Pre-Budget Submission | Budget 2018

Executive Summary

Budget 2018 will be the second of the 32nd Dáil and is framed under the new programme for government – *A Programme for Partnership Government*. It is in the spirit of this new partnership that Dublin Chamber of Commerce makes its pre-Budget Submission. The submission seeks to provide a clear set of principles that its **1,300 members, which employ 300,000 people nationally**, believe are essential to further economic and employment growth for the betterment of all of Ireland, both urban and rural.

Dublin businesses believe that the infrastructure crisis in housing, transport, education, health and utilities, is a unifying priority for business and society. Therefore, Dublin Chamber calls on the Government to **prioritise capital spending** in Budget 2018 and subsequent budgets. The Chamber believes the bulk of resources from revenue buoyancy should be focused on capital spending rather than increased current spending or tax cuts. The infrastructure deficit is a legacy of both the economic crisis and historic underinvestment. Ireland will not reach its full potential unless the bottlenecks to that growth are addressed.

Dublin Chamber also believes that there are a number of bottlenecks to growth that are facing entrepreneurs and micro-businesses. The most pressing bottlenecks to be addressed are:

- Attracting and retaining key talent;
- Attracting and retaining entrepreneurs and capital for investment in Ireland; and
- Maintaining a competitive positions vis-à-vis other economies.

The Chamber has compared Ireland and the UK to provide a competitive context for our proposals, as illustrated in the table overleaf. The UK is heavily focused on assisting micro and small businesses to grow, thereby increasing the employment potential of these companies.

Priority recommendations:

1. Prioritise investment in infrastructure projects that demonstrate the greatest return for Ireland.
2. Help businesses to attract and retain key talent with a tax-efficient share-based remuneration scheme for SMEs.
3. Attract and retain entrepreneurs and capital for investment in Ireland through competitive capital gains tax changes.

(€1.1905 per £1 – 10/05/17 – www.ft.com)	Ireland (Budget 2017)	UK & NI (Budget Spring 17)	Ireland Relative to UK vs Last year
Investment in Critical Infrastructure			
Gross public capital investment as % of GDP ('15)	1.7%	2.7%	NO CHANGE
Income tax			
Salary at which rate changes to 40% [1] [€/£]	€33,800	€53,752	WORSE
Effective total tax rate on dividends at higher rate	52%	32.5%	WORSE
Different assessment for self-employed.	Yes	No	BETTER
Possible to defer income tax on share-options given to specific key employees	No	Yes	NO CHANGE
Capital Gains Tax			
Standard rate	33%	20%	NO CHANGE
Effective rate first ~€1m on exit after five years	10%	10%	BETTER
Effective rate first ~€11m on exit after five years	31%	10%	SLIGHTLY BETTER
Corporate Tax			
Knowledge Development Box / Patent box income	6.25%	10%	MUCH BETTER
Corporate Tax rate (UK's by 2020)	12.50%	17%	WORSE
Value Added Tax			
Standard Rate	23%	20%	NO CHANGE
Registration Threshold for SME providing services [2]	€35,000	€107,994	WORSE
Cash Basis Threshold [3]	€2.0m	€2.08m	☯

[1] In the UK, the 40% rate comes into effect on income from £43,001.
[2] The threshold for the registration of VAT in the UK is £83,000.
[3] Businesses paying VAT on a cash accounting basis must switch to invoice basis when their turnover goes over £1.6m.

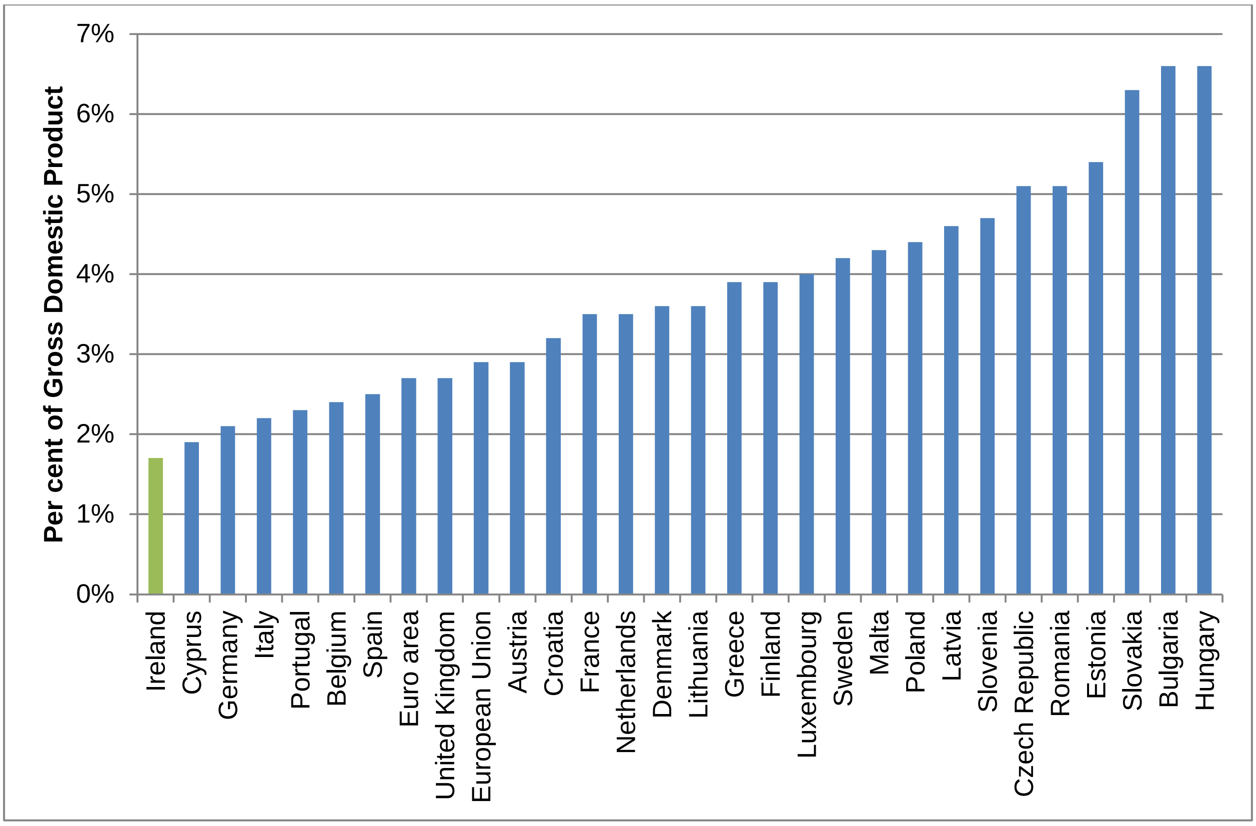
1. Infrastructure

This section examines the lack of investment in infrastructure, historically and presently, and makes several recommendations on remedying this resulting infrastructure deficit.

Lack of Investment

In 2015, Ireland recorded the lowest proportional capital spending in the European Union.

Fig. 1: General Government Gross Fixed Capital Formation, 2015[4]



There is a large deficit in infrastructure in Ireland, when considered against both historic and international measures. Ireland has suffered decades of underinvestment, as current spending programmes have been prioritised over investing in Ireland's future. The problems posed by Ireland's infrastructure deficit are becoming more acute.

For example, shortcomings in transport infrastructure have become more pressing, according to the European Commission in its country report for Ireland:[5]

> *"[…] significant infrastructure shortages remain, particularly in and around main urban areas. This situation is aggravated by rising economic activity, population growth and under-investment in recent years. According to the World Economic Forum's Global*

[4] Eurostat

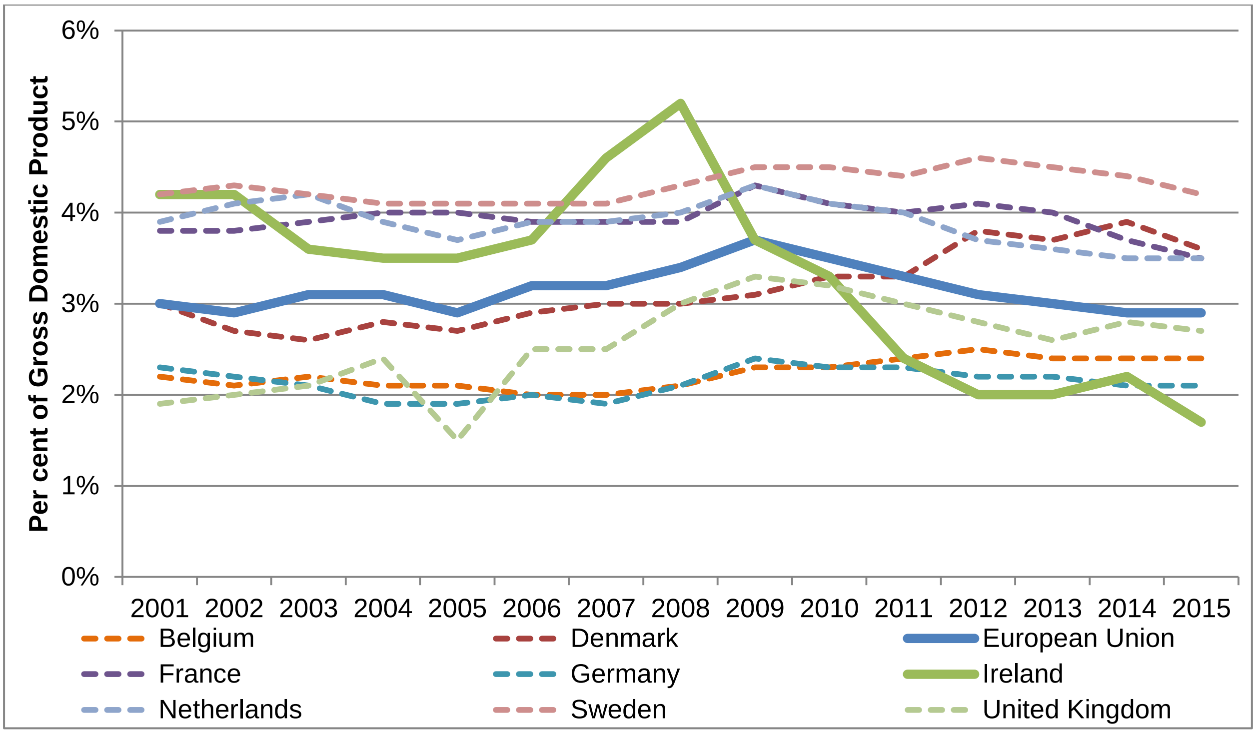
[5] European Commission, 2017, '*Country Report Ireland Including an In-Depth Review on the prevention and correction of macroeconomic imbalances*', p53

Competitiveness Index (GCI), Ireland ranks only 32nd for the quality of roads and 35th for railroad infrastructure, well below other EU countries."

If there is no focus on investing in the future, Ireland will not reach the standards of infrastructure achieved by its neighbours and competitors. Ireland must not merely spend equal to its competitor countries. In order to catch up to its competitors, Ireland must spend more than them in order to close the historical gap.

During the boom years, Ireland significantly increased capital spending. However this was short-lived and the quality and sustainability of this investment has been called into question. As can be seen in the graph below, Ireland's spending declined at a rapid pace and has failed to recover. Furthermore, it can be seen that Ireland's capital spending is significantly more variable than many other competitor countries. Planning for infrastructure is made more difficult in Ireland with the uncertainty surrounding the funds available.

Fig. 2: General Government Gross Fixed Capital Formation, 2001 – 2015[6]



The existing capital spending plan leaves much of the investment until future years, but even these levels of capital spending are insufficient to meet Ireland's future needs and at these levels, run a high risk of leaving Ireland increasingly uncompetitive as a country in which to live, work and invest in a business.

Table 1: Gross Capital Expenditure and Nominal GDP for Ireland, 2016 – 2021[7]

Year	2016	2017	2018	2019	2020	2021
Nominal GDP (€ millions)	€263,100	€275,100	€288,700	€302,900	€316,600	€330,800
Gross Capital Expenditure (€ millions)	€5,175	€5,630	€6,395	€7,160	€7,765	€8,375
Gross Capital Expenditure as a Percentage of Nominal GDP	2.0%	2.0%	2.2%	2.4%	2.5%	2.5%

[6] Eurostat
[7] Source: Department of Finance, 2016, 'Budget 2017: Economic and Fiscal Outlook'

Demographic Pressures

The potential to grow our economy, over the longer term will be constrained by demographic. According to the CSO, Ireland will have a population of 5.2 million people in 2031.[8] This is based on the M2F2 (Modified) scenario, the one most likely to occur. It should also be noted that his scenario is the one which projects the largest increase in the population.

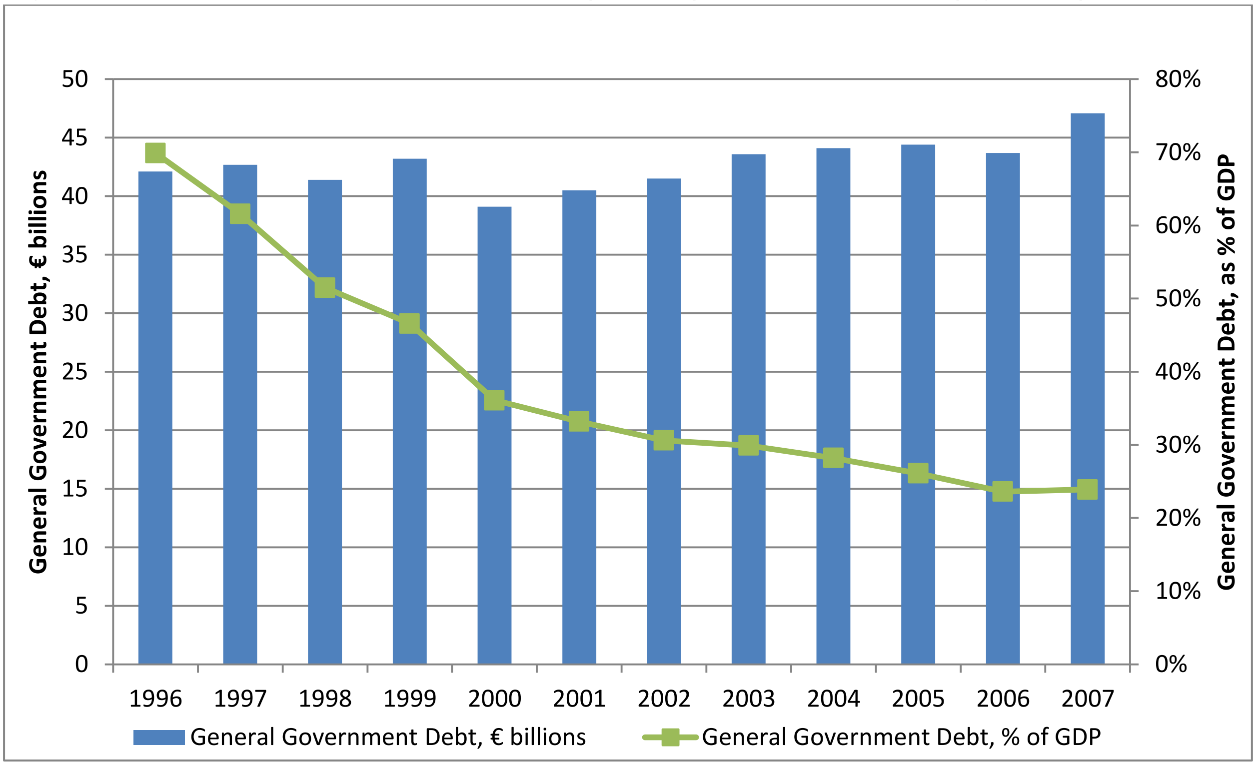
Population growth is notoriously hard to measure, largely due to the difficulty in measuring migration (both internally and internationally). The above forecast also projected what the national population would be in 2016, and underestimated it by 71,000. The population of the Greater Dublin Area was underestimated by 46,000, with the bulk of this (44,000) being in County Dublin.

The other significant aspect of demographic pressure on the Irish economy is that there is an increase in the average age of the population, by 1.3 years between the 2011 and 2016 census. This is as a result of decreasing birth rate in the last four years and people living longer. This will reduce the labour force as a proportion of the population over time. With an ageing population, it must be ensured that the required infrastructure is in place to both provide for an older population.

Prioritise Investment

Investment in productive infrastructure should be given top priority over increases in current spending and cuts in general taxation when determining how best to use the available fiscal space. Further delays in the delivery of key infrastructural programmes will constrain economic growth in the years ahead.

Fig. 3: General Government Debt in € Billions (left axis) and as a % of GDP (right axis), 1996 – 2007[9]



[8] Central Statistics Office, (2013), '*Regional Population Projections*'.
[9] National Treasury Management Agency, '*Historical Debt*'

Dublin Chamber acknowledges the constraints imposed by the Stability & Growth Pact (SGP) and associated commitments and notes the Government target of a debt-to-GDP ratio of 45%, well ahead of Ireland's formal SGP requirements.[10] Debt-reduction is important, and we believe that the best way of achieving this goal is to grow the economy, thereby improving both revenues and the debt ratio. It should be noted that Ireland's historically large National Debt from the 1980s did not fall in value terms. Rather the debt to GDP ratio fell throughout the 1990s and early 2000s as a result of growing the economy, as shown in Fig. 3, above.

Ireland has made brisk progress towards meeting its debt target under the SGP, with general government debt standing at 75.4% in Q4 2016, markedly ahead of EU Commission projections.[11] The EU Commission had already indicated that Irish fiscal sustainability is not at short-term risk, while medium and long-term risks are based as much on competitiveness concerns as on the level of Government debt.[12]

Recommendations

Dublin chamber proposes that consideration be given to a number of measures in order to finance the required increase in capital spending. These are:

- Increasing the use of Public Private Partnerships:
- Assigning revenue buoyancy to funding capital projects:
- Exploring innovative means of financing projects with the European Investment Bank: and,
- Reviewing the EU fiscal rules with other Member States.

These points are considered in turn below.

Recommendation 1.1: Unlock the potential of private finance by increasing the use of public private partnerships

The Stability & Growth Pact allows for flexibility in its spending restrictions for investments that are financed through public-private-partnerships, special purpose vehicles, or European investment funds. However, the proposed volume of private financing for new infrastructure projects under the existing Capital Plan is inadequate to meet capacity needed, accounting for just 2.5% of capital expenditure from 2017-2021, or €113 million per annum.

A 10% cap has been imposed by Government on the proposition of capital spending that can be financed using private finance.[13] We understand that a senior level group had been established to review the past experience of PPPs and their associated guidelines.[14] Dublin Chamber recommends that the Government remove the 10% cap on PPP funding.

Public Private Partnerships (PPPs) are long-term contracts between two units, one of which is normally a corporation (or group of corporations), called the operator, and the other normally a government unit called the grantor. The operator bears a significant expenditure to create a capital asset. The grantor can then either pay an annual fee to the operator for use of the asset or can allow the operator to charge users for their use of the asset. After a pre-determined time, legal ownership of the asset transfers automatically to the grantor.

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[10] https://www.rte.ie/news/budget-2017/2016/1011/823185-debt-to-gdp-target/

[11] CSO, GFQ12, Gross General Government Debt ESA2010 as a Percentage of the Annualised Gross Domestic Product by State & Quarter, http://www.cso.ie/px/pxeirestat/statire/SelectVarVal/Define.asp?Maintable=GFQ12&PLanguage=0

[12] European Commission DG ECFIN, Assessment of the 2016 Stability Programme for Ireland, p.17, http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2016/07_ie_scp_en.pdf#page=17

[13] Paschal Donohoe TD, Minister for Public Expenditure and Reform, responding to a Parliamentary Question 6th April, 2017.

[14] *ibid.*

There are two principal advantages of a PPP. Firstly it allows the grantor to transfer risk to the operator, for which the operator is necessarily compensated. Secondly, the expenditure is not classified as capital expenditure on the part of the grantor, which can allow the grantor to increase capital spending without contravening EU fiscal rules. This second advantage can only be availed of when the operator maintains economic ownership of the asset. While not being able to bear the complete increase in infrastructure measures on its own, the use of PPP contracts could go towards addressing the underspend, when taken as part of a suite of measures.

Economic ownership of the asset is determined by assessing which unit bears the majority of the risks and which unit is expected to receive a majority of the rewards of the assets. For the purposes of national accounting, the asset is allocated to this unit. The main risk and reward elements are:

- Construction risk, including most importantly cost overruns;
- Availability risk, including the possibility of additional costs such as maintenance;
- Demand risk, including the risk that demand for the services is higher or lower than forecast;
- Residual value and obsolescence risk, which include the risk that the asset will be worth less than the expected value at the end of the contract; and,
- The existence of grantor financing or granting of guarantees.

According to Eurostat's guidance, the risks and rewards are with the operator if the construction risk and either the demand or the availability risk have been effectively transferred. The grantor (Government) must be careful to avoid such arrangements that would negate this transfer of risk, such as majority financing, guarantees covering a majority of finance levied, termination clauses providing a majority reimbursement of finance provider or termination events at the initiative of the operator.

One argument often made against the use of PPP's is that Government can borrow money in debt markets at a lower rate of interest rate than the rate of return required by a private sector operator contracted as part of a PPP. However, it should be noted that a PPP represents a real transfer of risk to the operator. This is something which has value and is accordingly priced. By removing risk, the Government can better plan for the long-term cost of an asset and for investment in assets in the future.

In order to accelerate the use of PPPs, Dublin Chamber recommends:

- The 10% limit on the use of private finance be removed.
- Smaller capital projects should be bundled into packages of over €100m in order to attract more potential investors.
- The approach to transferring risk to the private sector is encouraged in the PPP Structure.

Recommendation 1.2: Ring-fence Revenue Buoyancy for Infrastructure

In the Summer Economic Statement 2016 and again in his Budget 2017 statement, Minister Noonan indicated his intention to establish a Rainy Day Fund to act as a counter-cyclical measure in the event of an economic shock. The Chamber proposes that the Rainy Day Fund should be used to ensure a steady level of capital expenditure projects. Further, revenue buoyancy should be transferred to the Fund.

The below table illustrates growth in what was to be spent in 2015 from initial forecasts in late 2013 to the actual outturn in 2015, along with a breakdown for current and capital expenditure.[15] [16]

[15] Department of Public Expenditure and Reform, (2013), '*Expenditure Report 2014*'
[16] Department of Public Expenditure and Reform (2014 – 2015) '*Revised Estimates of Public Expenditure 2015'; 'Revised Estimates of Public Expenditure 2016'*

Table 2: Current, Capital and Total Exchequer Expenditure for 2015 as planned from 2013 – 2015.

	October 2013, €bn	December 2014, €bn	December 2015 Estimate,[17] €bn	December 2015 Outturn, €bn	Growth from 2013 – 2015 Outturn, €bn
Current Expenditure	€48.3	€49.6	€51.1	€51.0	€2.7
Capital Expenditure	€3.3	€3.6	€3.8	€3.8	€.5
Total Expenditure	€51.5	€53.2	€54.9	€54.8	€3.3

In October 2013, the Government published the Expenditure report, setting out expenditure ceilings for all departments in both capital and current expenditure for 2014 – 2016. By December 2014, when the Revised Estimates for Public Expenditure for 2015 were published and adopted, this had increased, with the majority of the increase going to current spending, despite a decrease of 39,600 in the numbers unemployed over that time period.

Throughout the year 2015, it became apparent that corporation tax receipts were significantly above profile, ultimately bringing in approximately €2.3 billion more than profile. This, other tax rises, and continued positive forecasts for economic growth allowed spending to be increased during the year, with the estimates at the start of December 2015 forecasting that current spending would again take the lion's share of this increase.[18]

The final outturn figures for 2015, published in December 2015, showed a modest decrease in both current and capital spending relative to the final estimates, but did not represent a significant change.

In December 2015, the Minister for Finance informed the Oireachtas Committee that the Chairman of the Revenue Commissioners had forecast that all but approximately €300 million of the increase in corporation tax would continue to 2016.[19] [20] While these robust growth numbers were indeed tied to buoyancy in the economy and not tied to once off factors such as the settlements of large cases, it can be difficult to estimate the sustainability and long-term reliability of these gains.[21] The exchequer returns for the first quarter of 2017 show a lower take than forecasted under the headings of Income Tax, Excise Duty and Corporation Tax, leaving an overall shortfall of 2.4%, or €282 million.[22]

Recommendation 1.3: Innovative Financing Methods

Government needs to be creative and explore all available sources for capital and expertise, including off-balance sheet financing. Whilst this is not a panacea, there are models of financing whereby infrastructural deficits can be addressed without implications for fiscal capacity.

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[17] This estimate is the sum of the estimates published in December 2014 and supplementary estimates that were required during the year.

[18] The estimates dated December 2015 are the result of summing the estimates from December 2014 and any supplementary estimates voted through during 2015.

[19] http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/committeetakes/FIJ2015120300002?opendocument

[20] http://www.finance.gov.ie/sites/default/files/Letter%20from%20Revenue%20Chairman%20to%20Minister%20for%20Finance.pdf

[21] http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/committeetakes/FIJ2015120300002?opendocument

[22] Department of Finance, (March, 2017), '*Fiscal Monitor (Incorporating Exchequer Statement)*'

The European Fund for Strategic Investments (EFSI) run by the European Investment Bank is part of the European Union's Investment Plan for Europe. The expansion and enhancements of EFSI raises the potential for Ireland to increase its level of EFSI support, both for public and private sector projects. Ireland's Strategic Investment Fund, which acts as a sovereign investor with a dual mandate to create jobs and support economic growth in Ireland, is a strong potential partner to EFSI in Ireland.

The new EIB Office opened in Dublin has paved the way for stronger cooperation between the EIB and Ireland. The Government has established an "EIB-Ireland Financing Group", which includes relevant Irish Departments and Agencies working alongside senior EIB staff, to provide a strong ongoing pipeline of projects supported by EIB in Ireland.

Dublin Chamber believes that Government should fully explore alternative means of funding capital investment, including off-balance sheet financing. Lessons can be learned from other countries, such as the Netherlands, who have worked closely with the EIB to draw down finance for capital projects.

Recommendation 1.4: Reviewing the EU fiscal rules

It is important to acknowledge that these rules provide an important framework to ensure that the deficit and debt figures of Member States remain at sustainable levels over the medium-term. The implementation of the fiscal rules has been updated with the publication of the Vade Mecum 2017.[23]

This revision allows a deviation from the adjustment path towards the (Medium Term Budgetary Objective) MTO[24] of 0.5% of GDP as part of the Structural Reform Clause. This deviation must raise potential growth and have a positive budgetary effect in the long-term. It can only be used once during the each period of adjustment toward the MTO. While not an immediate fix, Dublin Chamber believes that increased investment in productive infrastructure would meet these requirements.

Specific Projects

Government should target investment in urban areas which offer the greatest return to Ireland overall. Transport funding, in particular, is more cost-efficient in high-density zones where greater use will be made of completed projects, while concentrating multiple investments in a defined area has a synergistic effect, with a positive overspill into the wider region. In practice, however, the prioritisation process for infrastructure projects is not informed by such principles.

As the heart of Ireland's economy and its largest population hub, Dublin has an especially urgent need for better infrastructure. Dublin is currently the 7th most congested city in Europe,[25] with public transport usage still standing at just 21.5%.[26] Despite this need, Dublin receives the least capital investment in public infrastructure per head of any Irish region.[27]

While the Chamber is calling for increased spending, it is cognisant both of fiscal constraints and of a requirement for prudence. Informed by this, the Chamber calls on Government to deliver projects which will deliver the strongest cost-benefit results.

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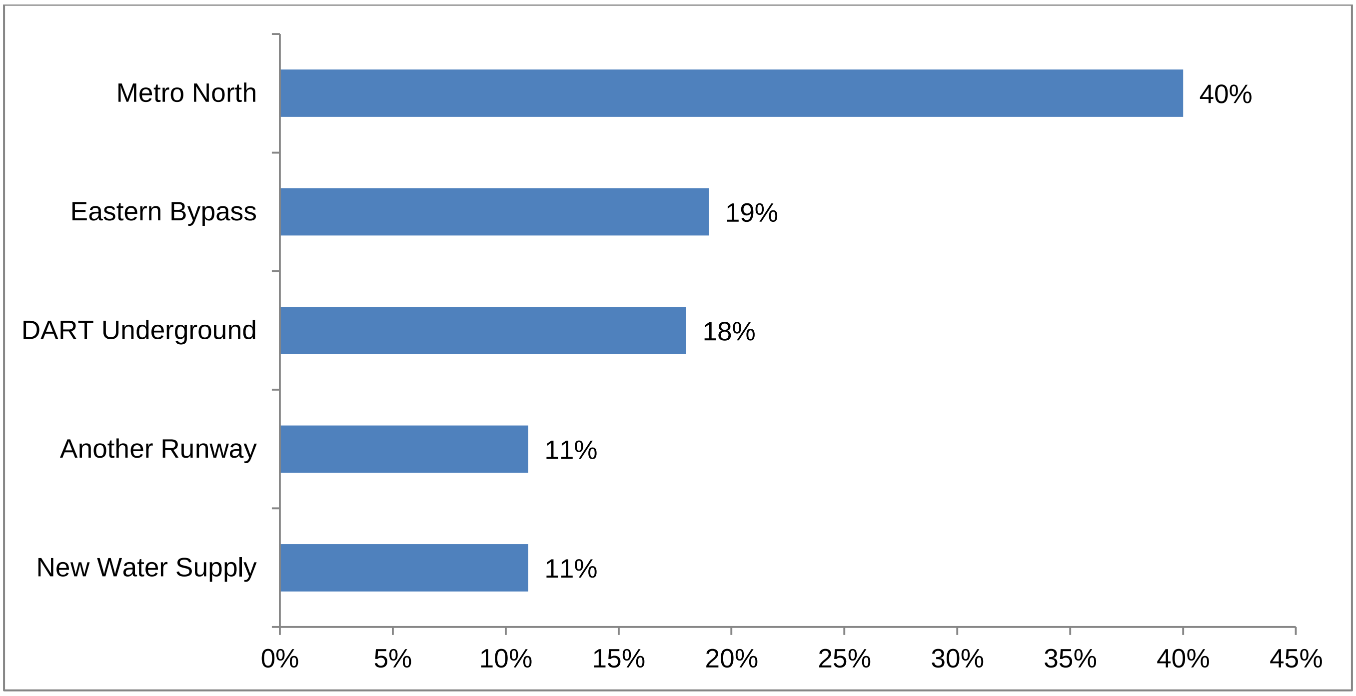
[23] European Commission, (2017) '*Vade Mecum on the Stability and Growth Pact*'
[24] The Medium Term Budgetary Objective (MTO) is a target that is reset every three years that aims to ensure sound fiscal policies and is binding on countries as part of the Stability and Growth Pact.
[25] TomTom Traffic Index, Europe – All Cities, https://www.tomtom.com/en_ie/trafficindex/list, accessed 14.12.2016
[26] CSO, Census 2011 Profile 10 – Door to door, http://www.cso.ie/en/newsandevents/pressreleases/2012pressreleases/pressreleasecensus2011profile10doortodoor/
[27] E. Morgenroth, *The Regional Development Impacts of Transport Infrastructure*, 2014

The Chamber conducts regular business sentiment surveys, part of which focus on infrastructure needs of the Greater Dublin Area. Below are the results of a Chamber survey, highlighting a clear priority for the expediting of the Metro North project.

Fig. 4: Infrastructure Projects Priority (Business Trends Survey Q1 2017).



Metro North and DART Underground

Rail investment must be focussed on where it will have the greatest economic, social, and environmental impact. Economic activity in the Greater Dublin Area accounts for over 53% of Ireland's GDP.[28] As well as being the heart of the Irish economy, the Greater Dublin Area is home to 40% of the State's population. Some 871,500 people were employed in the GDA in 2016, representing over 42% of the total number of people employed in the State.

In light of existing funding gaps and potential uncertainty around future rail investment, DART and Dublin Commuter routes must be prioritised for maintenance and development of network infrastructure. These are of critical importance to the national economy and have the greatest impact on congestion levels in the capital at peak traffic times. A focus should also be placed on maintaining and improving good rail links between Dublin and the other larger cities.

The cost of accelerated spending on these projects should be weighed against the costs to the economy of continuing traffic congestion. Over half of Dublin businesses reported increased costs due to congestion in 2016.[29]

Water Infrastructure

Any analysis of the need for infrastructure spending in the water sector must be cognisant of the fact the management of the national water infrastructure is going through a transition phase. The Eurostat

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[28] Central Statistics Office, 2017, '*County Incomes and Regional GDP*', Table 9b GVA per Region at Basic Prices, 2006 – 2014.
[29] Dublin Chamber Member Survey Q4 2016

determination that Irish Water would remain on the state's balance sheet has implications for the capital expenditure budget.

Dublin Chamber calls on the Government to clarify the implications for the capital expenditure plan as a whole, of this decision and to commit to funding the Eastern and Midlands Water Supply Project

Any delay in the creation of a new water source for the East and Midlands region will leave Dublin worryingly exposed to water shortages. The need for an additional water supply for Dublin was first identified in 1999, with the project then under the remit of Dublin City Council.

Irish Water has announced the selection of a preferred scheme for the Eastern and Midlands Region. This project has grown in scope, costing approximately €1 billion, and will provide water security for businesses across the Eastern and Midlands regions and also for approximately 40% of the State's population.

In comparable and competitor cities, the water drawn from the system is typically in the region of 80% of the network's capacity. In Dublin, this figure is approximately 98%. There is no headroom in Dublin, as was seen in 2013 when the Web-Summit caused the city to experience water shortages, with businesses closing temporarily as a result. This cost the economy in the region of €78 million per day of outages. The threat of water shortages in Dublin is already being recognised globally. A Stanford University study in 2014 identified Dublin as the second most vulnerable city in the world to water shortages in the future.

Eastern Bypass

Dublin Chamber remains a strong advocate of an Eastern By-Pass in Dublin. We believe that Government should give serious consideration to building an Eastern By-Pass that would close the existing 11km gap that exists on the south-eastern side of the city between the Dublin Port Tunnel and the M50. Dublin Chamber believes that the long-term benefits for the Dublin region would exceed the anticipated costs. If designed well, the creation of an Eastern By-Pass would not only provide a much needed solution to congestion in the city centre and the M50, but could also serve as an effective flood barrier that would protect at-risk parts of Dublin for the next 100 years.

2. Attract & Retain Key Talent in Ireland

In its research, the Chamber conducts surveys on a quarterly basis of its members. The resounding message coming from the business community is that investment in infrastructure is the top priority. However, the Chamber is also advocating some targeted tax measures that will have a significant impact on economic performance. They are capacity related also in that they attract capital for investment into business, encourage entrepreneurship and the attraction and retention of key talent in business. These measures are aimed at making it easier and more attractive to establish a business and to hire people into an existing business.

Recommendation 2.1.: Share Based Remuneration

Recommendation:	**Allow an employee that is granted share options in their employer's business to only be subject to income tax on the discount between the option exercise price and the market value of the shares on the date of grant of the option with the income tax liability arising on the date of exercise of the option.**
Market Failure:	Many businesses cannot target key employees with share-based remuneration as it is not tax-efficient and puts them at a disadvantage to larger, older businesses.
Target Group:	Expanding businesses.
Benefit:	Increases survival rates of small business, increases incentive for small businesses to train staff.

As part of the Programme for Partnership Government, there is a commitment to explore the mechanisms through which SMEs can reward key employees with shares in a tax efficient manner and in the Budget 2017 announcement, the Minister for Finance committed to developing an SME share-based remuneration scheme.

Capping the income tax that would arise on the exercise of share options would allow employers to attract and retain key employees that are crucial to the survival and growth of their business when these employees are in high demand by other employers.

Why Grant Options and Not Equity?

Granting a stake in a company can help employers attract and retain key staff that are crucial to the survival and growth of their business and can also encourage more employee 'buy-in' and thereby increase performance.

While increasing salary is one of the most obvious ways of attracting and retaining key staff, it is not an option that is open to all businesses. If a business is at an early stage of development or expansion, then cash flow may not be sufficient to allow an increase in salary. Employees may be willing to forego an increased salary in exchange for a stake in the company. If they are integral to the survival or growth of the company this will give them a claim over the increased value of the business in the future. Typically, a stake in the business can be given through the use of share options. Options are contracts that give the owner (of the contract) the right but not the obligation to purchase something. Typically, there are stipulations. For employee share options, these may be a time limit (either minimum or maximum), agreement to remain in employment with the grantor, or performance related.

Many studies have shown that increased employee ownership has a strong and positive correlation with business survival rates, increased employment security for employees, and ultimately increased compensation for employees. By having a stake in a company, employees are encouraged to work for the survival and growth of the company as their financial future is more dependent on the company's survival.

However, upfront income tax liabilities on the grant of shares in high risk early stage companies or uncapped deferred income tax liabilities on the exercise of share options can mitigate against the effectiveness of equity based remuneration for early stage companies.

Currently, there are two main categories of 'Revenue-approved' ways of implementing share-based remuneration. When a share-based remuneration scheme is approved by the Revenue Commissioners, certain tax benefits can be availed of. The disadvantage of these schemes is that they must be offered to all employees on a similar basis. While broad employee ownership of a business has many benefits, it is not a suitable tool for targeting key employees.

If an employer wishes to grant share options to an employee on a selective basis, that employee may be immediately (i.e. within that tax year) liable to pay income tax on that grant of shares. In small and young businesses, the employee's salary regularly is not sufficient to allow them to pay this tax bill.

It may be suggested that the employee sell some of the grant of options to fund the tax liability. However, frequently, there will not be a liquid market for these options, and the sale of the options to an outside party may not be permitted by the instrument granting them to the employee.

A larger or more mature business may well be able to afford the requisite increase in the employee's salary to allow them to settle their tax bill in the event of a grant of equity.

There are two market failures here to be addressed for SME companies:

- The lack of a liquid market for the share options means that the employee granted the shares cannot sell a portion of them to pay their tax liability and keep the remainder; and,
- At lower wage levels, income cannot be sacrificed, to fund optional tax liabilities, without falling below such a level as meets basic living standards.

How do we fix this?

Dublin Chamber proposes to allow an employee that is granted share options in their employer's business to only be subject to income tax on the discount between the option exercise price and the market value of the shares on the date of grant of the option with the income tax liability arising on the date of exercise of the option. The UK's Enterprise Management Incentive (EMI) is a useful comparator in this regard.

Dublin Chamber proposes that, similar to the UK's EMI scheme, the options could only be executable for ordinary shares. The standard SME criteria would have to apply on the date of grant of the options. If the company grew larger than the SME conditions, however, the employee granted options prior to the growth would not lose their deferral.

We propose that each employee can hold unexercised EMI options over shares worth up to €250,000. The maximum value of unexercised EMI options that can be held at any time by all the company's employees should be €3 million. Both limits are measured at the date of grant.

If the option exercise price is equal to the market value of the shares at the date of grant of the option, then no income tax would be liable. However, if these options are granted at a discount, then income tax is liable on the discount. The income tax liability will arise upon the exercise of the option by the employee.

The employee will be subject to capital gains tax on any uplift in value of the shares above the market value on the date of grant of the options.

Recommendation 2.2: Remove the 3% USC Surcharge for those earning above €100k

Recommendation:	**Remove the 3% USC Surcharge.**
Target Group:	Self-employed of all salary levels.
First year cost:	€59m.
Full year cost:	€144m.
Benefit:	Ensure tax equality of treatment for self-employed.

Dublin Chamber recommends the removal of the 3% USC surcharge on incomes over €100,000 for self-employed people. This was intended as a temporary measure, runs counter to Government's pro-entrepreneur policies and represents a significant disadvantage for cash negative self-employed individuals.

The USC surcharge on the self-employed was implemented in Budget 2011 to pay for the decrease in the USC charge to those who are entitled to medical cards, and to those who are aged over seventy. This surcharge was predicted to raise €80m to pay for those reductions, according to then Minister for Finance, Brian Lenihan TD. Further, this measure was intended to be temporary that 'if adopted, will be transitional in nature and will have effect until the end of the period of the national recovery plan.'[30]

Over recent budgets, Government has sought to lower the Universal Social Charge for lower income earners while maintaining it for higher income earners. However, the Government has also sought to both encourage entrepreneurial activity and equalise tax treatment between the self-employed and PAYE employees.

Entrepreneurs should be rewarded and encouraged for being risk takers and driving business growth. This charge is seen as unjust and unfair by virtually all commentators in this sector and we believe it is time for the Government to abolish this charge, stimulate the self-employed sector, and put it on a level playing pitch with the PAYE worker.

[30] Brian Lenihan TD, Minister for Finance, speaking at the Second Stage Debate of the *Finance Bill 2011*[January 25th 2011].

Recommendation 2.3: Increase Earned Income Tax Credit towards PAYE equivalent

Recommendation:	Increase Earned Income Credit to €1,650.
Market Failure:	Self-employed do not currently get to claim the PAYE credit.
Target Group:	Self-employed.
First year cost:	€58 million[31]
Full year cost:	€103 million[32]
Benefit:	Actual and perceived fairness of treatment of self-employed.

The Earned Income Credit introduced and increased in Finance Act 2015 and Finance Act 2016 respectively was a positive step towards re-balancing the inequity of treatment between self-employed people, who are not entitled to a PAYE tax credit, and PAYE employees. However, the current €950 value of the Earned Income Tax Credit continues to act as a barrier to potential entrepreneurs.

It is important that entrepreneurs are not disadvantaged, compared to PAYE employees, by the tax system. The introduction of Earned Income Credit was at a level that is 33.3% of the PAYE tax credit and then increased to 58% in the most recent Budget. The Earned Income Credit should give parity of treatment between the self-employed and PAYE workers and that the cap on the Earned Income Credit should be raised to €1,650 to match the PAYE credit.

The estimated cost of increasing the Earned Income Tax Credit to €1,650, according to the Revenue Commissioner's Ready Reckoner, is €58m for the first year and €103m in a total year. It would be of benefit to approximately 111,600 entrepreneurs and proprietary directors. This change would represent a significant recognition of the important role that can be played by the owner-managed business sector in job creation and in the ongoing improvement in Ireland's economy.

[31] Office of the Revenue Commissioners, 2017, '*Revenue Ready Reckoner*', p5
[32] *ibid.*

3. Attract & Retain Entrepreneurs' Capital

With the UK having made the decision to leave the European Union, and a 'Hard Brexit' seeming increasingly likely, the potential of a UK not bound by the EU's competition rules is a very real prospect. To combat this, it is crucial that Ireland seek to attract and retain entrepreneur's and their capital in order to establish and grow job-creating businesses.

Recommendation 3.1: Further improve Entrepreneur Relief for second year

Recommendation:	**Improve the Entrepreneur's relief on Capital Gains Tax by increasing the cap to €10m.**
Market Failure:	Currently the UK offers tax advantages to establish a business in Northern Ireland rather than Dublin.
Target Group:	Passive investors.
Gross cost:	€52m per annum (not including revenue from increased start-up activity).[33]
Benefit:	Net increase in number of scaling businesses in Ireland with additional jobs created as a result.

In Budget 2017, the Entrepreneur's Relief from Capital Gains Tax, introduced in Budget 2016, was improved by decreasing the applicable rate from 20% to 10%. However, the lifetime allowance was maintained at €1 million.

Increasing the limit to €10 million has two principal benefits. Firstly, while many will not avail of the full €10 million limit the first time that they sell a business, having a larger limit will allow them to establish another business with the same incentives. Secondly, with the potential for a business to be worth notably more than €1 million on sale, there is still a strong incentive to locate a business in Northern Ireland.

While it was signalled in the Budget 2017 announcement that this limit would be expanded in coming years, the pace at which it is expanded is important. If this measure is expanded slowly, it will encourage many to establish businesses in Northern Ireland rather than wait for the relief to be competitive.

Therefore, the Chamber recommends the expansion of the relief to move towards the level of relief provided in the UK. The applicable gains should be extended to €10m in Budget 2018.

[33] Tax Strategy Group 2016, cost of reducing from 20% to 10% and increasing limit to €10 million. Reduction in rates has already taken place, at a cost of €13 million according to the Department of Finance Budget 2017 documentation. Costings are non-dynamic.

Recommendation 3.2: Reduce CGT rate for shares in unquoted companies

Recommendation:	**Encourage investment in indigenous business by applying a lower rate of CGT (20%) to all investment in unquoted companies.**
Market Failure:	Thresholds for Entrepreneurs relief mean that small investors are incentivised to invest in Blue Chips rather than indigenous business.
Target Group:	Passive investors.
Benefit:	Increase in amount of investment by small passive investors in indigenous businesses.

While an expanded Entrepreneur's Relief from CGT will encourage people involved in a business to invest in it, there is no incentive for distanced parties to elect to invest in a start-up Irish business over a longer-established multinational.

Income and capital gains are taxed at different levels to reflect the inherent difference in risk profiles. This principle should be reflected in the way in which Capital Gains Tax is charged on investments in different companies. The distinction between unquoted companies, with a much less liquid market for the sale of shares, and large quoted companies, with a liquid market for the sale of shares, should be reflected in different rates of Capital Gains Tax.

The application of a uniform 33% CGT rate to all capital gains irrespective of the level of risk taken and contribution to the Irish economy of the underlying investment is inequitable. An Irish individual will pay the same CGT rate on a passive investment in large blue chip foreign companies as they will on high risk early stage Irish companies. People providing angel investment, providing their services as employees and shareholders who do not meet the 5% threshold to avail of Section 597AA are therefore unfavourably treated.

The UK have introduced a new lower CGT rate of 10% up to £10m of lifetime gains (in addition to the Entrepreneurs Relief) that can apply to long term investors in unquoted trading companies. We recommend that a lower rate of CGT of 20% should apply to all investment in unquoted trading companies where shares have been held for in excess of three years. A lifetime limit along the lines of the UK could also be considered.

A further benefit of encouraging investment in unquoted companies is that investment opportunities tend to be localised and thus the benefits are more likely to be felt in the local Irish economy. The suggestion here is for a 20% rate which is still substantially higher than the UK 10% rate that applies to such disposals, but it is recognised that it would be politically difficult to achieve an immediate move to such a lower rate.