over half of the companies surveyed reported that they had expanded into overseas markets in the last year.

The UK also recognises the benefits to be gained from identifying the star performers. The Department for Business, Innovation and Skills reports[21] that 6% of UK businesses with the highest growth rates were responsible for half of the new jobs created by existing businesses between 2002 and 2008. Small and medium sized businesses provide nearly 60% of jobs in the UK and account for 50% of GDP.

---

[19] *How Germany got it right on the economy* – The Washington Post, 24 November 2010

[20] *Financing, Business Strategy, Corporate Governance and Growth of Medium-Sized Business: An Exploratory Comparison of the UK and Germany – ICAEW, August 2009*

[21] *Backing Small Business* – Department for Business, Innovation & Skills, November 2010

6. Research Methodology

The purpose of the research project undertaken by the Institute in compiling this report was to gain an understanding of the key tax issues facing indigenous Irish businesses as they seek to maintain their markets, grow their revenue and secure new opportunities in a challenging economic environment.

Through our members, the Institute has access to a broad network of contacts, and was therefore uniquely positioned to canvass views which are representative of a large cross-section of indigenous Irish enterprise. 26% of the Institute's members are currently employed in the corporate sector. In addition, our members in practice have daily contact with thousands of Irish-owned and foreign-owned businesses and are therefore well-placed to understand the key challenges faced by Irish enterprises.

In this report, the Institute is presenting the key findings of our research with regard to tax policy and administration issues pertaining particularly to indigenous Irish companies. Our contribution in this regard is to communicate the views and findings of the businesses we spoke to and to put some context on them. The combined feedback received from businesses directly and from practitioner members who canvassed feedback, represented at least 100 indigenous Irish businesses.

All of our participants were keen to make a positive contribution to the development of a tax policy that supports domestic enterprise and all are knowledgeable in this area, having first-hand experience of how the system operates in practice.

The methodology adopted in this report consisted of two main elements:

1. Primary research, which involved obtaining feedback from members, industry figures and representatives of State bodies through:

- Face-to-face meetings,
- Telephone discussions, and
- Email correspondence.

2. Secondary research into the tax policy initiatives implemented by competing jurisdictions with a view to supporting indigenous enterprise.

Participation in the study was voluntary and participants were advised that all individual responses would remain confidential. While interviews were conducted primarily face to face, a number were conducted via telephone.

All interviews were carried out in July 2011 and August 2011.

The scope of the research was wide and encompassed a variety of industries including food and drink, construction and engineering, packaging, medical devices and software development.

We also conducted research into the tax systems of Ireland's main competing jurisdictions, with a view to determining how indigenous enterprise is cultivated elsewhere and gaining an understanding of how Ireland can learn from international best practice. The information reviewed as part of this secondary research process was derived from third party publications and other official material, which is recent to within the past few months.

7. Key Research Findings

The tax system can play a central role in fostering a stable core indigenous sector, supporting entrepreneurs and facilitating and encouraging overseas expansion of their business, where possible.

7.1 Current tax system - positive foundations

The feedback from our research was that the foundations of the existing tax system are good. For example, we received positive comment on the existing R&D system and the other tax supports for innovation. There is further analysis later in the report of areas where modifications would be welcome, but overall the view was that the foundations of the system are solid.

The businesses we spoke to were keen that proper recognition be given to what is best about our tax regime for business:

(a) 12.5% corporation tax rate

The ESRI[22] has published research which shows that the reduction of the rate to 12.5% in 2003 has had a significant long-run impact on the business and financial services sector. It was found that, by 2005, exports, output, employment and tax revenue from the sector were significantly higher than they would have been without the reduction in the tax rate.

(b) Relative ease of doing business and paying tax in Ireland

Ireland is the easiest country in the EU (and the seventh easiest country in the world) in which to pay taxes according to a study by PwC, the World Bank and the International Finance Corporation[23]. The country also ranks ninth in the world (and first in the Eurozone) in the World Bank's rankings on the ease of doing business[24].

(c) Support for tax initiatives for innovation

A number of steps have been taken in recent years to introduce and subsequently improve tax supports for research and development and the provision of intellectual property. These advances are discussed further below in this report.

---

[22] *The Macro-Economic Impact of Changing the Rate of Corporation Tax* – ESRI Working Paper 273

[23] *Paying Taxes 2011*: *The global picture* – PwC, the World Bank, IFC, 2011

[24] *Doing Business 2011* – The World Bank and the IFC, 2011

(d) Double Taxation Treaty network

Ireland now has 55 Double Taxation Treaties in effect, compared to 39 treaties in effect in 2000. The network now includes most of the world's major economies and Ireland now has tax treaties in effect with countries which, in aggregate, account for in excess of 80% of world GDP. Details of the Double Taxation Treaties currently in force are included at Appendix I.

(e) VAT

58% of Irish companies surveyed by Deloitte[25] reported that they had expanded into overseas markets in the last year. It is the experience of the exporters to whom we spoke as part of our survey that the VAT 13A procedure is of great benefit to exporters in reducing their compliance burden.

7.2 Certainty

Notwithstanding this positive attitude, the overwhelming message we received from every business we spoke to during this research was the absolute need for certainty and stability in tax policy for the next 3 years.

Taxpayers are currently dealing with extremely fraught economic conditions, over which they have little control, and they are acutely conscious of their susceptibility to a wide variety of external factors.

> *"Increased savings partly reflect the desire of households to reduce their debt but are also prompted by high levels of uncertainty about the future. The latter, in turn, reflect the extent of the deterioration in the labour market, as well as concern about the precise impact of the planned fiscal adjustment on household finances.*
>
> *At this point, it would be beneficial to reduce uncertainty by both deciding on and announcing, in as much detail as possible, the complete set of changes required to Government spending and taxation in order to bring the Government's finances convincingly back onto a sound footing. There is no benefit to be gained by delay in this regard and the sooner the Government can make more detail available of the composition of the full adjustment package, the better."*[26]

---

[25] *The Deloitte Best Managed Companies Awards 2011 Survey Results* – Deloitte, 2011

[26] *Central Bank Governor comments to the Oireachtas Committee on Finance, Public Expenditure and Reform*

The businesses we spoke to raised concerns over changes and reversals in tax policy that have taken place in recent times, as well as measures which these businesses felt had an unfair retrospective effect. The combination of these two factors has caused widespread unease within the business community as people worry about what is going to happen next.

It is notable that, for all of our respondents, this single concern overrode any specific tax issue.

We are not unique in Ireland in the desire for tax certainty:

> *"So it's our intention to introduce a system that puts predictability and stability first; a framework for making tax policy that is:*
>
> - *Not haphazard, but predictable - based upon a clear strategy that produces greater certainty about the future;*
> - *Not disorderly, but stable - focusing on fewer, better developed proposals; getting legislation right the first time round through proper consultation and allowing time for better scrutiny;*
> - *Not opaque, but transparent - explaining our rationale, sharing our analysis and our assumptions"* [27]

Institute proposals on certainty

- A well-thought-out and clearly-communicated tax strategy for the medium term would help allay the fears expressed to us by business and assist in planning and investment decisions.
- It is important that tax policy decisions taken do not have retrospective effect and are not subsequently changed once they are made (for example, the application of PRSI to share awards).
- The Institute welcomes recent comments by the Minister for Finance that certainty will be provided in the Government's 3 Year Plan.

7.3 Exporting and expanding to new markets

The Government has made it clear that Ireland's economic recovery must be export-led and, in that context, it will be essential to ensure that Irish companies expanding into

[27] *The Philip Hardman Memorial Lecture given to the Institute of Chartered Accountants in England & Wales by the Exchequer Secretary to the Treasury, David Gauke MP, in the City of London - 16 November 2010*

overseas markets are encouraged to retain their headquarters in Ireland and to repatriate profits earned overseas to Ireland.

Ambitious Irish companies which reach the limit of their organic growth potential in the domestic economy must be supported in their efforts to grow through acquisition of foreign companies. The tax system should facilitate and incentivise this activity.

Appendix II illustrates the distribution of our exports worldwide. It shows that 60% of our total exports are currently to EU countries with, in fact, 13% to the UK alone. There is enormous potential to expand further in other global markets – for example China, India, Russia etc.

Our respondents had a number of suggestions as to how indigenous companies can be incentivised to expand overseas and how they could be rewarded for taking the associated risks.

Encouraging staff

Irish companies seeking to gain a foothold in overseas markets will often wish to send key staff members overseas on a part-time basis in order to establish local bases. Our respondents note that those individuals would remain in the Irish tax net during their period abroad, which places the Irish company at a disadvantage in low income tax jurisdictions where their competitors use locally-employed staff. It is felt that some tax support would be desirable to compensate workers willing to travel abroad to assist in marketing their company, and Ireland, in other countries. In addition, such a programme would give companies exposure to new ideas and new ways of doing business, not currently being developed in Ireland, and would allow workers to gain new skills.

Sales and marketing costs

Sales and marketing expenditure is a cost of expansion and significant resources are applied by Irish companies in their efforts to reach new customers overseas. While such costs are currently deductible in calculating the taxable profits of the trade, companies expressed the view that an added "above the line" tax deduction would be extremely beneficial to them in their efforts to internationalise their operations and realise their export potential. It would also act as a type of reward for those companies willing to take the risk of overseas expansion.

Institute proposals on exporting and expanding to new markets

- Introduce an initiative to support employees who take the difficult decision to travel abroad for their Irish companies. These are companies which are seeking new customers and working to expand. Appendix II below demonstrates that there is huge potential to be gained by Irish businesses exploring new markets beyond the EU and some encouragement for key sales staff to take these steps would bring rewards for the Exchequer in terms of increased sales and tax revenues at home.

- Again, as part of a strategy to encourage and support businesses to expand into new markets, the Institute is proposing a relief for sales and marketing costs. Ideally the relief would operate "above the line", to reduce PRSI costs or as an offset against PAYE. As noted above, this type of assistance for business is more valuable than a deduction against corporation tax, at a time when many businesses have trading losses.

- First time exporters can often feel daunted by the complexity of overseas VAT rules. It would be useful to provide an information leaflet for them on the common VAT issues that arise for SMEs when they first begin to sell overseas. The Institute would be happy to work with State Agencies on such a project.

7.4 Developing a generation of invention

To achieve our growth targets and help us develop a strong indigenous sector for future generations, Ireland must develop its ability to export through enhanced innovation and intellectual property.

A number of measures have been introduced in recent years to help the growth of technology and the Smart Economy.

(a) The R&D tax credit

This was introduced at the rate of 20% in 2004 using a 2003 base year for expenditure. Since then, the rate has been increased to 25%, the scope has been extended and provision has been made for set-back of excess credits. However, the 2003 base year has remained in place.

(b) The Intellectual Property regime

A capital allowances regime was introduced in 2009 for certain intellectual property type assets. Again, the scope of assets qualifying has been extended somewhat.

(c) Investment in indigenous companies

The Employment and Investment Incentive Scheme (EIIS) was a new incentive introduced in Finance Act 2011 to replace the existing BES and Seed Capital schemes. Its aim is to promote equity investment in certain companies.

These are all important elements of support for the development of Ireland as a hub of innovation and intellectual property and are considered in more detail below, together with a discussion of how inventors can be rewarded and a consideration of the issues surrounding any reform of capital taxes.

7.4.1 The R&D tax credit

The report of the Commission on Taxation[28] stated that *"[a] competitive system for attracting R&D is an integral part of the development of the knowledge-based economy"*. The report of the Innovation Taskforce[29] stressed the importance of placing *"innovation at the heart of enterprise policy"* and of building on our past investments in R&D *"to strengthen the base of knowledge which is an essential element of a successful innovation ecosystem"*.

The importance of the R&D tax credit regime is also acknowledged in the Programme for Government, which contains some specific commitments in this area (discussed further below), such as introducing a volume basis for expenditures under €100,000 and streamlining the applications process. The proposals in the Programme for Government are welcome as it is vital that the system continue to evolve in order to ensure that Ireland is keeping pace with international best practice in this area.

A recent international survey by Deloitte[30] identified 26 countries worldwide which currently operate an R&D tax incentive scheme. In comparative terms, the Irish system is quite competitive as it does not require Government pre-approval in order to qualify for the credit and the credit is not restricted to particular industries, as is the case for a number of other countries. However, the report shows that Ireland is unique among the countries surveyed in operating an across-the-board "base year" system.

Competitor R&D systems

Our main competitor jurisdictions, including the UK, France, the Netherlands, Australia and Canada have R&D tax systems which operate on the volume basis. It is interesting to note that a recent study[31] published by the European Commission found that Brazil and Poland have now replaced France and Ireland in the list of the six most attractive countries for R&D investment by EU companies outside their own home country.

In addition, Australia is currently proposing to move to a tax credit system, instead of the current super deduction system. For companies with an annual turnover of less than AUD 20m, there will be a 45% refundable tax credit. Companies with a turnover of greater than AUD 20m will have access to a non-refundable 40% tax credit. Australia currently has a corporate tax rate of 30%.

---

[28] *Report 2009* – Commission on Taxation

[29] *Innovation Ireland* – Report of the Innovation Taskforce, March 2010

[30] *Global Survey of R&D Tax Incentives* – Deloitte, July 2011

[31] *The 2010 EU Survey on R&D Investment Business Trends* – European Commission, 2011

A number of countries also offer payroll tax initiatives to encourage companies to engage in innovative activities. For example, Belgium offers companies a 75% reduction in payroll taxes for researchers, provided the researchers are engaged in research and development activities and have a qualifying degree. The employee is treated for income tax purposes as if the payroll taxes were deducted at source. In the Netherlands, conducting R&D on applied new technology is also subsidised by reduced payroll taxes in respect of employees engaged in R&D of new products.

Singapore have introduced a Productivity and Innovation Credit (PIC) which provides for a 400% deduction for qualifying expenditure incurred on certain activities, including the leasing or acquisition of certain automation equipment, staff training, acquisition of IP, registration of IP rights, R&D and design.

Key feedback on R&D

Throughout our consultation process, we received the consistent message that a competitive R&D tax incentive system is critical to encouraging entrepreneurial activity and driving the "smart economy".

Our research found that business viewed the R&D tax credit as a very successful element of the Government's "smart economy" strategy. It was widely welcomed when it was initially launched in 2003 and the feedback which we received in respect of recent enhancements to the R&D tax credit system was very positive. In particular, companies welcomed the implementation of a system for monetising the credit, as well as the recent facilitation of the "above-the-line" basis of accounting for the credit.

However, concerns were raised in respect of a number of aspects of the system and these are discussed below:

(a) Volume basis

Our respondents were overwhelmingly in favour of moving to a volume based approach.

It was felt that the incremental approach using the 2003 base year is inappropriate in a period of recession and is acting as a disincentive to continue investing in R&D. The approach also penalises those companies which invested heavily in R&D in Ireland during 2003, companies which effectively led the way in this area. There is an effective volume basis already in place for companies which did not incur R&D expenditure in Ireland in 2003 and it is felt that the scheme would be easier to market and promote if a volume basis were introduced across the board.

As outlined above, the volume based approach is unique to the Irish system, as compared with the schemes operated in our competing jurisdictions.

We note that the Programme for Government commits, subject to a cost benefit analysis, to introducing a volume basis for companies with R&D expenditure of under €100,000, with a marginal relief to apply thereafter.

(b) Administration

A number of our respondents raised concerns in respect of the administrative requirements associated with making an R&D tax credit claim.

The claims procedure is viewed as unnecessarily onerous and is a significant barrier to claiming the credit. This is a recurring issue, as a separate claim is required in respect of each tax year for which the credit is sought, and the documentation requirements are quite burdensome. Accordingly, significant management time and resources, as well as the costs of engaging external advisors, are required to be expended each year, making the process quite costly for taxpayers.

This issue has been recognised in the UK, and in a recent consultation document[32] HM Treasury sets out various proposals for enhancing the R&D tax credit system. Particular emphasis is placed on improving the way in which the system benefits SMEs and incentivises them to conduct R&D. Among the ideas being considered is a voluntary "advance assurance" procedure for smaller companies and new start-ups, whereby those companies could obtain certainty as to whether their projects will qualify for the credit at an early stage. They could then rely on this advance clearance, subject to certain conditions, in order to make their claims for a number of years.

The Programme for Government commits, subject to a cost benefit analysis, to cutting down on "red tape" associated with the applications process and introducing a procedure whereby companies in receipt of a Research, Technology and Innovation (RTI) grant from one of the development agencies will be automatically deemed as entitled to the R&D tax credit.

(c) Education and Promotion of the Scheme

Only 18% of the companies surveyed in a recent study by KPMG[33] have claimed the R&D tax credit. The respondents cited the belief that the credit is not applicable to them as the dominant reason for not making a claim. This concern was also expressed by the companies we spoke to, who felt that the Business Expansion Scheme had been marketed quite effectively by government and that a similar approach could be successfully adopted in respect of the R&D tax credit.

---

[32] *Research and Development tax credits: response and further consultation* – HM Treasury, June 2011

[33] *Take a Closer Look 2010/11 – A Survey of Business Attitudes to Research & Development in Ireland in 2010* – KPMG, 2010

Institute proposals on R&D

- The strong preference of our respondents was that a volume basis be introduced. However, if it is felt that this is not feasible then an alternative suggestion might be to restate the 2003 threshold by reference to deflation. Another option may be to take a project-based approach, whereby a volume basis would be available in respect of new projects undertaken which are significantly different to the research and development activity being undertaken by the company in 2003.

- Streamline the claims process:

    - Review the documentation requirements.
    - Implement the commitment in the Programme for Government and introduce a procedure whereby companies in receipt of an RTI grant will be automatically deemed entitled to the R&D tax credit.
    - Introduce a procedure whereby the taxpayer could make a financial contribution to expedite the claim.
    - Ensure that there is ease of access for taxpayers to officials who can provide appropriate and timely advice.

- A targeted publicity campaign, focusing on the wide-ranging applicability of the credit should be launched in order to encourage uptake. In this regard, the Institute notes the approach of HMRC in Northern Ireland in this area[34] and the success of the Revenue Commissioners here in promoting and managing the BES scheme.

[34] *Your Research Our Support – Research and Development Tax Relief in Northern Ireland* - HMRC

7.4.2 The Intangible Property regime

While the IP regime is recognised as a cornerstone of the country's FDI strategy, its benefits for indigenous companies are equally attractive and it is vital that Irish companies incurring expenditure on IP are encouraged to translate basic research into commercialisation opportunities. International comparisons are instructive in demonstrating how this can be best achieved.

In recent years, a number of European countries have introduced "patent box" or "innovation box" type systems, whereby income from the use of IP is taxed at a lower effective tax rate. This is designed to ensure that basic research is taken to the next level and commercialised. There is no such special tax treatment for IP income in Ireland; provided the company is actively carrying on a trade of managing the IP, the income is taxed at the standard 12.5% rate.

HM Treasury in the UK recently published a "patent box" proposal, which would subject Patent Box regimes in other EU countries are even more attractive:

	Ireland	**United Kingdom**	**Netherlands**	**Luxembourg**	**Belgium**
Tax rate on IP income	12.5%	10%*	5%	5.76%	6.8%

*As proposed

Irish companies should also be encouraged to retain Ireland as their base from which to license and make the most of IP assets. We received feedback that the capital allowances method of relief can cause difficulties and that a "patent box" type system would be more manageable, while achieving the same end result in terms of the effective tax rate applicable to income from IP.

Institute proposals on IP

- The strong preference of our respondents was for the introduction of a "patent box" for income derived from the use of IP.
- If this is not achievable in the short term, then an alternative would be to remove the 10-year claw-back period and to ensure that the asset would continue to qualify for capital allowances for as long as it remains valuable in the business.

7.4.3 Investment in indigenous companies

The Employment and Investment Incentive Scheme (EIIS) was a new incentive introduced in Finance Act 2011 to replace the existing BES and Seed Capital schemes. Its aim is to promote equity investment in certain companies.

The introduction of the new scheme was broadly welcomed by the companies we spoke to and it was recognised that it contains a number of features which make it more attractive than the schemes it is replacing. Respondents expressed their approval of the broader application of the new scheme and the signals that it would be comparatively simpler to claim than its predecessors.

However, some concerns were expressed at the apparent complexity of the legislative provisions governing the scheme; the relevant section of Finance Act 2011 ran to 60 pages – over one quarter of the entire Act. It is hoped that some simplified guidelines will be issued regarding the application of the scheme and the procedure for making a claim. It is noted that the EIIS is subject to EU approval, and it then requires a Ministerial Commencement Order to give it effect. EU approval has not yet been granted, and we understand that the existing BES and Seed Capital schemes remain in force until such time as this approval is forthcoming.

The UK offers an "Entrepreneurs' Relief" which allows individuals to claim relief on qualifying gains, up to a certain limit. An "Enterprise Investment Scheme" is also in place, which is *"designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies"*[35].

Institute proposal to promote investment in indigenous companies

- The announcement of the EIIS scheme in Budget 2011 was welcome and we urgently await EU approval of the scheme. The legislation underpinning the relief is even more complex than the predecessor BES regime and the hope is that the relief will be well explained to businesses by government and a simple claims procedure will be adopted.

- The UK operates "Enterprise Management Incentives" (EMI) which are tax advantaged share options "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"[36]. It may be worth considering such a proposal in Ireland.

[35] *Enterprise Investment Scheme* – HMRC website

[36] *Enterprise Management Incentives* – HMRC website

7.4.4 Rewarding invention

The blanket abolition of the patent royalty exemption in Finance Act 2011 has had adverse cash flow consequences for entrepreneurs and companies who were availing of the relief. The impact on innovative individuals and the corporation tax burden on innovative companies was a cause of concern for a number of the businesses we spoke to. Their view was that a gap now exists whereby there is no form of initiative available to reward the individual efforts of inventors and those involved in innovation.

The companies we spoke to would like to see the introduction of initiatives which could help them attract and motivate key employees. This is particularly the case in the computer software industry, where it is extremely difficult for domestic companies to compete with their multinational competitors on salary levels.

As noted above, there are now welcome initiatives such as the R&D tax credit and the IP regime, which encourage innovation at the business level, but there is no equivalent income tax reward whereby individuals can be rewarded for engaging in productive innovative activity.

Institute proposal on an alternative for rewarding invention

- There is currently a gap in the innovation agenda, with no facility whereby employees engaged in innovative activity are encouraged to do this work. An initiative would be welcomed to fill this gap. It should be targeted and focussed and could be subject to certain conditions. For example, a cap could be imposed on the income that qualifies.

7.4.5 Capital taxes

As well as the issues highlighted above, which are specific to the innovation agenda, many of the entrepreneurs that we spoke to raised concerns over the future growth of their businesses, the need to pass on the businesses to the next generation and the uncertainty that exists at the moment over the capital tax regime.

These concerns were raised in light of the proposals in the National Recovery Plan and the commitments under the EU/IMF Programme of Financial Support for Ireland to reform CAT and CGT.

If we aspire to a more stable ***Mittelstand*** in Ireland for the reasons set out above, it is important that family businesses are passed down through our generations rather than being sold out to multi-nationals or indeed being broken up, due to the capital tax burden. To protect and grow Irish jobs we must allow entrepreneurs to grow their businesses, and the entrepreneurs we spoke to were clear that taxes on capital are of as much, if not more, consequence to them as taxes on income.

The lack of clarity surrounding the proposals for reform of CGT and CAT is causing concern and entrepreneurs would welcome a commitment from Government that the tax rates for business transactions will not be increased and that the business reliefs will not be curtailed.

Institute proposal on capital taxes

- Any reform of CGT and CAT must be fully thought out before being implemented and it must take into account the impact on business growth and family succession. Our priority at present is to create jobs and our capital taxes policy must reflect this overall strategic imperative.

7.5 Marginal income tax rates

Feedback we received from smaller companies was that many are struggling to pay employer payroll costs - primarily PRSI, combined with the current levels of minimum wage. Such companies will have competitors who are operating in jurisdictions with lower payroll tax burdens. The burden of employer PRSI was cited by a number of respondents as a significant barrier to the hiring and retention of personnel.

The companies we spoke to firmly believe that marginal income tax rates can go no higher i.e. we have reached the "tipping point" with income tax rates. A number of respondents expressed the concern that skilled professionals and other high-potential entrepreneurs may relocate to lower-tax jurisdictions if the income tax burden is further increased. It is not just the headline income tax rate but the marginal rate (including PRSI and the Universal Social Charge (USC)) that will be of concern to entrepreneurs wishing to remain in Ireland. The aggregate marginal rate (inclusive of income tax, PRSI and USC) is 52% for employees but 55% for the self-employed. This 3% effective surcharge on the self-employed is acting as a disincentive to those who wish to start their own businesses and is therefore hindering entrepreneurial activity, as evidenced by the GEM statistics quoted above.

Feedback from the study also shows that marginal tax rates are impacting on staff willingness to work overtime and thus productivity is impacted.

There have been significant increases in marginal tax rates for the employed and self employed since 2007.

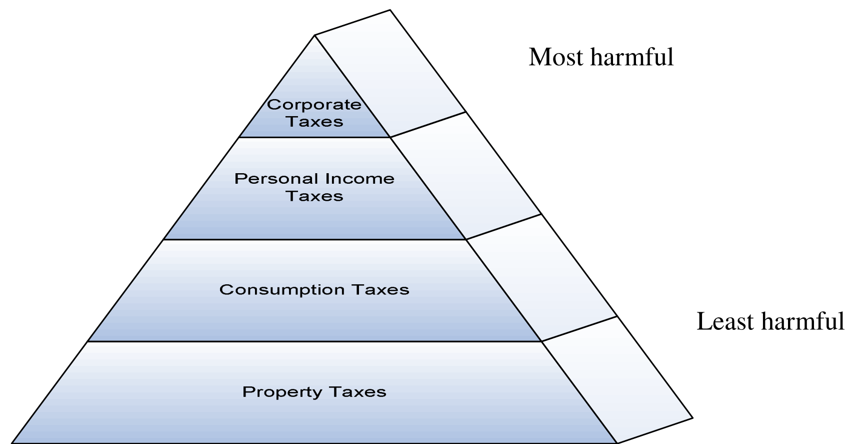
	Employed	**Self Employed**
Budget 2007	43.5%	46.5%
Budget 2008	43.5%	46.5%
Budget 2009	46.5%	49.5%
Supplementary Budget 2009	52%	55%
Budget 2010	52%	55%
Budget 2011	52%	55%

Our marginal tax rates are now amongst the highest in the OECD and this is a disincentive for work.

- The OECD[37] has noted that :

> *Taxes on immobile bases, such as property, and consumption are less distortive than those on factor income (such as personal and corporate income). Income tax hikes have a bearing on growth, because they influence labour utilisation (by affecting decisions on labour force participation and hours worked) and productivity (through incentives for human capital accumulation).*

[37] *Preparing Fiscal Consolidation* - OECD



OECD "Hierarchy" of Taxes – most harmful for growth

The Programme for Government commits to maintaining the current rates of income tax, together with the current bands and credits. However, the EU/IMF Programme of Financial Support for Ireland, dated 16 December 2010, stated that personal income tax bands and credits will be lowered, as part of the Government's revenue raising programme for Budget 2012. Given the number of rate changes that have occurred in the past number of years (see the table above), this is one of the key policy areas where certainty of treatment for the next 3 years is required.

Institute proposals on the marginal income tax rates

- Marginal tax rates should not be increased beyond their current levels, which are already very high by international standards. A statement of commitment to income tax rate stability would be welcome as part of an overall government message on certainty. This would help allay concerns over competitiveness.

- The differential in the marginal tax rate between the employed and the self-employed should be eliminated. The current position is inequitable and is not supportive of a domestic entrepreneurial culture.

- PRSI continues to be a major cost for business and all efforts must be made to try and minimise this cost, within the boundaries of our current economic constraints. Positive steps were taken in Finance (No.2) Act 2011 to temporarily reduce employer PRSI for employees earning up to €365 per week. Feedback from business was that the scheme would be worth expanding, as it has worked well in their experience. They would also welcome an increase in the earnings limit to €450. This is an example of assistance that is provided "above the line" which is very useful in cash flow terms for business.

7.6 Simplification

For the businesses that we spoke to in the "start-up" phase, their tax priority was simplicity and ease of doing business. Tax is very daunting for a new business and the most practical way we can help these entrepreneurs is to provide them with information and support so that their fledgling business gets off the ground.

It is notable that Ireland is one of only 9 EU countries which have not yet implemented a "one-stop-shop" procedure for starting up a new company[38].

Our respondents also welcomed the proposal in the Programme for Government to introduce a Single Business Tax for micro-enterprises – an idea raised by the Institute last year at an appearance before the Joint Oireachtas Committee on Economic and Regulatory Affairs on 30 November 2010.

A number of simplification initiatives have been adopted internationally and might be worthy of consideration by government. These initiatives are outlined in Appendix III.

Institute proposals on simplification

- New businesses should be able to avail of a "one-stop-shop" service to help support them with tax and other business issues. Ireland is one of only 9 EU countries which have not yet implemented a "one-stop-shop" procedure for starting up a new company. This service would pay for itself and it would be a more efficient way of providing help that currently comes from a number of separate agencies e.g. Revenue, Enterprise Boards, etc.

- Consideration of a simple micro-tax for the smallest of businesses.

- Prioritise simplification of the administrative procedures for claiming tax reliefs that are of critical cash flow importance to business e.g. the R&D tax credit and the new Employment and Investment Incentive.

[38] European Commission website - Start-up procedures under the Lisbon Agenda for Growth and Jobs. Actions in 2010

Appendices

Appendix I - Double Taxation Treaties

Considerable progress has been made over the past decade in expanding Ireland's Double Taxation Treaty network. Ireland has now signed tax treaties with 63 countries, of which 55 are in effect, compared to 39 tax treaties in effect in 2000. The network now includes most of the world's major economies and Ireland now has tax treaties in effect with countries which produce, in aggregate, over 80% of world GDP.

GDP of Top 100 Countries

		GDP US$m
1	United States	14,582,400
2	China	5,878,629
3	Japan	5,497,813
4	Germany	3,309,669
5	France	2,560,002
6	United Kingdom	2,246,079
7	Brazil	2,087,890
8	Italy	2,051,412
9	India	1,729,010
10	Canada	1,574,052
11	Russian Federation	1,479,819
12	Spain	1,407,405
13	Mexico	1,039,662
14	Korea, Rep.	1,014,483
15	Australia	924,843
16	Netherlands	783,413
17	Turkey	735,264
18	Indonesia	706,558
19	Switzerland	523,772
20	Poland	468,585
21	Belgium	467,472
22	Sweden	458,004
23	Norway	414,462
24	Venezuela, RB	387,852
25	Austria	376,162
26	Saudi Arabia	375,766
27	Argentina	368,712
28	South Africa	363,704
29	Iran, Islamic Rep.	331,015
30	Thailand	318,847

31	Denmark	310,405
32	Greece	304,865
33	Colombia	288,189
34	Finland	238,801
35	Malaysia	237,804
36	United Arab Emirates *	230,252
37	Portugal	228,538
38	Hong Kong SAR, China *	224,458
39	Singapore	222,699
40	Egypt, Arab Rep.	218,912
41	Israel	217,334
42	Ireland	203,892
43	Chile	203,443
44	Philippines	199,589
45	Nigeria	193,669
46	Czech Republic	192,152
47	Pakistan	174,799
48	Romania	161,624
49	Algeria	159,426
50	Peru	153,845
51	Kuwait *	148,024
52	Kazakhstan	142,987
53	Ukraine	137,929
54	Hungary	130,419
55	New Zealand	126,679
56	Vietnam	103,572
57	Bangladesh	100,076
58	Qatar	98,313
59	Morocco *	91,196
60	Slovak Republic	89,034
61	Angola	84,391
62	Iraq	82,150
63	Cuba	62,705
64	Libya	62,360
65	Sudan	62,046
66	Croatia	60,852
67	Syrian Arab Republic	59,103
68	Ecuador	58,910
69	Luxembourg	55,096

70	Belarus	54,713
71	Dominican Republic	51,577
72	Azerbaijan	51,092
73	Sri Lanka	49,552
74	Slovenia	47,763
75	Bulgaria	47,714
76	Oman	46,114
77	Tunisia	44,291
78	Guatemala	41,190
79	Uruguay	40,265
80	Lebanon	39,155
81	Serbia	39,128
82	Uzbekistan	38,982
83	Lithuania	36,306
84	Costa Rica	34,564
85	Kenya	31,409
86	Ghana	31,306
87	Ethiopia	29,717
88	Jordan	27,574
89	Panama	26,777
90	Yemen, Rep.	26,365
91	Cyprus	25,039
92	Latvia	24,010
93	Tanzania	23,057
94	Côte d'Ivoire	22,780
95	Cameroon	22,394
96	El Salvador	21,796
97	Macao SAR, China	21,736
98	Turkmenistan	21,074
99	Bahrain	20,595
100	Trinidad and Tobago	20,398

* Treaty signed but not yet in effect

Source: World Development Indicators database, World Bank, 1 July 2011

Appendix II - CSO External Trade Statistics

	Exports
Country	**Jan-May 2011**
	€million
Great Britain	5,041
Northern Ireland	562
Austria	126
Belgium	6,042
Bulgaria	18
Cyprus	10
Czech Republic	235
Denmark	175
Estonia	6
Finland	121
France	2,165
Germany	2,704
Greece	132
Italy	1,308
Latvia	25
Lithuania	17
Luxembourg	23
Hungary	83
Malta	10
Netherlands	1,344
Poland	243
Portugal	181
Romania	139
Slovakia	26
Slovenia	10
Spain	1,246
Sweden	345
EU Country not specified	4
Total EU	**22,336**
of which EuroZone	15,454
Australia	305
Brazil	112
Canada	268
China	946
India	83
Japan	690
Malaysia	177

Mexico	212
Norway	236
Philippines	59
Russia	231
Saudi Arabia	228
Singapore	236
South Africa	124
South Korea	141
Switzerland	1,449
Taiwan	68
Thailand	55
Turkey	222
USA	9,083
Other countries	1,215
Country unknown	20
Unclassified estimates	68
Total	**38,565**

Source: CSO External Trade Statistics, 23 August 2011

Appendix III – Tax Simplification: International Initiatives

Australia

Small businesses can avail of simplified tax depreciation rules, whereby assets can be pooled in order to make depreciation calculations easier. A full deduction may also be claimed for most assets costing less than AUD$1,000 each.

The entrepreneurs tax offset (ETO) is a tax offset equal to 25% of the income tax payable on business income of businesses with a turnover of AUD$50,000 or less.

New Zealand

Simplified rules for deducting legal expenditure were introduced from 1 April 2009. Business-related legal expenditure up to a maximum of NZD$10,000 per annum can be deducted, without needing to distinguish whether the expenses are revenue or capital in nature.

Hungary

Certain SMEs may deduct 40% of their interest costs from their tax liability, subject to a cap.

The Netherlands

The carry-back period for losses has been extended from one year to three years for corporate taxpayers.

Profit exemption for SMEs – increased from 10.5% to 12% as of 1 January 2010. A minimum criterion for spending time on a business was also dropped, facilitating those who wish to carry on their business alongside salaried employment.

United Kingdom

Significant progress is being made in the area of simplifying procedures for small businesses in the UK, with the establishment of the Office of Tax Simplification (OTS) in July 2010. The OTS is currently carrying out a review of small business taxation, and it published its interim report[39] in March of this year, which identifies as a key aim the introduction of a radical new approach to taxation for the very smallest unincorporated businesses.

Small businesses in the UK have enjoyed the benefits of the 4-page Short Tax Return since 2005.

---

[39] *Small business tax review* – Office of Tax Simplification, March 2011

Small businesses can avail of a VAT flat rate scheme. The flat rate scheme is designed to simplify VAT compliance for small businesses. Under the scheme, taxpayers calculate their VAT liability by applying a single percentage to their turnover in a VAT period. The scheme assists with cash flow planning and it is of particular benefit to those businesses whose customers are not VAT-registered.