ISME
Pre-Budget Submission
2019

THINK SME

To be presented to

Minister for Finance

Paschal Donohoe, T.D.

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INTRODUCTION

ISME, the Irish Small & Medium Enterprises Association, represents in excess of 10,500 SME businesses throughout the Republic, employing more than 245,000. We are an INDEPENDENT body representing owner managers of small & medium businesses in Ireland. We are independent because we rely solely on the resources of our members, not on banks, semi-states, or big business. We are the only independent representative body for SMEs in Ireland.

Our recommendations are primarily focussed on SMEs and in particular, owner managers. SMEs account for 99.7% of all enterprises in Ireland and account for 70% of all private sector employment. ***Some 930,000 (plus) of Ireland's 2m workforce are employed by an SME.***

The Irish economy continues to grow at the fastest rate in Europe. However, there exists a number of internal and external macro factors which cannot continue to be ignored by policy makers in shaping our fiscal policy:

- *Ireland remains a very heavily indebted country, especially when debt is considered relative to GNI*.*
- *Ireland is approaching full employment, but has severe bottle-necks in delivery of housing and infrastructure, presenting a material risk of over-heating.*
- *The Irish tax-base has narrowed markedly, and is overly dependent on income taxes from a minority, and corporation taxes from a very small number of potentially itinerant companies.*
- *Ireland's slippage from 6th to 12th placing in the IMD Competitiveness Ranking comes at a time when Ireland was never so dependent on relative competitiveness.*
- *A collective amnesia of how the fiscal and property crashes of 2008-10 occurred in Ireland has infected the trade unions, the public services, and a plurality of Oireachtas members.*
- *While trends in the UK suggest a softer Brexit, the political atmosphere is so febrile that it would be unwise to presume an orderly British withdrawal from the EU.*
- *The political and macro-economic situation in Italy threatens the stability of the euro.*
- *US trade and tax policies are volatile, and threaten the repatriation of substantial amounts of what are currently Irish corporation tax receipts. Congress has substantially diluted the Dodd-Frank Act, undermining the robustness of tier-two US banks.*
- *While there is no apparent appetite among the actors for trans-national confrontation, the conflicts in Syria and Yemen, and the actions of external forces such as Iran, Saudi Arabia, Turkey, Israel, Russia, and the United States, have elevated the possibility of widespread warfare in the Middle East and Persian Gulf. This, and the ongoing political chaos in Venezuela, have already impacted energy prices, which have been stable at relatively low levels for a long time.*

While none of the above threats may come to pass, or otherwise hurt Ireland, our debt position means that the Government would struggle to execute a counter-cyclical fiscal policy if the country's macro-economic environment disimproved. It therefore makes no sense for us to continue borrowing at the present time. Ireland should plan to run budget surpluses for the next number of years. As ISME pointed out last year, ***while it is acceptable to hope for the best, it is prudent to prepare for the worst.*** The recommendations made in this submission represent the key priorities of ISME members for Budget 2019.

EXECUTIVE SUMMARY

While we believe all the foregoing to be important, we consider the following measures to be the SME sector's priorities for Budget 2019:

1. Implement in full the 20 key tax recommendations made by the Irish Tax Institute.
2. Reduce the ***punitive 23% VAT*** rate to 21%, and retain the 9% rate.
3. Our taxes on property, **commercial rates and LPT**, need to be brought up to date and made fit for purpose.
4. ***Spending on infrastructure*** should be prioritised above current account spending, and should rise to 4% of GNI*. Capital expenditure must take priority over increasing current expenditure. We should nationalise the wholesale telecoms distribution network, in the same way as we do the electricity grid.
5. Our ***Inheritance Tax*** regime must be updated, both to increase yield, to encourage more intensive use of assets, and to incentivise the scaling up rather than sale of family businesses.
6. In light of the critical importance of international competitiveness for a small open economy, we recommend an ***increased scope for the Irish Fiscal Advisory Council (IFAC)***, to include in their remit ongoing commentary on the work of the National Competitiveness Council (NCC), so that the NCC has an external advocate.
7. Our ***further education and training*** regime is not consistent with activating a bigger workforce, or training the unskilled. Ireland's performance on NEETs[1] is markedly worse than the OECD average. We must divert spending from non-performing programs towards those which will expand our workforce in size, learning and expertise.

TAXATION

Irish Taxation Institute Proposals

The Irish Taxation Institute is the pre-eminent body in the provision of expert tax advice in Ireland. ISME wholeheartedly endorses their 20 Key Tax Recommendations,[2] but re-orders them as follows, consistent with the views of our members:

1. **A Tax Strategy** is required which will positively support and shift Ireland's export strategy. (ISME comment: our tax strategy appears to have been developed with foreign-owned MNCs in mind only. We need to address this with a tax strategy that encourages, not penalises, growth in the indigenous enterprise sector)
2. We need an end to the **tax disparities and discrimination against the self-employed.** Those who create employment and wealth in the economy should not be punished by the PAYE and USC systems for doing so.
3. Our **CGT rate at 33%** is fourth highest in the OECD, and negatively impacts investment and scaling in Irish businesses. No
4. **Entrepreneur relief is too tightly restricted to owner-managers,** and discourages external investors from the possibility of a lower CGT rate. This restriction should be removed, and the €1m lifetime threshold for entrepreneur relief also needs to be increased to a minimum of €10m.
5. The progressivity of our **marginal tax rates** above the average industrial wage discourage personal advancement, upskilling and promotion.
6. A workable share-based employee scheme is also required for SMEs to enable them to attract and retain the best talent. The **KEEP scheme** introduced last year is too complicated and restrictive for use by SMEs.
7. The administrative blockers for businesses in claiming the **R&D tax credit** must be removed. As with the KEEP scheme, the structuring of the R&D tax credit discourages or prevents SMEs from applying for it.
8. Similarly, the **Knowledge Development Box (KDB)** has not been developed with SMEs in mind. It needs to be made simpler to avail of.
9. Ireland has a limited number of individuals who have funds to invest in business through the **Employment and Investment Incentive (EII)**. SMEs are too reliant on the pillar banks, and need a more diverse range of finance options. The annual cap of €150,000 for investors should be lifted towards the equivalent in the UK of Stg£1m investment limit.

[1] https://www.oecd.org/ireland/sag2016-ireland.pdf

[2] A future tax strategy to grow Irish indigenous exports June 2017, Chapter 11

10. **The EII income tax relief for investors is also split into two tranches –** 30% in the year of investment and an additional 10% after three years. This split relief concept reduces the attractiveness of the EII and should be removed.
11. **EII rules require the investor to hold less than 30% of the company's shares**, denying relief to the founder shareholder, who may want to inject more funding into the business. This restriction should be removed from our regime.
12. Limitations on **outsourcing in the R&D tax credit regime** restrict collaboration among Irish businesses and between businesses and third-level institutions. These restrictions do not exists under the OECD Modified Nexus rules and should be removed.
13. The **Start-Up Refunds for Entrepreneurs (SURE)** scheme should be extended to include new business founders who were previously self-employed and are starting up another business.
14. **Dividend income is taxed at high marginal personal tax rates of up to 55%**, which does not encourage equity investment in Irish business. Introduce a lower flat rate of taxation on dividend income.
15. Consider **a new talent regime similar to SARP** but targeted at SMEs.
16. **Close the gaps in Ireland's double taxation agreement (DTA) network across Latin America, Africa and southern Asia.**
17. The **Foreign Earnings Deduction (FED)** reduces the income tax bill of employees travelling to develop exports in 30 countries. The range of qualifying countries should be broadened.
18. **Companies sending employees abroad short-term, often experience difficulties with tax, payroll, and double taxation** issues. A streamlined approach to tax compliance is needed.
19. Uncertainty about the **tax treatment of travel expenses** is creating concern for some workers sent abroad. Legislation in this area urgently needs to be brought up to date to deal with this issue.
20. Last but not least, we consider the Irish Tax Institute's suggestion for an **information campaign explaining both the tax policies in the strategy** to be worth pursuing by the Revenue.

ISME Taxation Proposals

In addition to the Irish Taxation Institute proposals above, we consider the following to be essential for the SME sector:

VAT

The top rate of VAT is acting as a disincentive to spend in the economy. The **headline rate of VAT should be reduced from 23% to 21%.**

There has been much recent criticism of the 9% VAT rate given to the tourism and hospitality sectors. This is a Dublin-centric criticism. While the tourism and hospitality are doing very well in the capital, this is less true beyond it. Given our status as a very high-wage economy, the 9% rate has gone some way to maintaining competitiveness and stimulating demand. It must be retained as a permanent rate and should be expanded to all labour-intensive industries.

School Uniforms over a certain size currently attract VAT of 23%. All School Uniforms, of whatever size, should be zero rated for VAT purposes.

Property Taxes

Commercial Rates and Local Property Taxes are technically linked, in that they are both based on what are effectively 'retail' valuations for property. The legislative basis for our rates system dates from 1898, and is unfit for purpose. Our members are willing to consider updated rates calculations systems. The current rates system requires substantial overhaul before it threatens business viability. It discriminates against town-centre operators, and encourages donut development, contrary to Project Ireland 2040.

Similarly, LPT is based on an open-market valuation basis, which penalises urban-dwellers, and those who invest in and upgrade their homes. LPT discourages densification and urbanisation, both key objectives in the National Planning Framework for Project Ireland 2040. The **current structure of commercial rates and LPT make a nonsense of Government strategy** and must be addressed soon.

Capital Acquisitions Tax (CAT)

CAT was introduced in 1975 as an inheritance /gift tax with a threshold of the equivalent of €190,461. If indexed at the CPI rate, this would now equate to over €1.3m, instead of the current €310,000 ('Group A'). The effect of this is to diminish the attractiveness of intergenerational transfer of business, and is one of the reasons so few Irish family businesses reach the scale of their continental cohorts.

There is a 90% CAT relief in the transfer of business assets from one generation to another. But this only applies where control of the business transfers at the same time. This is neither possible nor desirable in all cases. In many cases the first generation retains title in property, in order to maintain a post-retirement pension. If family-owned Irish business are going to 'scale not sale' then **CAT measures similar to those employed in Europe[3] must be adopted here**, as they already are in the treatment of family farms.

SPENDING

Infrastructure

The Global Innovation Index[4] ranks Ireland's gross capital formation at 60th of 128 countries. This would be acceptable if we had a well-developed national infrastructure, which Ireland does not.

Ireland has a shortage of affordable housing, and critical underinvestment in its potable and waste water infrastructure. It has under-developed high-capacity urban transport networks. It remains dependent on fossil fuels for energy generation. It has yet to complete its inter-urban motorway network. The National Broadband Plan is not advancing at an acceptable rate.[5]

The domestic economy continues to struggle and is in need of an investment stimulus. Well-planned infrastructural projects could help to boost jobs, spending and consumer sentiment. It is also a key competitiveness issue and is important in attracting FDI to Ireland. Capital investment is a far higher priority for Ireland than current expenditure. **Capital Infrastructure investment for 2019 and following years should be set at a rate of 4% of GNI***.

Conscious of our position on fiscal prudence, we suggest that capital expenditure is categorised into short, medium and longer-term priorities, with a view to elongating state expenditures in a counter-cyclical fashion.

Broadband

In our view, the National Broadband Plan (NBP) has simply not delivered on its promises, and the outlook remains uncertain.

In view of the fact that the State has not sold the national electrical or gas distribution networks, and the sclerotic pace of broadband rollout, ISME has strong reservations about the emerging NBP proposition, which is based around three geographically distinct broadband providers. There is a risk of three micro-monopolies emerging. There is also a risk of network duplication, which will be cost-additive for the market.

Strong telecommunications infrastructure is a strategic national asset. After decades waiting for an efficient solution to emerge from the market, ISME believes that the wholesale distribution network should be bought back by the State and nationalised. We consider the sale of distribution network when Telecom Éireann was privatised to have had catastrophic consequences for the market. Now is the time to reverse that decision. We can't afford to wait any longer, and the wholesale market in Ireland does not function for consumers or businesses.

We need a strong core infrastructure owned by and managed by a company like Eirgrid, providing open access to all qualifying companies on a pay-for-play basis. Fixing a fair value to the wholesale network would be difficult, but not impossible. We estimate it to be in the €1.5-€2bn range. In view of the fact that it would be immediately leased to operators, we believe it would not impact the government balance sheet.

Encouraging the Green Economy

Ireland will not meet its greenhouse gas (GHG) reduction targets as the economy improves. The DCCAE commitments to supportive tax policies in its National Mitigation Plan are aspirational and non-specific. The type of aggressive tax incentive measures that are already under way in Norway are merely 'under consideration' in the National Mitigation Plan. This is the unfortunate consequence of taxing the motoring sector so heavily over the decades: The Exchequer is reluctant to countenance any move away from CO2-intensive transport because of considerations of revenue forgone.

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[3] Western Europe aligned on tax treatment of Family Business transfer (PWC April 2015)

[4] https://www.globalinnovationindex.org/gii-2017-report

[5] https://www.siliconrepublic.com/comms/national-broadband-plan-delays

The SME sector can play an active role in assisting the State if it is appropriately encouraged to do so. Those technologies which can markedly reduce energy consumption, such as LED lighting, should be incentivised with measures such as reducing or removing the recycling charge, and preferential VAT rates. The Government should be willing to consider use of the VAT system to further stimulate the sale of low-consumption technologies. The recently reported confirmation by Revenue that it intends to view car-charging at work as a BIK runs entirely counter to Government policy, and must be overturned. Until electric options become deeply and cost-effectively embedded in society, tax policy will have to be used as an instrument to encourage it.

Similarly, the current methodology for calculating the PSO levy (which is under review by DCCAE as part of the Integrated Single Electricity Market (I-SEM) project) runs counter to Government policy on encouraging uptake of low-carbon technologies. Until this review is completed, the PSO levy must be frozen.

National Training Fund

As part of its Spending Review 2017, DPER completed an 'Analysis of Further Education and Training by Education Training Boards.' Its conclusions are concerning. The National Training Fund (NTF) was established in 2000 "to give skills to, or raise skills amongst those in, or seeking employment."

Employers pay for this National Training Fund through a levy on employers of 0.8% of employees' reckonable earnings collected through the employer's PAYE/PRSI system.

There needs to be a substantial re-balancing of education spending away from third-level and university-delivered education towards skills-based training and life-long learning.

OTHER

Review of Indigenous Industrial Policy

There is now a consensus among trade and economics professionals that Ireland's economic policy remains too heavily invested in the multi-national corporation sector. While ISME is first to acknowledge the contribution from this sector to corporation and payroll tax receipts, and to high levels of disposable income, the sector remains very exposed to externalities such as US trade and tax policy. As far back as 1982, the Telesis Report argued that Irish industrial policy was excessively focussed on mobile investment from abroad, at the expense of indigenous industry. Similarly, the Culliton Report of 1992 argued for the creation of an agency solely devoted to Irish industry. While we now have Enterprise Ireland, we lack a national vision of what policy prescriptions indigenous enterprise should follow in order to allow them to scale, and to decrease our importance on MNCs.

ISME has argued since 2003 for a fundamental review of indigenous industrial policy. We believe the case has never been stronger than now to institute one.

Statutory Redundancy Rebate

One of the unintended effects of making redundancy more expensive or difficult for employers is that they are less likely to hire employees, and more likely to use agency or contracted labour. The Global Innovation Index[6] places Ireland 56th (of 128 countries) for ease and cost of redundancy.

The Government reduced the rebate on Statutory Redundancy in 2012, and eliminated it in 2013. This was a mistake. Employers always had liability for a proportion of Statutory Redundancy payments, but the State provided an 'insurance policy' via the social fund to pay the balance. The employers' contribution to this fund was set at 0.5% (recovered via PRSI) in the Redundancy Payments Acts 1979. **This contribution was not terminated when the rebate ended.**

The employers' payments to the redundancy fund generated a substantial surplus over the fund's liabilities. In 2002, the then Department of Social Welfare paid a dividend of €635m to the Exchequer. The removal of a rebate (which employers were already paying for) was wrong, although done in the teeth of the recession. This justification no longer exists. The Statutory Redundancy rebate should be reinstated at its 2012 level (60%). Failing this, the requirement to pay statutory redundancy should be eliminated, or, employers' PRSI should be reduced by 0.5% in lieu.

[6] https://www.globalinnovationindex.org/gii-2017-report

Peer to Peer Lending

While SME access to credit has eased somewhat, the marginal cost of access remains high, and Ireland remains overly dependent on the pillar banks for SME finance. Yet there are many fine peer-to-peer lenders in the Irish market, which operate without local regulation, although some are regulated in the UK.
The **unregulated status of local P2P lenders makes investing in P2P lending less attractive**. The UKs Financial Conduct Authority has regulated P2P lending in the UK from April 2014. These regulations could act as a template.

Public Sector Reform

Public sector pay and pensions now account for more than one-third of all current spending, yet there is widespread public dissatisfaction with the efficiency, effectiveness and quality of services delivered in the Health, Education and Justice sectors.
The gap between public and private sector pay[7] is an established factual and statistical reality. The current 'restoration' process means that public sector pay as a proportion of total government spending is accelerating faster than it did during the boom. **The State should commit to reducing this gap to 10% by 2025.**
The issue is no longer merely fiscal, it is moral. The continued unchallenged diversion of State resources into public service current expenditure represents an unjustified transfer of wealth from the poorer, exposed majority to the cosseted minority, at the expense of infrastructural spending, and the future generations who will have to repay our profligacy. A decade after we sustained our last fiscal crash, we are steadily building towards another.
If it comes to a choice between widespread and damaging industrial unrest, or a repeat of the fiscal crash of 2008-2010, the former is far preferable to the latter. We can, through a continued focus on productivity and reform deliver a world class public service that plays a necessary and strategic role in the economy.
The Public Sector Pay Commission should confine any of its recommendations on public sector pay to those areas which show under-payment by comparison to international benchmarks. International benchmarking was promised in the first phase, but was not completed.

Labour Force Activation: Disability Sector

As Ireland approaches full employment, we can **ensure the workplace activation of this under-used cohort of workers** with four simple measures:

1. Amalgamate all the current supports into one overall grant that will cover everything needed to accommodate an employee with a disability at work - Workplace Access Grant.
2. Minimise the financial risk for employers. The current structure means that an employer is expected to employ and pay a person with a disability who is unable to take up the offered work until their supports are in place.
3. Remove the onus from the employer to apply for grant support and empower the jobseeker with a disability to seek work with their supports already in place. The employee with a disability should be fully equipped for their own employment and career prospects without the need to engage an employer in the process.
4. Allocate €250,000 to the Employer Disability Information (EDI) service, to allow it to meet employers and educate them on inclusive employment; grow the EDI website to include employer toolkits, case studies, and guides; and run a marketing campaign to challenge employers' attitudes to the recruitment and retention of workers with disabilities.

Pensions

The size of the unfunded deficit in State pensions is estimated at €450bn, composed of a public sector liability of approximately €115bn, and a social fund liability of approximately €335bn (KPMG valuation as of 2015). This is more than twice the current level of total Government debt.
The proposal for auto enrolment into a Universal Retirement Savings Scheme (URSS) must be progressed. Employee and Government should make a defined percentage contribution.

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[7] http://cso.ie/en/releasesandpublications/er/elcq/earningsandlabourcostsq42016finalq12017preliminaryestimates/

- We believe that the broad policy goal of a URSS should be that all workers, employed and self-employed should be included.
- The cost of URSS must not add to the cost of labour to employers.
- In order to encourage up-take the State must contribute to the URSS (this would be in lieu of State contributions to a national pensions reserve fund).
- The State must be the main agency involved both in the collection, recording, investing and distribution of benefits.

It will also be important to consider and review the interaction with existing private pension arrangements. All public sector employees should be in the URSS, to preclude the inequalities that exist now[8]. We believe that the system should be mandatory auto-enrolment with limited opt-outs.

Upward-Only Rent Reviews

After wages, rent is the next largest cost for most businesses. In many cases, companies are currently paying rents that have little or no correlation to the market value of their property. Rents in Ireland are almost twice the international average. The only way out of the UORR is to put a business into examinership, a process too expensive for the majority of businesses. The establishment of Rent Pressure Zones debunked the myth of a constitutional bar to intervention in commercial rents.

[8] https://www.irishtimes.com/business/financial-services/public-sector-pensions-worth-millions-new-figures-show-1.3143604

TAXATION

- Implement the 20 key tax recommendations of the Irish Taxation Institute
- The highest 23% rate of VAT should be decreased to 21% to boost domestic demand.
- The 9% rate for tourism must be retained and extended to other labour intensive industries.
- All School Uniforms, of whatever size, be zero rated for VAT purposes
- Update and reform the current ARV calculation system for commercial rates, and reform of the LPT system
- Update and our CAT regime to encourage scaling of family businesses, and intergenerational transfer

SPENDING

- Increase spending on infrastructure to 4% of GNI*, addressing bottlenecks such as housing and water supply first
- Spread capital expenditures forward, pushing back less urgent demands into our next economic down-turn
- Buy the core distribution network for telephony and data transmission infrastructure back into state ownership.
- Implement tax policies that align with, and encourage, private sector expenditure on the green economy
- Divert spending away from the university sector towards skills-based, vocational and life-long learning

OTHER

- Conduct an immediate review of indigenous industrial policy in order to reduce our dependence on foreign-owned multi-national corporations.
- Reintroduce the Statutory Redundancy Rebate (or remove the 0.5% employers' PRSI levy which funds it.
- Regulate peer-to-peer lending in Ireland.
- Reduce the public-private sector pay gap to 10% by 2025.
- Permit no pay increases in the public sector that are not objectively justified by recruitment or retention issues, or are warranted by comparison to international benchmarks.
- Introduce labour force activation measures which encourage employers to hire people with disabilities
- Initiate a Universal Retirement Savings Scheme to address the massive pensions deficit in Ireland
- Ban all (including historic) upward-only rent reviews