



**Irish Taxation
Institute**

Educating, Developing & Representing

Pre-Budget 2009 Submission

Incentivising Entrepreneurship and Economic Growth

September 2008

Table of Contents

Executive Summary	3
Summary ITI Proposals	6
1 Introduction	9
1.1 The Irish Taxation Institute	9
1.2 Contributing to Debate	9
1.3 Working in partnership	9
1.4 The Submission Process	10
1.5 Contacting Us	10
1.6 Background and Context of Submission	11
2. Encouraging Entrepreneurship	13
2.1 Eliminating Disincentives to Entrepreneurship	13
2.1.1 Close Company Surcharge on Professional Services Income	13
2.1.2 Income Tax – Commencement Rules	14
2.1.3 Inequitable Interest on Late Payment of Tax	16
2.1.4 Impact of Regulation	18
2.1.5 Enhancing the Attractiveness of the Business Expansion Scheme	20
2.2 Suggestions for Incentivising Entrepreneurship	21
2.2.1 Working Tax Credit for the Self-Employed	21
2.2.2 Improvement to Pension Relief	22
2.2.3 Carry-Back of Losses against PAYE Income	22
2.2.4 Impact of Change of Trade on Loss Relief	23
3 Enhancing Foreign Direct Investment	24
4. Enhancing the Consultation Process	25
Appendix I	27
Appendix II	32
Bibliography	34

Executive Summary

In preparing our pre-Budget submission this year we recognise the less favourable circumstances the Irish economy currently faces and the tight constraints on budgetary spending. Notwithstanding these, it is important that endeavours to enhance Ireland's competitiveness are supported and a continuing commitment is given to the National Development Plan and to maintaining a low tax regime, while ensuring the Exchequer deficit is effectively managed.

In this submission we have focused on two main themes:

- 1. Encouraging entrepreneurship**
- 2. Enhancing foreign direct investment**

A full list of all our proposals supporting these themes follows this Executive Summary.

Encouraging entrepreneurship

Now, more than ever, it is essential to ensure that the administration of the tax system is as streamlined as possible and that any unnecessary complexities faced by struggling taxpayers are removed. Those issues which are hampering entrepreneurship need to be addressed and positive incentives activated to promote investment in fledgling and struggling businesses across the country.

In these difficult times, cash-flow is a key issue for business. Even those businesses which are managing to sustain their work flow are struggling to receive timely payment for goods and services. In turn, this squeezes resources for payment of salaries and cash available for paying creditors (including the Revenue Commissioners).

To the extent that there are existing obstacles to entrepreneurship in the tax system, these need to be identified and addressed. We have outlined certain difficulties in this submission that we have identified and believe that solutions can be found for many of the issues which would improve matters for taxpayers at no significant cost to the Exchequer. Examples are the simplification of the archaic income tax commencement rules, the amendment of certain VAT accounting and filing provisions and the adjustment of Business Expansion Scheme (BES) investment deadlines.

Other issues raised may have certain Exchequer costs but we believe they need to be addressed on the grounds of fairness for the taxpayer. This applies to the disparity in our interest regime on tax under and overpayments, which is costing taxpayers excessive and penal amounts in very difficult times.

In terms of new ideas to incentivise entrepreneurship we suggest a range of measures including the introduction of a working tax credit for the self employed, measures to

allow for greater investment in pension schemes by the self employed and some amendments to the income tax loss relief regime to provide taxpayers with greater flexibility in times when losses are more likely to arise.

Enhancing foreign direct investment

In our recent submission to the Commission on Taxation and our pre-Budget 2007 submission we stressed the importance of measures to enhance foreign direct investment and boost Ireland's competitiveness in the international arena. While some of the measures we suggested in the Commission on Taxation submission were of a medium term strategic nature, it is important to reflect on them here and to pick up the specific recommendations we have also made in the past.

There are some key elements still missing from our holding company regime:

- Relief from withholding tax on outbound interest, royalties and dividends
- Full exemption from tax for dividends
- Full consolidated tax grouping
- A comprehensive system of rulings
- A wider treaty network

From a strategic perspective, we recommend that the regime is reviewed by a multi-stakeholder tax policy forum. We would also like to see specific steps taken to deal with relief for intellectual property acquisition and progress on a "white list" to address gaps in the treaty network where delays are anticipated.

Enhancing the Consultation Process

On a final note, we are all very aware of the tight timeframe within which Budget and Finance Act 2009 will be framed. We feel more than ever that caution needs to be exercised before introducing complex measures in this Finance Bill without full and comprehensive debate in advance.

Major policy initiatives require proper scrutiny and should not be included in the annual Finance Bill but should be the subject of a technical bill to be issued several months later. This is a change to the setting of tax policy that the Institute has long advocated and we wish to see it implemented on a permanent basis. However, it is even more critical this year given the particularly short timetable envisaged.

We recommend that the annual Finance Bill, to be issued shortly after the Budget, should focus on:

1. Legislative changes in relation to customs and excise tax
2. Any changes in the tax rates or tax bands
3. Only urgent amendments to anti-avoidance legislation, rather than major systematic changes

4. Updates to the tax treaties schedule, so as not to delay when they are brought into effect.

All other complex technical changes should be deferred to a separate technical Bill in the interests of ensuring full and proper consultation.

Summary ITI Proposals

In total there are 21 proposals which we believe will assist business and boost the economy in these challenging times.

They are summarised as follows:

Encouraging entrepreneurship

Entrepreneurship can be encouraged by both eliminating disincentives and providing further incentives to those considering setting up in business for the first time.

Eliminating disincentives

1. The close company surcharge on professional service companies acts to discourage the retention of profits which are needed to fund company growth. As this surcharge is no longer appropriate it should be abolished.
2. The rules for calculating the income tax liabilities arising in the first 3 years of operation as a sole trader are complex and in need of revision. Given that cash flow difficulties are common when starting up in business, we believe that a basis which allows tax liabilities to be calculated by reference to cash receipts for the first 3 years of trading would greatly assist small business.
3. The disparity between the rates of interest on tax overpaid and tax underpaid is inequitable. The rates should be aligned closer to each other and with commercial rates.
4. Assessments for interest on late payment of tax should not be raised after 2 years from the date on which a late payment of tax was made. Prompt assessment and collection would give greater certainty to the taxpayer and the Exchequer on amounts due.
5. New businesses should be treated with some leniency in the first 3 years of operation and interest should not be applied to late payments of income tax or corporation tax where a payment is made within 2 months of the due date.
6. The same VAT registration threshold should apply to both goods and services. This should be set at the highest limit permitted. The newly published European Commission “Small Business Act” recommends a VAT registration threshold of €100,000 to help small businesses. We recommend that this limit is adopted.
7. A welcome increase from €635,000 to €1,000,000 was introduced to the threshold for accounting for VAT on a cash basis in 2007. To widen the scope of businesses who can avail of this option we recommend that this threshold should be further increased to €2 million.
8. A number of VAT filing options currently exist for smaller taxpayers. These should be streamlined by allowing taxpayers who have an annual VAT liability

of less than €100,000 to pay and file VAT annually with an option to pay and file on a bi-monthly basis.

9. All companies should have the choice to base their preliminary corporation tax liability on 100% of their prior year corporation tax liability. This would lead to increased certainty for the taxpayer as to their obligations and improved forecasting of receipts by the Exchequer.
10. The deadline for making a qualifying payment into a Business Expansion Scheme (BES) should be extended to 31 January following the year of assessment in which the investor wishes to claim the relief. This would increase the attractiveness of BES to investors.
11. Where a BES scheme requires certification from Irish State bodies, applications for certification should be processed within 4 weeks of their submission.

Further Suggestions for Incentives

12. A “working tax credit” should be available to the self-employed, aligned with the credit available to PAYE employees.
13. The self-employed should be able to avail of a tax deduction for the cost of annual/monthly travel passes in the same way that employees can.
14. Pension relief for the self-employed should be improved so that relief can be based on earnings immediately prior to start up of the business. Such earnings would be at a higher level, affording greater investment in the pension fund. Any excess relief should be available for carry-forward against future income.
15. Sole traders should be allowed to offset losses incurred in the first 3 years of operation against PAYE paid in the 3 years immediately prior to start-up. In this way the sole trader could receive a refund of tax when cash is most needed.
16. Where a taxpayer has incurred losses in a failed trade and subsequently commences a new trade, the losses are not available for carry forward against the new trade. Such a provision does not recognise the reality that an entrepreneur may need to adapt their trade, especially in the current context. Consideration should be given to introducing a mechanism to allow for the carry-forward of losses in certain circumstances against the future profits of a second trading venture.

Enhancing Foreign Direct Investment

17. Undertake a review of the holding company regime to consider issues such as:
 - (a) withholding tax on outbound dividends, interest and royalties.
 - (b) full exemption from tax on foreign dividends.
 - (c) full consolidated tax grouping.
 - (d) a more comprehensive and time-efficient system of rulings where taxpayers could obtain some certainty of treatment and binding pre-transaction clearances.
18. Enhance the tax treaty network, setting a target of a minimum of 10 new treaties to be ratified by 2012.

19. Identify a “white list” of countries with whom a treaty is being prepared, to allow treaty benefits to be availed of prior to ratification.
20. There is currently no provision for corporation tax relief for an Irish company on the acquisition of brands, non-industrial know-how, or intellectual property (IP) related goodwill. In addition, the limited relief for know-how that is currently available does not apply to the acquisition of know-how from a related party, and therefore discourages large multinational companies from locating their IP management and design processes in Ireland.

Enhancing the Consultation Process

21. Given the tight timeframe between the Budget and the Finance Bill 2009, we recommend that complex measures should be introduced through a later separate “technical” bill to allow sufficient time for debate and consultation. This change should be made on a permanent basis.

By adopting the proposals set out in this submission we consider that the Government will assist Ireland’s competitiveness in the current economic turbulence.

1 Introduction

1.1 The Irish Taxation Institute

The Irish Taxation Institute (ITI) is the leading representative body for taxation affairs in Ireland. Our membership of Registered Tax Consultants includes tax advisors, accountants, barristers, lawyers, and other corporate and business professionals. Our mission is to support an efficient, fair and competitive tax system that promotes an understanding of and expertise in taxation and encourages economic and social progress.

Our 6,000 members work with corporate leaders, Government, State agencies, representative groups, professional organisations and the general public. Through our membership of the Confédération Fiscale Européenne, we monitor and influence legislation and tax policy developments in the EU and internationally.

For over 40 years, ITI has been Ireland's provider of Registered Tax Consultants through our 3 year (AITI) and 1 year (TMITI) tax qualification courses. Our professional development programme provides continued education, appropriate advice, specialist seminars and other support services for members. This ensures Registered Tax Consultants remain professionally competent throughout their working lives.

Through our nationwide branch network and comprehensive committee structure, our members are actively involved in developing and advancing research on taxation, economic and social policy. Drawing on this expert team, ITI produces a comprehensive suite of taxation publications covering the full range of tax topics.

1.2 Contributing to Debate

As part of our representational role, we engage regularly with key stakeholders in the policy formulation arena to give our members perspective on key tax policy issues. In addition to the production of an annual pre-Budget submission, we make submissions to the Department of Finance, the Revenue Commissioners and other relevant arms of the State and EU stakeholders on issues ranging from the administration of the tax system to overarching policy. In that context, we welcome the opportunity to make this submission and look forward to discussing the proposals contained therein with all key stakeholders as part of the Budget and Finance Bill formulation processes.

1.3 Working in partnership

The ITI and its members are proud of the constructive and collaborative relationships enjoyed with key stakeholders in tax policy formulation in Ireland and, in particular, the Department of Finance and the Revenue Commissioners. The Taxes Administration Liaison Committee (TALC) continues to provide a robust forum for the exchange of

views and the resolution of both policy and practical administrative issues as they arise. Registered Tax Consultants have a key role to play in the smooth running of the tax administration system and we look forward to the continuation of this mutually beneficial approach in the future. This submission is presented within the context of such collaborative work and we are happy to provide expertise and assistance in the development of the proposals as required.

Many of the recommendations contained within this submission have arisen as a result of interactions with the above stakeholders, together with workshops with the Department of Enterprise Trade and Employment at which ITI made contributions, which were incorporated into the report of the Higher Level Group on Business Regulation, on easing the cost of regulation on business.

1.4 The Submission Process

This submission is a result of extensive consultation within our membership as well as with the wider business community and other representative bodies. As with all our work in the tax policy area, it is guided by a set of principles that include our belief in a tax administration system that is simple, transparent, robust and stable, and one that delivers low compliance costs for the taxpayer. In addition, we provide support for the Government on tax policy issues that improve the economic position of the country both domestically and internationally. In that context, we trust that the ideas put forward will prove useful in the overall debate on what we consider to be important issues for our members, for business and the economy in general.

1.5 Contacting Us

We look forward to meeting with the relevant stakeholders and interested parties to discuss the issues raised in this submission. For further information, please contact:

Mark Redmond, Chief Executive
mredmond@taxireland.ie or + 353 1 663 1700

Cora O'Brien, Director of Technical Services
cobrien@taxireland.ie or + 353 1 663 1700

1.6 Background and Context of Submission

Our submission last year, *Tax and the next phase of Ireland's Economic Development*, looked at sustaining and improving Ireland's position through incentivising research & development (R&D) activities and suggested legislative measures to support a simple and fair system of taxation. Our focus this year continues to be on sustaining and improving Ireland's competitiveness while taking into account the less favourable economic climate that Ireland now faces.

Recent commentary on the downturn in the domestic and global economy has made for sombre reading. Undoubtedly, Ireland is facing challenging times with unemployment increasing and tax revenues reflecting the slowdown in economic activity.

In considering the above it is important that we do not lose sight of the success Ireland has achieved to date.

"We have a very low level of public debt; down from 53% of GDP in 1998 to 25% at the end of 2007. We have very flexible markets. We have a low burden of taxation and over two million people in work."¹

There is no doubt that Ireland is an attractive place to do business. Ireland has a strong track record in attracting investment, supported by the low rate of corporate tax of 12.5%, various well thought out and effective tax incentives and a highly educated workforce. In particular, low taxes have played a large part in Ireland's success and should remain the cornerstone of our tax policy.

In the face of economic uncertainty and increasing competition from overseas for multi-nationals' business we should not overlook Ireland's indigenous enterprises. In 2004 small businesses (those with fewer than 50 people employed) accounted for over 60% of the workforce in Ireland. Small firms in the services sector accounted for €74bn in turnover which was greater than half the turnover for the total sector².

In his Budget speech on 5 December 2007, then Minister for Finance, An Taoiseach, Brian Cowen TD, commented on his commitment to creating a competitive and pro-enterprise environment.

"We will maintain our focus on deepening the competitiveness of the economy so that we more than match most of our competitors; we will continue to prioritise the needs of the disadvantaged and those who need our support within the resources that are available; and we will continue to create an environment where working people are rewarded for their efforts, while enterprises are encouraged to invest through a strong and consistent pro-enterprise tax system"

¹ Statement by Brian Lenihan T.D, Minister for Finance, 8 July 2008

² CSO, Small Business in Ireland, May 2007 p.7

We support this commitment to improving Ireland's competitiveness and have prepared this submission with this objective in mind.

2. Encouraging Entrepreneurship

In this submission, we have sought to identify a number of measures in the current tax system that discourage entrepreneurship. We have also attempted to suggest alternatives and additional measures that could encourage those wishing to start out in business on their own. We have prepared a case study at Appendix I that demonstrates a number of the disincentives. Mr Joe Bloggs, who is 45 years of age was made redundant from his job in the construction industry, where he worked as a quantity surveyor. He has set up as a sole trader offering his skills on a consultancy basis from 1 May 2008. He has enlisted one employee to assist him. Through the case study we have outlined a number of tax issues which can impede the operation of any new business.

The decision to start up in business is a risky and courageous one and tax policy should be used to support enterprising taxpayers who make it. Given the current global economic climate and competition from overseas, it has never been more important to focus on Ireland's indigenous talent and entrepreneurship.

2.1 Eliminating Disincentives to Entrepreneurship

The following are the disincentives to starting up in business that we believe should be eliminated.

2.1.1 Close Company Surcharge on Professional Services Income

Issue

Many individuals make the decision to start out in business as unincorporated sole traders. A variety of factors influence this decision, including the type of business, the cost of incorporation, and whether the profits generated will exceed the entrepreneur's personal cash requirements.

As a result of legal requirements or industry practice, certain businesses must incorporate. If our case study subject, Joe Bloggs, incorporated a company he would fall within the professional services close company surcharge provisions of section 441 Taxes Consolidation Act ("TCA") 1997. Under this section a surcharge is imposed on the undistributed income of a company whose business consists of or includes the "carrying on of a profession or the provision of professional services". The meaning of a profession is not defined in legislation, but Revenue have set out the activities they consider to constitute the carrying out of a profession in Tax Briefing 48. This list includes architects and quantity surveyors.

Consequences

As a result of the combination of the surcharge and the 12.5% corporate tax rate applicable, an effective rate of tax of 20% can apply to trading profits of a professional

services company before distribution. In contrast, a non professional services company would suffer tax at only 12.5%. This excessive charge to tax is a disincentive to retaining profits that could be reinvested in the company to fund business growth and increase employment. In the crucial start-up phase, when there is greater need for capital investment to grow the business, it seems particularly unfair to penalise an enterprise for retaining profits that will be reinvested.

ITI Recommendation

We believe that the above close company rules are inappropriate in the current economic climate. We recommend that the surcharge on professional services income should be abolished as it acts as a disincentive to business growth.

2.1.2 Income Tax – Commencement Rules

Issue

Appendix I outlines the income tax payment regime for Joe Bloggs who is setting up in business as a sole trader. For the first 3 years of business, complex “commencement rules”, set out under section 66 TCA 1997 apply. In order to illustrate their complexity we have set out the rules below:

- Year 1 - Profits for the first year are taxable on an actual basis, i.e., the profits are assessed from the date of commencement to the following 31 December.
- Year 2 - In the second year, the following rules apply:
 - a) If there is only one set of accounts made up to a date within that year and these accounts are for 12 months, the full profits for the 12 months are assessed.
 - b) If accounts are for less than one year or there is more than one set of accounts made up to a date or dates within that tax year, the full profits of the 12 months ending on the later of those dates are assessed.
 - c) In any other case the actual profits are assessed.
- Year 3 - In the third year the profits assessed to tax are those arising in the accounting period ending in that year. A reduction may be made to profits assessed in the third year to the extent that the profits assessed in year 2 exceeded the actual profits arising in year 2.

These rules, even at first glance, appear complex. The rules break the link with the accruals accounting concept which strives to match costs with the revenues generated by incurring those costs. The commencement rules can also place a strain on the cash-flow of new enterprises.

Consequence

According to the latest ISME credit survey, small businesses are waiting an average of 67 days for payment, with only 24% of companies being paid within the standard 30 day payment period.³

On the basis that this 67 day time-lag applies to Joe's business, we have set out in Chart 1 and Chart 2 of Appendix I the accounting profits he has earned compared with the actual cash received for the first years of operation. The Charts illustrate that there is a significant shortfall in cash.

As Joe provides a professional service, if he were to supply his services to a local authority or State body he would also suffer Professional Services Withholding Tax (PSWT) at source at the standard rate of tax at 20%, under Section 523 TCA 1997. This would further reduce the cash he actually receives for his services.

If we assume that profits accrue evenly over the period and take into account the time-lag in receiving actual payment, by his first preliminary tax deadline of 31 October 2008 Joe will have received cash from his business of €31,415 out of which he faces a preliminary income tax liability of €27,601 (Chart 4 Appendix I). This represents 88% of cash received. Out of this cash he must also meet any capital expenses incurred, and any drawings to support himself and his family. Liabilities for years 2 and 3 together with business cash receipts, net of income tax, are also set out in detail in this example.

Although technically he has a preliminary tax liability due for payment on 31 October 2008, a Revenue Statement of Practice⁴ exists that allows him to delay the payment of his first year liability until the second year of trading. This concession has no legislative footing and it is by no means clear that all taxpayers in such a situation are aware of this concession. While this practice alleviates to some extent the demand on his cash resources in the first year of trading, it can result in a requirement to pay a large liability in the second year of trading. In reality, in Joe's circumstances given the amount of preliminary tax due compared with cash actually received he will have no choice but to avail of this concession. If he were to get into financial difficulties in year 2 he may be unable to pay the liability arising. Underpayments of tax are further compounded by interest charges.

A shortage of cash can give rise to difficulties in meeting day to day expenses of doing business. In addition cash-flow difficulties can make it difficult for sole traders to meet their tax obligations. This has been recognised by Revenue, where for example a cash basis of accounting for VAT has been introduced for small businesses with turnover below a certain threshold. It would be appropriate to consider a cash basis for accounting for income tax also, in certain circumstances.

³ ISME, ISME Credit Watch press release – Late Payments Crippling Business, 4 July 2008

⁴ Statement of Practice SOPIT/2/91 p22, confirmed in "Starting in Business – A Revenue Guide" June 2007, p10

ITI Recommendation

Many new businesses experience cash-flow difficulties and efforts have been made to alleviate this in other areas of taxation through, for example, the cash basis of accounting for VAT.

We recommend that consideration should be given to introducing a simple form of cash receipts basis of accounting for income tax for the first 3 years of trading.

2.1.3 Inequitable Interest on Late Payment of Tax

Issue

Many new businesses experience cash-flow difficulties. This can arise from the need to extend their credit terms in order to compete and from their initial capital expenditure requirements. Cash-flow difficulties can occasionally create problems for otherwise compliant taxpayers in meeting their tax payment obligations, resulting in late payment of taxes and subsequent interest charges.

Under section 1080 TCA 1997 an effective interest rate of 10% per annum applies to underpaid non-fiduciary taxes such as income tax and capital gains tax. Although this rate was reduced from 11.75% in Finance Act 2005, the 11.75% rate remains in place for VAT and PAYE. Where interest is paid by Revenue on an overpayment of tax it is paid at a rate of 4% per annum. Interest due on underpaid tax accrues from the date the tax is due. In contrast, where interest is paid by Revenue on a refund of tax it accrues 3 months after an application for repayment – it does not accrue from the date of overpayment. In practice, this means that taxpayers seldom actually obtain interest on refunds of tax overpaid. Where, for example, an overpayment of preliminary income tax is made on 31 October, a claim for repayment cannot be made until the tax year is over and a return is submitted. As a result of this, interest is often denied for at least 5 months from the date of overpayment. In some cases, where tax has been deducted at source the period could be much longer.

Consequence

Many businesses are not as fortunate as the example in our case study to be in a positive cash position. Even those who are making profits can experience a significant time-lag between the generation of profits and the receipt of cash, as illustrated at 2.1.2 above.

Cash-flow difficulties interfere with businesses' ability to pay their creditors and employees, without which the business is likely to fail. These difficulties should not be compounded by an inequitable rate of interest on tax underpaid. In addition, interest applies even in cases where there is no loss of revenue to the Exchequer. In the case where tax has been overpaid and a refund is delayed, the entrepreneur will receive minimal interest, if any, to compensate him/her. The difference between both the rates

and the timing of the application of interest for tax underpaid and overpaid are inherently unfair.

In the UK, interest rates are more commercially based. The rates currently prevailing are 7.5% per annum on underpaid tax and 4% per annum on tax overpaid. The interest rates are also updated regularly to reflect actual UK market rates. Interest on overpayments accrue from the date the overpayment is made until the repayment is issued.

One of the reasons why interest rates were fixed here in the past rather than being varied in line with market adjustments was because of the resultant complexity in calculating the interest amount. However, nowadays, new IT solutions can easily overcome this problem. For example, a calculation tool is available on the website of the HM Revenue and Customs which enables taxpayers to calculate with ease interest due on underpaid tax, regardless of the varying rates. As part of the Revenue offshore funds initiatives, a spreadsheet which enabled taxpayers to calculate penalties and interest applicable historically was available on Revenue's website. A similar tool could be made available to take account of varying rates going forward.

The impact of interest charges is further exacerbated by demands for interest arising several years after the end of the period to which the interest charge relates. Such a practice leads to uncertainty for the taxpayer and an exposure to an unexpected liability.

ITI Recommendations

Recommendation 1

ITI fully accepts that interest should be charged on tax that is paid late. However, we recommend that interest rates should be reviewed regularly to ensure that they are appropriate given prevailing bank rates. The disparity between the rates of interest on tax underpaid and overpaid should be removed to reflect commercial conditions.

As pointed out in our recent submission to the Commission on Taxation, the disparity between the rates is particularly penal in cases where there is no loss of revenue to the Exchequer.

Recommendation 2

We also recommend that some leniency should be applied to businesses in their first 3 years of operation. In particular, no interest should be applied where a payment of income tax or corporation tax is made late, provided it is made within a specified timeframe, e.g., within 2 months of the due date.

Recommendation 3

We recognise that legislation provides Revenue with the right to assess tax up to 4 years after the end of an assessable period. However, we would recommend that a 2 year time limit should be introduced for assessing interest on late payment of tax where full payment has been made but it has been made late. This 2 year time limit would run from the date the payment is made.

Prompt collection of interest would allow for greater certainty for the taxpayer as to his/her outstanding liabilities to Revenue and early collection of interest by Revenue

2.1.4 Impact of Regulation

Issue

International studies have shown that the tax system can often be the largest contributor to administrative burdens. For example, in the Dutch system, 3 of the top 10 most burdensome regulations related to tax law.⁵ In the 1990s the Dutch Government listed the reduction of administration as one of their top 3 priorities aimed at boosting the economy and committed to cutting administrative burdens by 25% net over a 4 year period.

The rollout of Revenue's Online Service (ROS) has made a significant contribution to the reduction of the administration burden faced by Irish businesses. Welcome changes have been introduced to allow businesses with tax liabilities below certain limits make returns for PAYE and VAT on a varied time basis depending on their liabilities. Administration does, nonetheless, impede the operation of business, particularly for those operating on their own or with minimal staff.

Consequence

In a small business the entrepreneur's time is at a premium. The time spent on administration detracts from the time that could be spent on building contacts, customers, and on growing the business. In particular, those who are operating on their own can feel overwhelmed by the burden of administration that is presented to them. In a survey of 500 businesses by the ITI in October 2007, over half of the respondents believed that the administration of their tax affairs placed a burden on their business. VAT and PAYE/PRSI were cited as being the two biggest administrative burdens on business today.⁶

A pro-enterprise tax system should support business with minimal interference and minimal red tape.

⁵ The Hague, From Producing Burdens to Reducing Burdens, 2004, p11

⁶ ITI/Sunday Business Post, RedC poll, October 2007

We applaud the Government's commitment to reduce the administrative burden of national regulation on business by 25% by 2012⁷, which corresponds with a European Commission initiative. We look forward to positive changes being made in relation to tax administration and suggest that the measures set out below in particular be given priority.

We have additional suggestions for improvements that Revenue could make to the tax administration system in their "care and management" role. We are pursuing these through the relevant channels with Revenue. Some of these suggestions are set out in Appendix II.

ITI Recommendations

Recommendation 1

We recommend that one VAT registration threshold should apply to both goods and services. The newly published European Commission's "Small Business Act for Europe", encourages Member States to increase the VAT registration threshold to €100,000 for small businesses. We recommend that this threshold is adopted.

Recommendation 2

A welcome increase from €635,000 to €1,000,000 was introduced to the threshold for accounting for VAT on a cash basis in 2007. In order to widen the scope of businesses that can avail of this option, we recommend that this threshold should be further increased to €2 million.

Recommendation 3

A number of VAT filing options currently exist for taxpayers with low VAT liabilities. These should be streamlined by allowing "smaller" taxpayers, i.e; those with an annual VAT liability below €100,000 to file and pay VAT annually with an option to pay and file on a bi-monthly basis.

Recommendation 4

We recommend that all companies should have the choice to base their first instalment of preliminary tax on 100% of their prior year liability rather than 90% of the current year liability. This would reduce the burden for companies of calculating their tax liability at several points in the year. In addition, it would give companies greater certainty. As many companies would be likely to avail of this option, it would introduce greater certainty into the forecasting of Exchequer returns.

⁷ Department of Enterprise Trade and Employment, Tánaiste to prioritise cut in Red Tape for Business, Press Release, 13 August 2008

2.1.5 Enhancing the Attractiveness of the Business Expansion Scheme

Issue

The Business Expansion Scheme (BES) allows for much needed capital investment in indigenous Irish businesses within the scope of the scheme. Companies use BES funds to enhance their capital expenditure, expand their business and increase their workforce. The scheme has done much to support an enterprise culture in Ireland. Welcome enhancements were made to the scheme in Finance Act 2007, through an increase in the investment limit and the tax relief available.

However, practical constraints can impact on the attractiveness of the scheme to investors. In order to avail of tax relief for a year of assessment the qualifying BES investment must be made prior to 31 December of that year. In prior years, by concession, qualifying payments made up to 31 January of the following year would qualify for relief. The strict application of the 31 December deadline creates fundraising difficulties. This is particularly true where some schemes announced in Budget 2007 did not receive EU approval until September 2007, giving a timeframe of just 4 months in which to raise investments which qualified for tax relief in 2007.

Certain BES schemes also require approval from State agencies. Fáilte Ireland, for example, must approve schemes in relation to holiday accommodation. Delays in the certification process can result in a delay in launching a scheme. This in turn reduces the attractiveness of a scheme to investors who wish to benefit from the tax relief in the year in which the scheme is announced.

Consequence

BES provides an important source of funds to many small Irish businesses. The administrative measures applicable to it should not discourage investors. It can be difficult to raise funds from investors at the end of a tax year given the preliminary tax obligations and cash-flow difficulties they face. In addition, where there are delays in approval at EU level or in receipt of certification this can result in a short window in which to raise the funds. Simple measures, which we set out below, would remove these disincentives and make the scheme more attractive.

ITI Recommendations

Recommendation 1

We recommend that the deadline for making a qualifying payment into a BES scheme be extended to 31 January following the year of assessment in which a claim for relief is made.

Recommendation 2

Where schemes require certification from Irish State bodies, BES applications should be processed within 4 weeks of receipt.

2.2 Suggestions for Incentivising Entrepreneurship

The issues outlined above focussed on steps that could be taken to remove barriers to entrepreneurship. In this section of our submission we highlight some ideas for actively incentivising business activity.

2.2.1 Working Tax Credit for the Self-Employed

Issue

Under section 472 TCA 1997 an individual who is in receipt of emoluments on which PAYE has been deducted is entitled to a PAYE/employee tax credit of €1,830 for 2008. Where an individual becomes self-employed he/she no longer has an entitlement to the credit. We would recommend that a “working tax credit” should be introduced and available to the self-employed, in line with that available to PAYE employees.

In addition, where an employer pays for a travel pass for staff for commuting to and from work, the employee does not suffer a tax liability on the benefit. No such relief from tax exists for those who are self-employed.

Consequence

The tax system should not penalise a taxpayer for exhibiting an entrepreneurial spirit. Although monetarily the above are small in amount, they are nonetheless important to the taxpayer.

ITI Recommendations

Recommendation 1

We recommend that a “working tax credit” should be introduced for self-employed persons, in line with the credit available to PAYE employees.

Recommendation 2

We recommend that travel passes, which would be exempt from a charge to benefit-in-kind in the hands of an employee, should be tax deductible in calculating the tax liability of a self-employed person.

2.2.2 Improvement to Pension Relief

Issue

Tax relief plays a pivotal role in encouraging taxpayers to make adequate provision for their retirement. Such tax relief provides the dual benefit of encouraging the taxpayer to provide for their old age while reducing their dependence on State support. In our case study, Joe, as a 45 year old, can claim tax relief for pension contributions of up to 25% of his net relevant earnings. However, in many start up situations such tax relief is of limited use to entrepreneurs due to uncertain, erratic cash flows and the low earnings on which the relief is calculated.

Consequence

The low net relevant earnings on which to base the relief, is a disincentive for an entrepreneur to fund his pension in the early years. It may be several years before sufficient earnings make the tax relief worthwhile. From the perspective of funding his retirement, an entrepreneur at a later stage of life may feel it is more beneficial for him to remain in employment rather than become self-employed. We recognise that in the early years of operation there may be a limited amount of surplus cash available to the entrepreneur, but he should nonetheless make some provision for his pension and be supported in doing so.

ITI Recommendation

We recommend that tax relief for pensions should be amended to allow tax relief for the first 6 years of self-employment to be based on employment income arising prior to the set up of the business.

The taxpayer would be subject to the limits appropriate to his/her current age when claiming the relief but the relief would be calculated on the earnings on a rolling 6 year basis. The tax relief applicable to the pension contributions would be offset against the current self-employed income. Where this is insufficient to allow for full relief it should be carried forward against future self-employed income.

2.2.3 Carry-Back of Losses against PAYE Income

Issue

For many start-up businesses the first number of years of operation are a time of slow growth and persistent losses. Although these losses can be carried forward against future profits, it can be a number of years before they are realised. Where a company is incorporated, a refund of income tax paid by the entrepreneur for the preceding 6 years

can be obtained by way of the Seed Capital Scheme. No such relief exists for sole traders.

Consequence

It may be a number of years before a sole trader will generate profits against which losses can be utilised. Many enterprises struggle and fail in this period due to a lack of cash. A tax refund mechanism would act as an encouragement in difficult times, making funds available to the trader when most needed.

ITI Recommendation

We recommend that losses incurred in the first 3 years of operation of a sole trade should be available for offset against the trader's PAYE income arising in the 3 years prior to commencing to trade.

Such a measure would incentivise those wishing to start up in business by providing them with cash at an early stage when their need is greatest. The measure should be cost neutral to the Exchequer in the long term as these losses would otherwise be carried forward against future taxable profits.

2.2.4 Impact of Change of Trade on Loss Relief

Issue

Many new businesses struggle and collapse in the first number of years of trading, particularly in the current climate. An entrepreneur may need to discontinue his/her unsuccessful initial venture and branch out into a different trade or market in order to ultimately establish a viable business.

Under section 382 TCA 1997, where a taxpayer has incurred an unrelieved trading loss it can be carried forward for offset against future profits of the same trade. Should the taxpayer subsequently commence a different trade, any trading losses carried forward cannot be relieved against profits of this new trade.

Consequence

This restriction on loss relief provides no support to entrepreneurs who are experiencing trading difficulties in persevering with a second, more viable business.

ITI Recommendation

We recommend that consideration should be given to establishing a mechanism which allows for the following:

Where a sole trader's business fails within the first 5 years of operation and a new trade is commenced, losses incurred in the first trade could be carried forward against profits of a subsequent trade.

Before claiming the relief it would be necessary for sufficient time to have elapsed to ensure that the taxpayer had submitted a tax return for the initial trade. Also, such relief would only be available where the subsequent trade was carried on by the sole trader in his/her own capacity rather than through a partnership or company.

3 Enhancing Foreign Direct Investment

Issue

Ireland has come a long way in competing in a global marketplace and our tax policy played no small part in the huge achievements made. The presence of international companies in Ireland remains a core component of our economy. One thousand multinational companies have chosen Ireland as their strategic European base. IDA-supported companies paid €3 billion in corporate tax last year, accounting for 44% of the total corporate tax take of €6.7 billion.⁸ Our tax treaty network is a central part of our overall tax package and is critical to obtaining further foreign direct investment (FDI).

We would like to reiterate the suggestions that we made in our pre-Budget 2007 submission and our recent submission to the Commission on Taxation, which are summarised below. We consider that these proposals will strengthen Ireland's position as an attractive country for overseas investment. Prioritizing the tax treaty network will encourage both foreign investment and boost Ireland's international trade. Similarly, a clear system of clearances and rulings available from Revenue would encourage transactional activity.

ITI Recommendations

Recommendation 1

Undertake a review of the holding company regime to consider issues such as:

⁸ www.idaireland.com homepage

- 1. Withholding tax on outbound dividends, interest and royalties**
- 2. Full exemption from tax on foreign dividends**
- 3. Full consolidated tax grouping**
- 4. A more comprehensive and time-efficient system of rulings where taxpayers could obtain some certainty of treatment and binding pre-transaction clearances**

Recommendation 2

A minimum of 10 treaties should be ratified by 2012. Initial focus should be on those countries where the greatest need arises such as Turkey, Singapore and Brazil.

Recommendation 3

A “white list” of countries with which a treaty is being prepared should be identified to fast track them and allow them to avail of benefits prior to treaty ratification.

We understand that arising from a Constitutional review, treaties must now be ratified through the annual Finance Act rather than by Statutory Instrument. As such, the importance of fast tracking the “white list” is even greater.

Recommendation 4

There is currently no provision for corporation tax relief for an Irish company on the acquisition of brands, non-industrial know-how, or intellectual property (IP) related goodwill. In addition, the limited relief for know-how that is currently available does not apply to the acquisition of know-how from a related party, and therefore discourages large multinational companies from locating their IP management and design processes in Ireland.

4. Enhancing the Consultation Process

Issue

We are all very aware of the tight timeframe within which Budget and Finance Act 2009 will be framed. We feel more than ever that caution needs to be exercised before introducing complex measures in this Finance Bill without full and comprehensive debate in advance.

Major policy initiatives require proper scrutiny and should not be included in the annual Finance Bill but should be the subject of a technical bill to be issued several months later. This is a change to the setting of tax policy that the Institute has long advocated and we wish to see it implemented on a permanent basis. However, it is even more critical this year, given the particularly short timetable envisaged.

ITI Recommendation

We recommend that the annual Finance Bill to be issued shortly after the Budget should focus on:

- 1. Legislative changes in relation to customs and excise tax**
- 2. Any changes in the tax rates or tax bands**
- 3. Only urgent amendments to anti-avoidance legislation, rather than major systematic changes**
- 4. Updates to the tax treaties schedule, so as not to delay when they are brought into effect**

All other complex technical changes should be deferred to a separate technical Bill in the interests of ensuring full and proper consultation.

Appendix I

Case Study of an Entrepreneur

Mr Joe Bloggs is 45 years old and an experienced quantity surveyor. Due to the current economic downturn he has recently been made redundant from his job in a construction company, where he worked for 20 years. He has set up his own business as a sole trader to provide his services on a consultancy basis to a variety of clients. He has engaged one employee to assist him with this work.

As he has never been self-employed before, he has met with a Registered Tax Consultant to ensure that he is aware of all of his tax obligations.

He commenced to trade on 1 May 2008 and will prepare his accounts to 30 April each year. He has estimated for the year ended 30 April 2009 that he will make a profit of €100,000, to 30 April 2010 a profit of €150,000 and a profit of €200,000 to 30 April 2011.

We illustrate in Chart 1 and Chart 2 below the accounting profits arising over the years in question and the estimated cash received, assuming a lag of 67 days between generation of profits and receipt of cash. Chart 3 illustrates the application of the commencement rules.

Chart 1 Accounting periods and profits arising

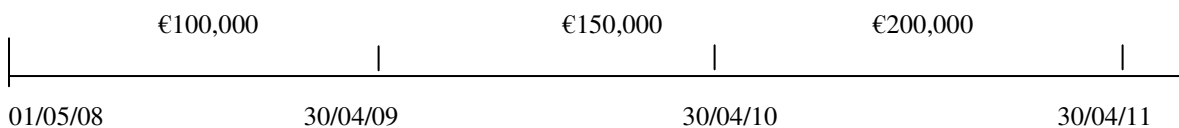
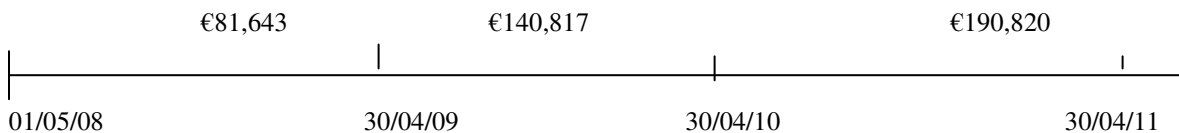


Chart 2 Cash Received over Accounting Periods (67 day time-lag)



Calculation of Liabilities

a) Assessable 2008 Tax Year – Year 1

1 May 2008 to 31 December 2008
8 months' profits
 $€100,000 \times 8/12 = €66,670$

b) Assessable 2009 Tax Year – Year 2

Profits arising in the accounting period ended 30 April 2009, i.e., €100,000

c) Assessable 2010 Tax Year – Year 3

Profits arising in the accounting period ended 30 April 2010, i.e., €150,000

Calculation of Second Year Excess

1/1/09 – 30/04/09	4/12 x 100,000	=	33,330
1/5/09 – 31/12/09	8/12 x 150,000	=	<u>100,005</u>
Profits actually arising			133,335
Profits Assessed to tax			100,000

As the profits assessed are less than those arising, no second year excess arises.

d) Comparison of Accounts Profits and Taxable Profits to 31 December 2010

Tax Assessable Profits to 31 December 2010

Tax Year	Profits Assessed to Tax
	€
2008	66,670
2009	100,000
2010	<u>150,000</u>
Total profits assessed to 31 December 2010	316,670

Total Accounting Profits Actually Earned to 31 December 2010

	€
Accounting year ended 30 April 2009	100,000
Accounting year ended 30 April 2010	150,000
9 months to 31 December 2010	<u>150,000</u>
Total profits earned by 31 December 2010	400,000

e) Tax Due

Assuming Joe pays tax at his marginal rate of 41%, PRSI at 3% and levies at 2%, and 2.5% levy on income in excess of €100,100, he will have the following tax liabilities for the first three tax years

Year	Total Tax Liabilities €	Preliminary tax €
2008	30,668	27,601
2009	46,000	30,668
2010	69,249	46,000

This is based on the assumption that he bases his preliminary tax on either 100% of the previous year or 90% of the current year, depending on which results in the least amount of tax payable.

Chart 4

Comparison of Tax Payable and Cash Received Where Statement of Practice IT/2/91 Concession Not Availed Of

Date Tax Due	Tax Payable €	Total Accumulated Cash Available net of Income Tax €
31 October 2008	27,601*	31,415
31 October 2009	33,735**	119,524
31 October 2010	61,332***	251,497

Note: Joe could also elect to pay 105% of his income tax liability for the pre-preceding year if he availed of a direct debit option.

*90% of current year liability

**Balance for 2008 (30,668 – 27,601) + 100% 2008 liability (€30,668) = 33,735

***Balance for 2009 (46,000 – 30,668) + 100% of 2009 liability (€46,000) = 61,332

Chart 5

Comparison of Tax Payable and Cash Received Where Statement of Practice IT/2/91 Concession Availed of

Date Tax Due	Tax Payable €	Total Accumulated Cash Available net of Income Tax €
31 October 2008	0*	31,415

31 October 2009	61,336**	147,125
31 October 2010	61,332***	251,497

* Nil under SOPIT/2/91

**100% of 2008 (30,668) + 100% of 2008 as preliminary tax for 2009 (30,668) = 61,336

*** Balance for 2009(15,332) + 100% of 2009 as preliminary tax for 2010 (46,000) =
61,332

Appendix II

Simplification Measures to Improve Administration of the Tax System

Start-Ups and Small Business

Start-up companies and small businesses are particularly vulnerable to the demands of tax administration on their time. To reduce the administration burden we make the following recommendations

- County Enterprise Boards should have Liaison Officers in place to deal with those starting up in business. Ideally this person would be the taxpayers' one point of contact with regard to queries arising on starting up in business.
- E-registration for businesses should be introduced without delay.
- Allow small businesses to submit just one tax return. The form could cover VAT details of input and output credits, income tax for sole traders, corporation tax and PAYE/PRSI in the case of companies.
- Simplify bad debt relief.
- Simplify the Form 11. The current form is 22 pages long. It should be possible to have a number of set pages to be completed and additional pages could be submitted where appropriate, as is the case in the UK
- Ensure all guidance is issued in plain English to aid understanding.

Supporting Business Growth

In times where economic conditions have grown difficult it is essential that more is done to ensure that Ireland remains a favourable place to do business. On this basis we make the following recommendations:

- Simplify the calculation of disallowed business entertainment. For tax purposes only, entertainment expenses incurred on staff entertainment are tax deductible. Reviewing expenses to identify what portion is allowable is time-consuming. It should be possible to calculate the allowable amount based on a ratio using prior years expenditure as a guideline.
- Remove the lack of consistency between VAT and Direct Taxes in the treatment of staff entertainment. Such entertainment is not deductible for VAT but is deductible for Income Tax and Corporation tax. This anomaly should be rectified.
- Self assessment should be extended more fully to taxes such as DWT and RCT.
- The structure of PRSI and levies is an area in urgent need of simplification. There are 9 classes of PRSI with 30 subclasses within these.
- Allow temporary VAT registration as a means of simplifying one-off transactions
- Ease Registration issues arising from non-residency.
- A VAT general reverse charge provision should be in place for business to business (B2B) transactions

- Review RCT with a view to reducing the amount of paperwork involved.
- Facilitate eRCT without delay.
- A business-friendly approach should be introduced to the operation of RCT. In recognition that the taxpayer is collecting tax for Revenue a more lenient approach should be taken with regard to imposing interest and penalties for minor errors. In particular in cases where there is no loss of revenue.
- The threshold for inclusion of details on Form 46G should be increased.
- The necessity to complete an annual VAT return should be removed where bi-monthly returns are filed, as the return provides no additional information.
- Tax clearance certificate procedures should be improved.
- Greater information sharing should be encouraged between Government departments to remove the need for duplicate information to be provided by the taxpayer.
- Fairness should be followed whereby a taxpayer who files a return late faces interest charges and a penalty within days, whereas a refund of tax to the taxpayer may be delayed by months with no recompense to him.
- In order to encourage certainty, significant changes should not be made to legislation or administration of taxes without consultation.
- The employer PRSI threshold for application of the 8.5% PRSI rate has been set at earnings of €365 per week since 2002. Retaining the same limit regardless of inflation increases wage costs for employers. The threshold should be indexed.
- An annual disposals limit should be introduced for CGT rather than the existing exemption on gains.
- The appeals systems should be overhauled and decisions should be publicised.

Helping PAYE Taxpayers

- The Form 12 should be reduced. The Form 12 is currently 16 pages long. It should be possible to have 2 set pages for completion with additional sections completed where appropriate.
- Form 12 should be made available on ROS as a priority.
- Dividend withholding tax exemption should be introduced for the over 65.
- The High Net Worth Individual Return should be simplified.
- The pension differentials between self-employed and employed persons should be removed.
- Further efforts should be made to educate taxpayers on their right to claim reliefs. Brian Cowen, in the 2007 Budget committed to making it easier for taxpayers to get their entitlements.
- Only 1 claim form should be required to claim any reliefs available which are not provided at source.
- As above, all thresholds should be inflation-proof.

Bibliography

Publications

Central Statistics Office, *Small Business in Ireland*, May 2007

Commission of the European Communities, *A Small Business Act for Europe*, June 2008

Department of Enterprise Trade and Employment, *Press release – Tánaiste to prioritise cut in red tape for business*, August 2008

Department of Finance, *Exchequer Statement*, July 2008

Department of Finance, *Statement by Brian Lenihan TD Minister for Finance*, July 8 2008

IDA Ireland, www.idaireland.com

ISME, *ISME Credit Watch Press Release – Late Payments Crippling Business*, 4 July 2008

ITI/The Sunday Business Post, *RedC poll*, October 2007

Revenue Commissioners *Statement of Practice IT/2/91*, June 1991

Revenue Commissioners *Starting in Business – A Revenue Guide*, June 2007

The Hague, *From Producing Burdens to Reducing Burdens*, August 2004