

Team Name: 'The Tax Entrepreneurs'
Team Members: *Gordon Curtis, Karen Doyle, Laura Frankish and Richard O'Donnell,
Dun Laoghaire Institute of Art, Design & Technology.*

Lecturer: *Conor Heagney*
Email address: conor.heagney@iadt.ie
Mobile: *086 – 061 3133*
Word Count: *1,856.*

Introduction

We are 4 entrepreneurship students in IADT. Last year, we published a magazine 'Make €ents' as part of our degree course. Unfortunately we found ourselves in financial difficulty during this enterprise; our (printing) expenses were significantly larger than our (advertising) income. After a lot of thinking, hard decisions and stress, we managed to reduce our expenses and to increase our income. This sobering experience informs our Fantasy Budget proposals and in a way, gave us an understanding of what it's like to have a budget deficit. This is why we have focused on the public sector pay and pensions bill from the expense viewpoint. We hope to increase tax revenues by encouraging enterprise to help on the income side of the Government's accounts.

Our proposals concern:

1. Investment in start-up companies (enterprise)
2. PRSI tax holiday for start-up companies (enterprise)
3. Public servants starting their own businesses (enterprise / public expenditure)
4. Raising the public sector retirement age to 70 years (public expenditure).

Proposal 1.

Double the Capital Gains Tax deduction for investments in ordinary shares of start-up trading companies.

How the proposal would work.

An individual or company invests €10,000 in ordinary shares of a start-up company within the first three years of trading. Assume these shares are sold many years later for €25,000. The cash gain is €15,000. This proposal would allow the investor to deduct the cost, €10,000, twice in the calculation of the capital gain. In this case the capital gain would be reduced to €5,000. The maximum qualifying investment would be €200,000 per company.

Main idea.

Budget 2009 introduced an exemption from corporation tax and capital gains tax for the first three years of a start-up trading company provided the tax does not exceed €40,000 annually. This proposal seeks to extend this tax holiday to persons who invest in such start-up companies. It is difficult to attract funds into start-up companies. This tax relief is designed to make such investments more attractive.

Benefits for Ireland:

1. Investment in start-up companies is encouraged in a period when it is extremely difficult for such companies to attract funds.
2. Investors in high-risk start-up companies pay no capital gains tax on the first 100% of the capital return on their investment.

Potential issues:

1. Loss of tax revenue. The maximum loss of capital gains tax is €44,000 per company i.e. €200,000 @ 22%. Many start-up companies do not survive with capital losses often going unused as the founder / investors may not have offsetting capital gains. Accordingly the overall capital gains tax cost of this proposal is unlikely to be significant.

Conclusion

Investments in start-up companies carry a high risk. In an economic recession many investors decide, after a cost / benefit analysis, not to invest. This proposal seeks to encourage such investment by increasing the potential benefits.

Proposal 2.

Three year employer's PRSI tax holiday for start-up trading companies.

How the proposal would work.

The Pay Related Social Insurance (PRSI) system applies to individuals employed in the State under a contract of service. The employee and employer must each pay PRSI. The standard rate of employer's PRSI is 10.75% of pay. This proposal would exempt start-up trading companies from employer's PRSI for the first three years of operations. The limit on this tax holiday, including corporation tax and capital gains tax, would be €40,000 annually.

Main idea.

Budget 2009 introduced an exemption from corporation tax and capital gains tax for the first three years of a start-up company provided the tax does not exceed €40,000 annually. This proposal seeks to extend the tax holiday to employer's PRSI.

Benefits for Ireland:

1. Enterprise is encouraged. Many start-up companies may not have significant corporation tax or capital gains tax liabilities, but employer's PRSI is likely to be a significant cost in many cases.
2. It makes it more attractive to employ staff.
3. Entrepreneurs will be less likely to try 'to do everything themselves' and may be able to focus on critical issues such as selling and promotion.

Potential issue:

1. Loss of revenue for the government. This is limited to €40,000 annually. If this proposal helps the company to survive, the Government is likely to recoup PRSI foregone many times over in future years.

Conclusion

The economy needs more start-up companies and more employment. This proposal aims to support both needs.

Proposal 3.

Allow public servants, retiring early, to borrow up to 25% of their pension fund to invest in their own start-up businesses. The loan would be made by the National Pension Reserve Fund on an interest-free basis.

How the proposal would work.

On early retirement from the public sector, individuals could borrow up to 25% of the value of their pension funds. These funds must be invested in a start-up trading company. The loans would be repayable on the normal retirement date (see also proposal 4) of the public servants turned entrepreneurs. The lump sum portion of the individual's pension fund could be used to make this repayment.

Main idea.

This proposal seeks to encourage entrepreneurial public servants to set up their own businesses.

The Global Entrepreneurship Monitor report (2007) found that 8.2% of the adult population living in Ireland is engaged in entrepreneurial activity. The corresponding figure in 2006 was 7.4% (www.enterprise-ireland.com). A significant percentage of public servants are likely to be interested in starting their own businesses.

Benefits for Ireland:

1. The public sector wage and pension bills will be reduced.
2. More start-up businesses should lead to more economic activity and more tax revenue for the Government.
3. Cheap and ready source of finance for start-up businesses.
4. Entrepreneurial public servants are likely to achieve more work satisfaction in their own businesses rather than within an economically constrained public sector.
5. Less unemployment benefit payments required for individuals who leave the public service.
6. There is no bad debt risk as the loans will be secured on the individual's pension fund.

Potential issues:

1. The National Pension Reserve Fund loses out on interest. If this is a major concern, a low interest rate could be applied to the loans. Alternatively the maximum loan could be reduced to less than 25% of the pension fund so that accumulated interest could be repaid on the 'normal retirement date.
2. Individuals could lose their lump sum pension entitlement if their business fails. The regular pension (75% of the fund) will remain. This kind of financial risk is a normal element of entrepreneurship.

Conclusion

This proposal seeks to smooth the move of entrepreneurial public servants into the world of enterprise. This will reduce the public sector wage bill and increase tax revenues. Even if very few people take advantage of this proposal, it sends out a powerful pro-enterprise message at a minimal cost to the Government.

Proposal 4.

Raise the retirement age in the public sector to 70 years.

How the proposal would work.

This budget policy proposes to increase the retirement age in the public sector to 70 years over the next 15 years i.e. by 2023. The retirement age would increase by one year every three years with the first increase occurring in 2011.

All public servants will receive a 'working tax credit' of €2,000 for each tax year between the ages of 65 and 70 years. Flexible working arrangements will be introduced for public servants between the ages of 65 and 70 such as 3 day working weeks. Early redundancy packages will be available to those who do not wish to continue working until the age of 70.

Main idea.

To reduce the current and future 'public sector pensions time bomb'.

According to the Central Statistics Office (CSO) there were 373,100 public sector employees in June 2008

(<http://www.cso.ie/releasespublications/documents/earnings/current/psempearn.pdf>).

The Irish Business and Employers' Confederation (IBEC) calculates that a private sector worker would have to pay up to 28% of annual salary, over 40 years, to obtain a 'public sector pension'

(http://www.finfacts.com/irelandbusinessnews/publish/article_10007566.shtml).

Taoiseach, Brian Cowen recently estimated the public sector pension bill at €75 billion. Life expectancy is expected to increase from its current level of 76.7 years to 86.5 years for males by 2041 and from 81.5 to 88.2 years for females

(CSO:http://www.cso.ie/newsevents/pr_poplabfor2011.htm). The green paper report on pensions states that the pension support ratio (PSR = ratio people of working age to pensioners) was 5.6. The PSR is estimated to decline to 1.8 by 2061.

(2006: <http://www.pensionsgreenpaper.ie/downloads/GreenPaperexecsummary.pdf>).

In summary, the public sector pension bill is big and is predicted to get substantially bigger. This proposal seeks to reduce this major cost for the Government.

Benefits for Ireland:

1. Major cost saving for the Government. The average current retirement period, based on the above figures is approximately 15 years. If the retirement age is reduced by 5 years, the saving is approximately one third of the public sector pension bill or €25 billion. This estimation needs to be reduced for the phasing-in process, the increase in life expectancies, early redundancy packages, flexible working and the extra tax credits. Nevertheless the potential for protecting Government resources is substantial.
2. Public servants have the option of working for an extra 5 years. Their income will be boosted by the 'working tax credit' of €2,000. Longer life expectancies are likely to lead to a capacity to work longer.
3. As well as having to fund 5 years less for pension purposes, public servants will be contributing to the pension fund, and paying tax, for an extra 5 years.

Potential issues:

1. Public servants and their unions may consider this to be unfair and a retrospective change in the terms of their employment contracts. On a macro basis, the Government would need to explain the critical national importance of this measure. On a micro basis, the flexible working and early retirement options may deal with many of the issues.

Conclusion

The scale of the 'public sector pensions time bomb' is very significant. The recent dramatic falls in share values emphasise how precarious the national pension funding situation is. This proposal would protect national resources and thereby strengthen the Government's ability to provide pensions not just for public servants but for all its people i.e. through the social welfare pension system. While this proposal would not be popular, the general public are likely to understand it during this time of economic crisis.

Evaluation of Budget 2009 and Overall Conclusion.

Budget 2009 had to deal with an extremely difficult set of economic circumstances. On the expenditure side, the Government has made a large number of relatively small cuts. In addition, the Government announced, on 26 November 2008, a major review of the Public sector.

Our proposals, on the other hand, seek to make a small number of potentially very significant expenditure cuts. Budget 2009 promoted enterprise through the introduction of a very welcome tax holiday for start-up trading companies. Our proposals go much further in attempting to harness the entrepreneurial abilities of our people. We hope you agree.