ISME
Pre-Budget Submission 2021

Recession to Recovery

ISME Pre-Budget Submission 2021

Presented to

Minister for Finance

Paschal Donohoe, T.D.

And

Minister for Public Expenditure and Reform

Michael McGrath T.D.

July 2020

ISME Irish SME Association

Contents

INTRODUCTION 4
EXECUTIVE SUMMARY 5
COVID-19 5
  Policy Responses to Covid-19 5
  The July Stimulus 7
TAXATION 7
  Irish Taxation Institute Proposals 7
  ISME Taxation Proposals 9
    VAT 9
    Property Taxes 9
    Capital Acquisitions Tax (CAT) 9
SPENDING 10
  Infrastructure 10
  Broadband 10
  Encouraging the Green Economy 10
  National Training Fund 10
OTHER 12
  Review of Indigenous Industrial Policy 12
  Statutory Redundancy Rebate 12
  Peer to Peer Lending 12
  Public Sector Reform 13
  Pensions Reform 14
  National Minimum Wage 15
  Upward-Only Rent Reviews 17
  Social Progress Indicator 17

ISME Pre-Budget Submission 2021

INTRODUCTION

ISME, the Irish Small & Medium Enterprises Association, represents more than 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.

Last year, ISME themed its Pre-Budget Submission 'Preparing for Squally Seas,' because of a confluence of macro-economic factors. While no one could have foreseen a global recession sparked by governmental fiat due to a viral pandemic, the reasons behind ISME's fiscal conservatism were clear: we always must be ready to tackle the unexpected.

ISME calls on Government to loosen the purse-strings now for the same reason we have called for fiscal prudence for the last three years. Governments must act in the long-term good of the citizens and must spend counter-cyclically. Now, we must spend.

Domestically, our concerns are:

- *We received no social dividend from near-record low unemployment pre-pandemic. We now face several years of highly inflated social protection spending. We must use this crisis to properly fund our social protection pensions through auto-enrolment, while simultaneously reforming working and disability supports.*
- *The health vote was out of control pre-covid-19. The Sláintecare program can only proceed if accompanied by a fundamental cost and efficiency review within our health service.*
- *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 is worryingly dependent on corporation tax to bolster the national accounts.*
- *No meaningful Government action has taken place to tackle the insurance reform agenda.*

As the economy improved rapidly from 2017, we should have brought our current account under control. We didn't and therefore we continue to maintain a highly indebted society. Ireland's fiscal stance cannot be to borrow a bit when times are good and borrow a lot when times are bad. Covid-19 will take our per-capita Government debt close to €50,000. Only Japan, where most government debt is held domestically, has a higher per capita debt. Three quarters of Ireland's Government debt is externally owned.

ISME Pre-Budget Submission 2021

EXECUTIVE SUMMARY

Our budget priorities remain little changed from last year, and are as follows for Budget 2021:

1. Extend fiscal life-support to SMEs through targeted, grant-based liquidity supports.
2. Implement in full the 20 key tax recommendations made by the Irish Tax Institute.
3. Make permanent the temporary reduction in the ***punitive 23% VAT*** rate to 21%.
4. Our taxes on property, ***commercial rates and LPT***, need to be reformed.
5. While ***spending on infrastructure*** is now at the levels we have previously sought, we are concerned about value for money, particularly on the National Broadband Plan.
6. Our ***inheritance Tax*** regime must be reformed to incentivise the scaling up rather than sale of family businesses.
7. Government continues to ignore the reports by the ***Irish Fiscal Advisory Council (IFAC).*** In view of where the global economic cycle is at present, this is a matter of concern.
8. Our ***further education and training*** regime is inconsistent with activating a bigger workforce, or training the unskilled. We also acknowledge that our domestic SME base requires extensive training to improve its productivity. This should be incentivised via the tax system like the Teagasc 'Green Cert.'

COVID-19

A decade ago, Ireland entered what we now refer to as the 'Great Recession,' an economic event which had global origins but which domestically saw a fiscal collapse for the Exchequer, a property price collapse, and a collapse of our banking sector.

The collapse in property prices brought insolvency and bankruptcy to thousands of companies and citizens. The collapse of the banking sector resulted in an arguably unjustified transfer of private sector debt to the State balance sheet of €64bn. And the fiscal collapse of the Exchequer meant that maintenance of our public sector was achieved only through a massive level of borrowing, which accounts for more than half of our current €205bn national debt.

The result of these three separate crises was an unemployment rate that peaked at 14.7% in 2012. While the standard metric for unemployment by the CSO puts the current unemployment level at 5.3% for June[1] the total number of people being supported by the Pandemic Unemployment Payment (PUP) brings the adjusted rate of unemployment to 22.5%. We must also recognise that the availability to employers of the Temporary Wage Subsidy Scheme (TWSS) and the current restrictions on employees claiming redundancy are artificially supressing the true unemployment rate. Therefore, the real rate of underlying unemployment is much closer to 22% than it is to 5%.

Policy Responses to Covid-19

The unique economic characteristics of the recession caused by the Covid-19 pandemic required appropriate policy responses. This recession is not caused by any form of commercial irresponsibility, it is caused by a necessary Government-imposed restriction of economic activity. Therefore, the policy responses must be tailored to remedy the symptoms of this pandemic-induced recession.

On 21st July, the Central Bank published its SME Market Report.[2] Some of the key findings are worth noting here.

1. The shock to firms' turnover has been large (21% of firms report turnover is 75%).
2. Firms with the most constrained revenue have reduced their non-personnel costs the most, those reporting revenue declines of over 50% have reduced non-personnel costs by 43%.
3. The Accommodation & Food sector has reduced non-personnel costs the most – 49% of firms in this sector have reduced non-personnel costs by more than 50%.

[1] https://www.cso.ie/en/releasesandpublications/er/mue/monthlyunemploymentjune2020/
[2] SME Market Report 2020

ISME Pre-Budget Submission 2021

4. Survey evidence suggests 39% of firms have unpaid invoices, amounting to around 20% of 2019 revenue for the typical firm, which may pressure cash flow or amplify shocks upon company failure.
5. As many as 42% of firms report changing or deferring payments to manage cash flow, increasing to 91% of firms in the Accommodation & Food sector.
6. As of May, 72% of SMEs reported no change in access to finance and 6% of SMEs reported a decrease.
7. Smaller firms lack a bank lending relationship, particularly micro firms (36%), which can help inform lenders credit assessments and support the firm's access to finance.
8. Greater SME indebtedness in the Accommodation & Food sector (20% exceeding half of turnover) may limit capacity to borrow more, but 44% in this sector do not hold any debt, while 57% of all firms do not hold any debt.
9. Some of the sectors with the largest amount of outstanding bank debt (Accommodation & Food and Wholesale & Retail) are more exposed to the shock from Covid-19.
10. Many SME revolving loans have zero or small undrawn balances indicating limited working capital credit buffers.
11. Banks report SME lending standards have tightened in Q1 and Q2 and are expected to tighten slightly in Q3.
12. Before the pandemic, the SME default rate on the stock of lending was 6.7 per cent and higher in some sectors with relatively higher Covid-19 exposure such as Construction and Wholesale & Retail.

It is self-evident from the Central Bank report that debt is not the solution for the majority of SMEs affected by Covid-19, yet that is precisely the policy prescription the Government has applied to date (details of the terms of the 'July Stimulus' are as yet unavailable). It is clear that SMEs don't want debt, and banks don't want to lend to them. The vast bulk of the liquidity solutions provided to SMEs since the start of the crisis have been debt-based.[3] This compares very poorly with Germany,[4] where direct grants of up to €15,000 are available to small businesses, and debt is provided to them at rates *below* that charged to medium and large firms under the KfW program.

The SME Recovery Plan (of which ISME is a member) found in July 2020 that a compensation package to cover *half* the losses for *half* the micro and small firms which have sustained losses during the pandemic would come to €10.3bn.

	Companies returns	Total CT Liable	Employees	Earnings	Income Tax	USC	Employer PRSI	VAT
	Number	€m	Number	€m	€m	€m	€m	€m
All Enterprises	164,201	8,105	2,120,485	52,393	9,303	1,990	6,748	9,081
FMCs Only	5,925	6,258	468,731	17,540	3,770	793	2,484	3,210
Irish MNCs	362	373	84,911	2,460	459	96	340	167
SMEs	**157,914**	**1,474**	**1,566,843**	**32,394**	**5,074**	**1,101**	**3,924**	**5,704**
FMCs Only	4%	77%	22%	33%	41%	40%	37%	35%
Irish MNCs	0.2%	4.6%	4.0%	4.7%	4.9%	4.8%	5.0%	1.8%
SMEs	96%	18%	74%	62%	55%	55%	58%	63%

Taking the Revenue tax data from 2019 in the chart above, SMEs (excluding Irish multinationals) account for 49% of the total tax yield from the productive economy. More importantly though is the fact that they account for 74% of jobs. Even a single-figure percentage in SME mortality will cost thousands of jobs. The longer we dither with the rollout of an aggressive SME rescue package, the greater the permanent damage to the economy will be. Cognisant of this, we ask Government to recognise that:

1. SMEs are economically and socially essential to our country.
2. They require a bailout (although not one as large as the €105bn bailout of our public services in the Great Recession), and,
3. They require a post-pandemic boost to demand.

The CSO, in its recent Business Impact of COVID-19 Survey[5] noted both severely reduced sales *and* a high cost fixed cost of operation (due to cost of PPE, cleaning materials and disinfection) as a result of the pandemic. The median

[3] https://dbei.gov.ie/en/Publications/Publication-files/Take-up-of-DBEI-COVID-19-Business-Supports.pdf
[4] https://home.kpmg/xx/en/home/insights/2020/04/germany-government-and-institution-measures-in-response-to-covid.html
[5] https://www.cso.ie/en/releasesandpublications/er/bic19/businessimpactofcovid-19survey1junto28jun2020/

ISME Pre-Budget Submission 2021

on Covid-19 measures for micro business was €500, for small was €4,000, and for medium was €10,000. This makes the decision to reopen shuttered businesses marginal for many.

In view of the Central Bank's findings above, the bulk of the bailout for SMEs must be comprised of direct grant assistance, and the debt component must be at rates below 2%, spread out over seven years, with a 100% state guarantee, and with a one-year repayment holiday.

The July Stimulus

On 23rd July, the Government announced a €7.4bn package of fiscal measures to tackle the economic impacts of Covid-19. This encompassed an expansion of the existing Covid-19 business supports, and an increase in the Restart Grant package to €300m, with the grant ceiling being raised to €25,000.

ISME surveyed its accounting professionals to understand the level of B2B debt outstanding. This has reduced from €78,000 in April to €76,000 in July. It represents approximately €10.6bn of potentially impaired B2B debt between SMEs in the Irish economy. The maximum grant assistance of €25,000 available in the July Stimulus must be set in this context.

This is why we consider the liquidity measures announced in the July Stimulus to have fallen short: the majority of measures announced are debt-based at a time when both SMEs and their lenders are sceptical about their ability to repay lending. While the TWSS has reduced the rate of cash burn for businesses, it can only be used to service payroll costs, not to pay down debt. Maintaining the wage subsidy scheme helps keep people in employment, thus avoiding the €10.5k annual welfare cost of the person on jobseeker's allowance, and the attendant loss of tax revenues.

The Restart Grant element of €300m makes up only 4% of the total package. Furthermore, the grants are tied to the previous year's rates bill, which rules out many non-rate paying businesses which still have substantial debts. There is also a newly introduced turnover hurdle of €100,000 per employee, above which the business does not qualify for grant assistance. This will disbar many high turnover but low margin businesses from grants.

While €7.4bn sounds like a large number, we must understand its components. €2.6bn (35%) of the stimulus is comprised of income supports, which cannot be used to capitalise a business or pay losses. €2bn (27%) of the stimulus is the Credit Guarantee Scheme (CGS), which is off-balance sheet for the Government and is a (partial) contingent liability only in the event of default by borrowers. The previous CGS resulted in drawdown of €152m of €1.2bn committed, or 13%. The tax deferrals of €1bn come with an interest rate of 3% for those businesses that avail of them.

The situation regarding employees earning over €76K appears to have been carried forward in the Employment Wage subsidy scheme ('EWSS'), in that their employer cannot avail of supports. See our comments below regarding those workers who pay most in PAYE and social contributions. In addition, proprietary directors are specifically excluded from EWSS, another gratuitous and unjustified adjustment for business owners who support most employment in this country.

In summary, while ISME desperately wants the July Stimulus to succeed, too much of it is debt-based, and the rest cannot be used to address losses. We believe the grant element of Covid-19 business supports will have to be revisited in the October budget. A grant package proportional to that announced by the German government would amount to approximately €2.5bn.

TAXATION

Irish Taxation Institute Proposals

Even in recession, it is important to remember that 'this too will pass' and we need to concentrate on long-term reform of our tax code. The Government has also indicated that there will be a Commission on Taxation and Social Welfare in the life of the current Dáil, which we believe is long overdue.

ISME Pre-Budget Submission 2021

The Irish Taxation Institute is the pre-eminent body in the provision of expert tax advice in Ireland. As we did for Budget 2020, ISME wholeheartedly endorses their 20 Key Tax Recommendations,[6] 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. A reduction in CGT would almost certainly increase the yield. Those who support the current CGT rate should be asked to justify whether they support a lower than possible tax yield.
4. **Entrepreneur relief is too tightly restricted to owner-managers** and discourages external and serial passive 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. While Government policy purports to encourage equity investment in SMEs, the subsequent treatment of those very investors is punitive.
5. The progressivity of our **marginal tax rates**** above the average industrial wage discourage personal advancement, upskilling and promotion.
6. The **KEEP scheme** remains too complicated and restrictive for use by SMEs. The changes announced in budget 2019 have not addressed this, and the 'lifetime limit' element introduced has made the scheme less attractive.
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. The **Knowledge Development Box (KDB)** remains in need of reform for SMEs.
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.
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. 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 exist 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. (A proviso could be that the self-employed person cannot have previously left a Revenue debt unpaid.)
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 and their administration** to be worth pursuing by the Revenue.

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

ISME Pre-Budget Submission 2021

** While ISME understands the fiscal and political difficulties with raising the marginal rate thresholds, Irish workers are taxed at marginal rates at far too low a level of income, even by comparison with Scandinavian exemplars. Currently, the marginal rate for a single worker kicks in above €35,300, which is 15% below the current average industrial wage of €41,695 (Q1 2020). We suggest future taxation policy should set benchmarks against the average industrial wage, with a view to getting to 150% (i.e. €62,542). This would still be a low marginal rate threshold by international comparison.

ISME Taxation Proposals

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

VAT

When the 9% VAT rate was originally introduced, it was accompanied by an increase in the standard rate from 21% to 23%. The 9% rate has been removed, despite its having attracted over 30,000 jobs into the hospitality sector. Yet the 23% rate has remained in place and is one of the highest rates in Europe.

The temporary reduction of the punitive 23% rate to 21% should be made permanent at its original level. If it has the impact of stimulating consumer spending, the net impact on public finances will not be significant as the VAT take will increase overall if spending is increased.

The UK has taken an aggressive step in lowering their hospitality rate of VAT to 5%. This change is already altering consumer behaviour in the Republic, with shopping and wedding bookings heading across the border. There is a solid business case for a reduction in the 13.5% VAT rate, even if on a temporary basis such as one year.

The costs of cleaning materials and PPE for Covid-19 will remain a substantial drag on businesses for some time to come, especially those businesses which cannot recover their VAT. Government should urgently consider zero-rating relevant goods and materials.

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

Reform of property taxes is long overdue. 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. Furthermore, the exemption of post-2013 builds is a fundamental and inexcusable inequity in the taxation system which must be plugged immediately if it is not to face legal challenge.

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 €335,000 ('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

ISME Pre-Budget Submission 2021

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 must be reformed.

SPENDING

Infrastructure

Ireland has a shortage of affordable housing, and critical underinvestment in its potable and wastewater 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.

As we enter what will hopefully be a short-lived recession due to Covid-19, it is important to capitalise on reduced asset and construction costs and fill infrastructural gaps. Doing so is one of the easiest and most productive ways in which a Government can provide a counter-cyclical stimulus.

Broadband

The formation of a new Government should provide a context and opportunity to revisit the National Broadband Plan. ISME is in favour of enhanced access to high quality broadband, but this should not involve the laying of fibre cables to every one-off house in the state. Connection of other utilities such as water, foul water, and electricity is paid for by the consumer in those cases. The NBP fails to state a justification for connecting every single household, irrespective of location, to fibre.

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.

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.

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.

Given the imminent ending of the UK's transition period on 1st January, and the considerable cost (especially for SMEs) of ISO 14001 accreditation, there should be assistance for achieving locally based and affordable equivalents such as Ecomerit.

National Training Fund

The National Training Fund continues in substantial surplus while we have a number of known shortfalls in education, as well as a substantial degree of 'over-education.'[7] The NFT needs to be targeted at addressing the emerging issues:

ISME Pre-Budget Submission 2021

[7] https://www.irishtimes.com/news/education/irish-workers-are-most-overqualified-in-europe-1.3229608

- As Ireland reaches peak employment, many sectors across Ireland are facing a national skills crisis, which is affecting the competitiveness of enterprises. The lack of skilled employees is causing poaching of staff, unrealistic and unsustainable strains on employers to compete to maintain their employees. This skills shortage is affecting the competitiveness of enterprises.
- Apprenticeships offer both the employer and apprentice an excellent way of training however the two-tiered apprenticeship schemes offered by government will continue to cause hardship for employment sectors where the median wage is low. The post 2016 apprenticeships require the employer to pay the apprentice while both on and off the job. This system must be reviewed to encourage employers to take on and train apprentices in a sustainable way. A supporting scheme should be made available to support post 2016 apprenticeship (like Job bridge or Jobs plus) or to reintroduce the pre-2016 model where the government covers the cost of training while the apprentice is off the job as in electrical, plumbing and motor apprenticeships etc.
- Training rate: The removal of the training rate has affected some employers' ability to train staff and many sectors are no longer taking on trainees. While the protection of low paid workers is a priority, this must be balanced with the demands and cost of training apprentices. Additional support should be made available to encourage employers to engage with available apprenticeships.
- Life-long learning as a key component in workforce development. Additional financial support should be directed from the NTF towards supporting those in employment, to upskill them in a manner that is enterprise-led.

We need to align pre-employment education to the needs of the industry. Additionally, a review of career guidance should take place to support school leavers choose a path that is most appropriate, and to emphasise the benefits of apprenticeships for students with the apt skills.

ISME acknowledges that the productivity issue among Irish SMEs is real. Productivity is static or falling in the domestic economy, as is profitability. In his Seanad Public Consultation Committee Report on Small and Medium Sized Businesses in Ireland,[8] Senator Padraig O'Céidigh identifies productivity as a key element in value creation by SMEs. This is occurring at a time when there is an increasing trend toward protectionism globally; when our nearest and largest trading partner is leaving the single market, and when US, OECD and EU Commission trade and corporation tax policies threaten the long-term viability of our traditional industrial policies based around foreign multi-national corporations.

If we are to scale our indigenous enterprise base, it is imperative that we address latent deficits in managerial skills within our SMEs; particularly financial management, IT capability, marketing capability, innovation, personnel development, risk identification and management, research capability, and strategic planning.

As we stated in our 2020 Pre-Budget Submission, we recognise the shortfalls in education and training among SME owners and managers. We have widespread, multi-sector support for our proposal for a QQI Level 6 course in Business Management, incentivised in a similar manner to the Teagasc Level 6 Specific Purpose Certificate in Farm Administration (the 'Green Cert') for farmers. We believe that providing these tax incentives is the only way to ensure rapid, extensive penetration of this training.

Given what we believe will be long tail-effects from Covid-19, and the likelihood that our nearest trading partner will operate on WTO rules from 1st January, we wish to urgently prioritise rollout of this course, with tax incentivisation similar to the Green Cert.

Since this qualification will not be limited to the second generation in family businesses, there will be a requirement for a tax benefit beyond the CAT reduction currently applicable under the Green Cert. We suggest this could be by way

ISME Pre-Budget Submission 2021

[8] https://data.oireachtas.ie/ie/oireachtas/committee/dail/32/seanad_public_consultation_committee/reports/2019/2019-05-16_small-and-medium-sized-businesses-in-ireland_en.pdf

of additional tax credits. However, given the fact that the NTF will have accumulated more than half a billion euro by the end of 2020, we see the expenditures under this program netting off only a small fraction of the funds available under the NTF.

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 dependence on the MNC sector.

ISME has argued every year since 2003 for a fundamental review of indigenous industrial policy. Our call for a policy review is not a binary SME 'or' MNC. We see a mutually beneficial symbiosis between the two in a 21st Century policy review. We believe the case has never been stronger to initiate one now.

Statutory Redundancy Rebate

ISME has lobbied for several years for the restoration of the statutory redundancy rebate. While this issue attracted no attention as we approached full employment, the jobs market is being ravaged by Covid-19. 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 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 Covid-19 moratorium on redundancies will soon end, and a tidal wave of redundancies is inevitable as businesses restructure through the pandemic. The more expensive the Government makes it to lay people off, the more reluctant businesses will be to re-hire once the pandemic is over. The statutory redundancy payment could make the difference between a solvent and an insolvent business. Therefore, 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.

Peer to Peer Lending

Covid-19 has cruelly exposed our over-dependence on our pillar banks. Despite huge effort by the SBCI to distribute urgently needed liquidity to our SME sector, that effort has run into the sands once credit applications get into our pillar banks. Ireland needs to broaden its banking base, and regulation of our peer-to-peer sector is a long overdue measure necessary in doing so.

ISME Pre-Budget Submission 2021

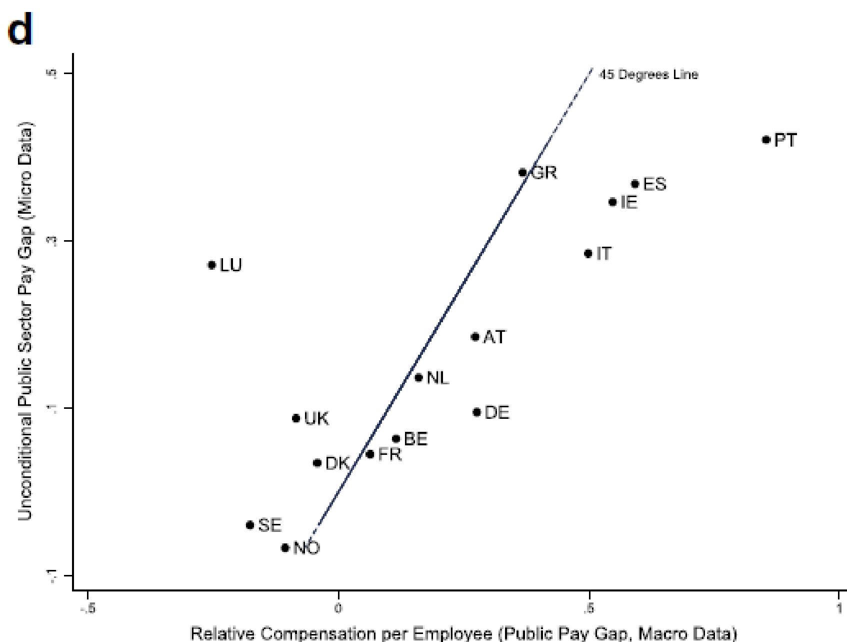
Peer to peer lending remains unregulated, despite the influx of more providers. The longer this situation continues, the greater the risk we run of a major failure in the shadow lending area.

Public Sector Reform

The gap between public and private sector pay[9] (as of Q1 2020) stands at €244.85, or 33%. This is the lowest the gap has been for many years. It came at a time when the private sector was effectively at full employment, and when one would normally expect private sector remuneration to exceed public sector. This is already the case in the UK, where private sector pay nominally exceeds public sector pay by 0.5%. We know of no material level of age, qualifications, educational or vocational superiority of the Irish public service over their UK counterparts.

Even at a low of 33%, this gap is only elsewhere seen in Mediterranean countries[10] (See figure 1 below) where private sector pay is far lower. This means that SMEs are competing against ***both*** foreign multinationals and the State for talent. That is a very difficult place to be for the majority of SMEs.

Figure 1: Understanding the public sector pay gap (Source: Campos et al)



ISME previously called for Government to ***reduce the public-private sector pay gap to 10% by 2025.*** This now looks unachievable, as the pandemic will increase the public-private sector gap again.

ISME believes that Government commitments to increase public sector pay this year were made at election time and preceded the Covid-19 pandemic. Those commitments should be reviewed. However, if it is the case that Government can morally countenance increasing public sector pay at a time of record unemployment in the private sector, then it *must* demand reform.
It is interesting in this regard that most of the clamour for pay increases come from those sectors with the poorest performance records. The OECD's recent Country Report[11] found a significant shortfall in outcomes for the public for the Health, Education and Justice sectors. This is morally unjustified and fiscally unsustainable.

We consider the absence of a permanent pay-setting mechanism to be detrimental to good order in the public finances. The setting up of ad hoc commissions such as the Public Service Pay Commission in 2017 is no substitute for the maintenance of a standing pay commission such as the UK's Pay Review Body (PRB), which is run by the Office of

[9] https://www.cso.ie/en/releasesandpublications/er/elcq/earningsandlabourcostsq42019finalq12020preliminaryestimates/
[10] https://izajolp.springeropen.com/articles/10.1186/s40173-017-0086-0
[11] OECD Country Report Ireland 2020

ISME Pre-Budget Submission 2021

Manpower Economics.[12] Despite the size of the UK's public service, the standing secretariat of the PRB is just 30 people. It is fed with specialist sectoral information in respect of doctors and dentists, NHS, police, prison service, schoolteachers, senior public service staff, and the armed forces.

Given the size and cost of the Irish public service, and the fact that the findings of the Public Service Pay Commission have been ignored by some of the trade unions, the establishment of an agency analogous to the UK PRB is warranted here. It would ensure that pay adjustments would be data-driven rather than extorted under the threat of industrial action.

The constant and ongoing threat of industrial unrest cannot be used as a justification for continued refusal to reform our public services. We can, through a continued focus on productivity and reform deliver, a world class public service affordable to our citizens and children. Properly digitising our public services in the public cloud can be part of the strategy to achieve that objective.

Pensions Reform

The introduction of the Covid-19 Temporary Wage Supplement Scheme exposed our employees' PRSI payment for what it really is, a marginal tax rate addition, not a genuine social insurance payment. This was also the finding of the last Commission on Taxation.

The TWSS saw the support for higher earning employees gradually tapered until those earning over €76,000 (in the first iteration) had no TWSS at all. Given that this employee cohort makes up 14% of taxpayers, but pays 48% of payroll taxes and social contributions, this is outrageous. This disgraceful situation was only partially addressed in later iterations of the TWSS.

The PRSI system must cease to be used as a marginal form of taxation and must start to be used as social insurance. As we are advising the DEASP:

1. ISME supports previous policy recommendations to move towards and auto-enrolment system for state pensions. State pensions must operate on a total-contributions basis, must provide for those who wish (or need) to retire earlier, and must allow those who contribute more (or who choose to work longer) to benefit more. Pensions must operate on a social insurance model, not on a taxation and fixed benefit model, Auto-enrolment should become the basis for all pensions paid in the state, including public service employees.

2. Jobseeker's Benefit is paid as a fixed weekly allowance to workers who have lost their jobs, irrespective of what their income level prior to unemployment. This is entirely inconsistent with the fact that the PRSI ceiling of €75,036 was eliminated in Budget 2011. Ireland must either re-introduce PRSI ceilings for employees or move to a social insurance model for payment of Jobseeker's Benefit. The Danish social insurance system allows those made unemployed can avail of a time-bound benefit up to 90% of their salary.

3. The disability allowance system must preclude payment for 'lifestyle' disabilities, such as illiteracy. It is wholly improper for the state to pay someone to be illiterate.

The 'strawman' consultation by DEASP for pension reform, while welcome, does not go far enough, in that it fails to tackle the issue of the unfunded liabilities for public service and social protection pensions. Together, these liabilities total more than €450bn, which is more than twice the size of the Irish national debt.

[12] https://www.gov.uk/government/organisations/office-of-manpower-economics

ISME Pre-Budget Submission 2021

While we acknowledge the pension benefits of an Automatic Enrolment (AE) for the employee, the proposed funding mechanism would have a negative employment impact, especially for lower paid workers. The employer contribution up to a maximum of 6% would represent a substantial increase in payroll cost for a great deal of employers, especially as the initially mooted state contribution of 25% has already been reduced to 20% in the latest iteration of the proposals. This would be a considerable burden, even if Coviud-19 associated costs were not present. While we acknowledge that the social contributions paid by Irish employers and employees by EU standards is low, so are the benefits to employees (which are fixed), and there is further the fact that pre-tax Irish payroll costs are high. This suggests that for a 6% employer contribution to not adversely affected employment levels, employees will have to absorb some or all of this (i.e. gross earnings cannot rise by the full amount of the increase).

The quantum of the proposed State contribution to the AE scheme is miniscule by comparison to its massive subsidisation of public service pensions and would be a maximum of €1,125 per worker per annum. Public service pension accrual attracts favourable tax treatment that is not accorded to private sector pensions savings. This would not encourage those who currently contribute to their personal pension to migrate to the AE scheme.

The unfunded pensions liabilities of the State are the largest threat to its long-term financial stability, and the DEASP remains the largest-spending Government department. It is therefore imperative that the DEASP receives robust, honest, independent and objective advice on addressing the entire pensions issue (and not just private sector pension coverage) from the ESRI, IFAC and/or NTMA, as well as the advice of external consultants not on the public payroll.

The AE scheme should be the first step taken to bring equivalence between public and private sector pensions according to the Revenue's pensions and tax evaluation criteria. DEASP should commit to elimination of the apartheid between public and private sector with a fixed period of time.

Despite exchequer pensions amounting to more than €2.7bn annually, only one department details its pensions expenditure as a separate vote. The practice of analysing departmental pensions as a separate vote should be extended to all departments beyond the Department of Defence.

National Minimum Wage

Ireland has the second-highest National Minimum Wage (NMW) in Europe (see figure 2). For several years now, this has been increased on an annual basis, without reference to underlying increases in cost of living. There appears to be a confusion in Ireland about what a NMW is designed to achieve; and the concept of a 'living wage' is frequently used as an analogue or used as an alternative baseline to the NMW.

Raising the NMW is a political cop-out from the more difficult issue of controlling the cost of living in Ireland; something for which successive governments have abdicated responsibility to the private sector. Ireland is the second most expensive country to live in within the EU, after Denmark (see figure 3). This would be bearable for the populace if our public services were as developed as those in Denmark, but they are not. It is noteworthy that Denmark has no NMW.

For many service-based industries such as the hairdressing, cafes and restaurants, 2019 has been a particularly tough year following the reversal of the VAT rate from 9% to 13.5%, an increase in the National Minimum Wage, an increase in employers' PRSI contribution towards the National Training Fund, the abolition of the sub-minimum training rates and the introduction of banded hour contracts.

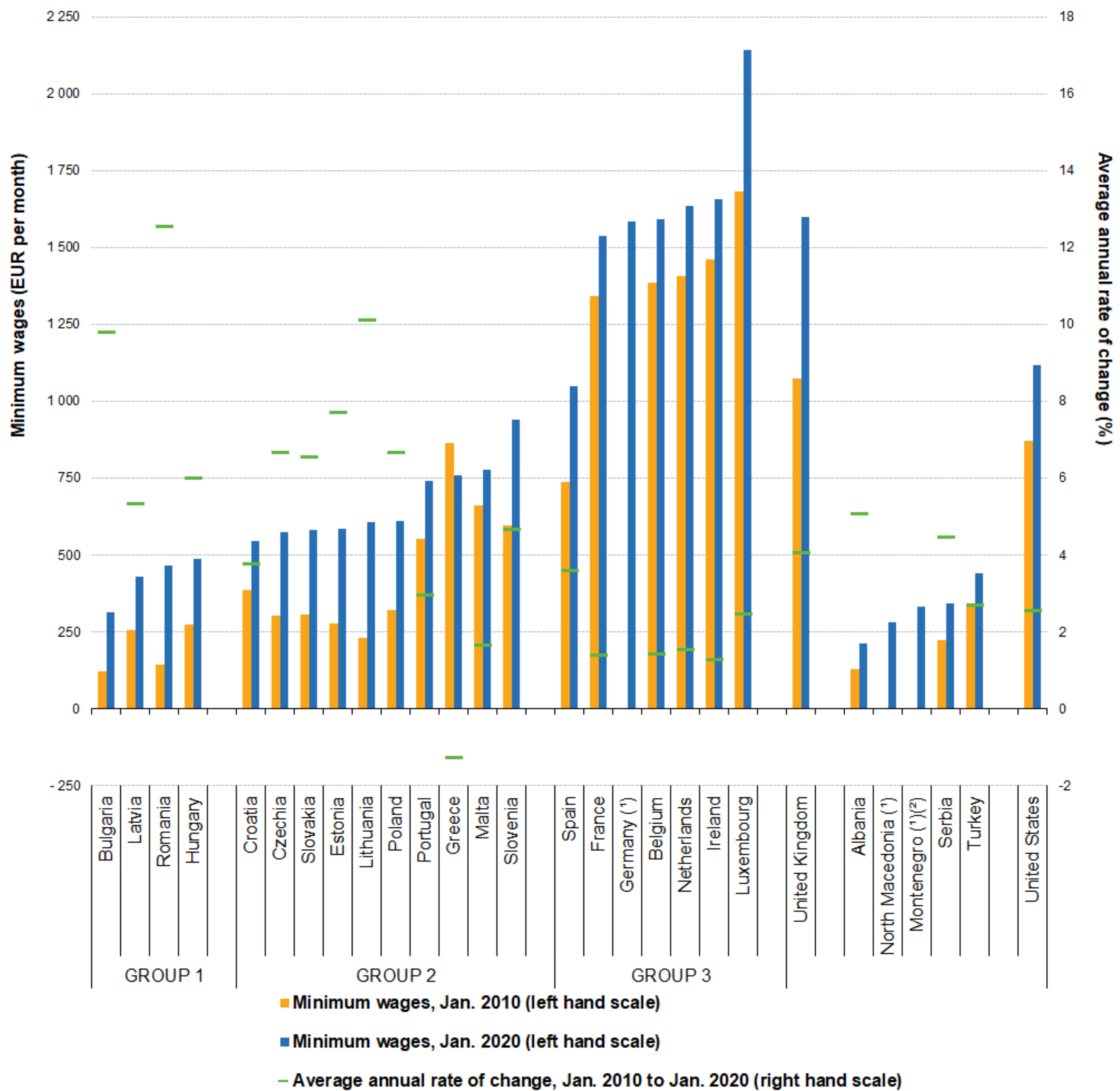
As we head toward a possibly hard Brexit on 1st January, it is worth noting that the NMW and the *National Living Wage* in the UK is £8.21/hr, equivalent to circa €9.09/hr. The Irish NMW is €10.10/hr, and sterling continues to decline. Government must stop outsourcing the rising cost of living to employers via the NMW and must start to take seriously the need to reduce costs of living for citizens in Ireland.

While we note the recent decision by the Low Pay Commission not to issue a recommendation on the NMW at this time, we feel that instead of issuing annual recommendations on the NMW, they should be required to make a competitive comparison of our NMW with peer and near countries.

ISME Pre-Budget Submission 2021

Figure 2: NMW in the EU (Source: Eurostat)

Minimum wages, January 2010 and January 2020
(EUR per month and %)

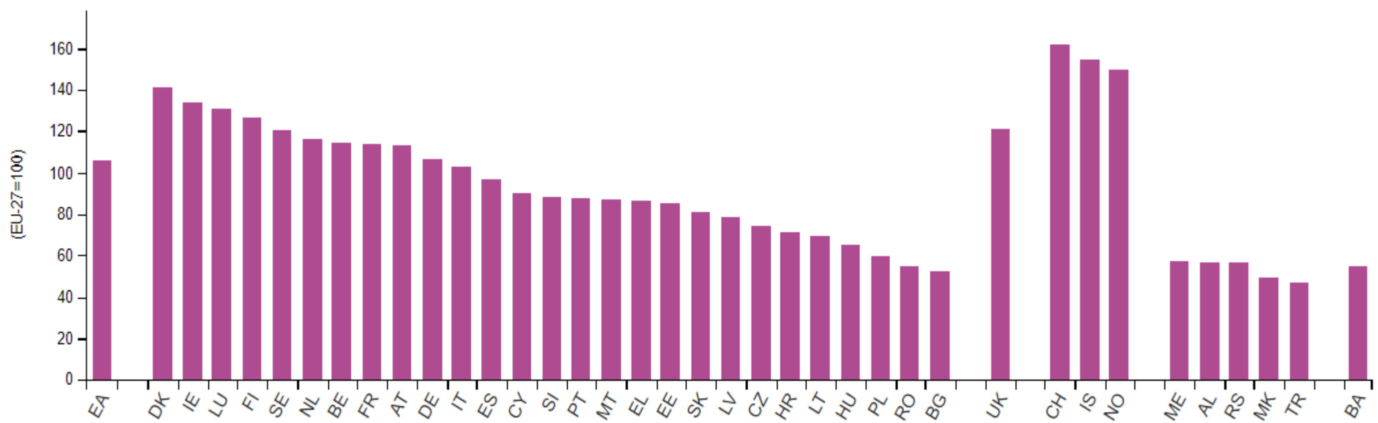


Note: Denmark, Italy, Cyprus, Austria, Finland and Sweden: no national minimum wage.
(¹) January 2010 and average annual rate of change not available.
(²) July 2018 instead of January 2020.
Source: Eurostat (online data code: earn_mw_cur)

eurostat

eurostat

Figure 3: Consumer Prices EU 2019 (Source: Eurostat)



Source: Eurostat (online data code: prc_ppp_ind)

eurostat

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 legal way out of UORR is to put a business into examinership, a process too expensive for the majority of businesses.

Despite the abolition of UORRs on new leases[13], extant UORR lease contracts have remained in place. At the time of original legislation, the Government of the day cited constitutional issues[14] for their inability to ban historic leases. Interestingly, when the issue of spiralling domestic rents become a political issue, these constitutional issues evaporated; the establishment of Rent Pressure Zones debunked the myth of a constitutional bar to intervention in commercial rents. UORRs are an anachronism, for which there are many modern market-based alternatives. They continue to exert a drag on high street retail at the very time that sector is under immense pressure from online. As NAMA is being wound down, it is likely that the Government will face less opposition should it decide to ban all UORRs.

Social Progress Indicator

Despite the Covid-19 pandemic and other societal challenges, Ireland remains a relatively good place to live compared to some of its peers. Despite this, political discourse is regularly suffocated by cries that suggest Ireland is a third world country with public services to match. We therefore need an objective, politically neutral basis on which to identify those areas where improvement is, in fact, required.

ISME therefore considers it essential that Ireland develops a Social Progress Indicator, hopefully agreed through the National Economic Dialogue process, which would contribute far more to the budgetary debate than an endless discursion on our GDP and our GNI*.

ISME Pre-Budget Submission

[13] https://www.ucem.ac.uk/wp-content/uploads/2016/01/Irish_Rent_Reviews.pdf
[14] http://www.justice.ie/en/JELR/Pages/PR11000247

iSME Irish SME Association

SUMMARY OF ISME PRE-BUDGET SUBMISSION RECOMMENDATIONS

TAXATION

- Implement the 20 key tax recommendations of the Irish Taxation Institute
- The highest 23% rate of VAT should be decreased to 21% on a permanent basis to boost domestic demand.
- Cleaning materials and PPE associated with Covid-19 spread prevention should be zero-rated for VAT, at least for a period
- All School Uniforms, of whatever size, should be zero rated for VAT purposes
- Update and reform the current ARV calculation system for commercial rates, and reform of the LPT system
- Update our CAT regime to encourage scaling of family businesses, and intergenerational transfer
- Use the taxation system to incentivise a Basic Business Qualification at QQI level 6 for every business owner and manager

SPENDING

- Significantly boost Covid-19 supports for the SME sector, particularly via direct grants
- Spread capital expenditures forward, pushing back less urgent demands into our next economic down-turn
- 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, or are paid for by productivity.
- Establish a standing Public Service Pay Commission
- 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
- Stop increasing the NMW, reduce the costs of living (especially housing cost) instead

ISME Pre-Budget Submission 2021