Certainty Please

Ahead of Brexit, the government should do more to provide tax certainty to Irish SMEs and introduce some targeted tax measures, writes **Michael O'Scathaill**, Tax Director in Crowe

Much of the commentary on the taxation of Irish business tends to focus on the role of multinationals, often to the detriment of the SME sector. While multinationals undoubtedly make a significant contribution to the Exchequer, the government is also reliant on the indigenous SME sector to help it meet its objectives of creating sustainable employment and rebalancing the economy across the regions.

Notwithstanding the economic upturn and favourable short-term forecasts, the climate for the SME sector continues to be challenging. Managing staff costs, broadband coverage and raising finance all pose challenges. Above all, the spectre of Brexit, with all the uncertainties and challenges it brings, looms over the Irish economy.

Brexit And SMEs

Brexit might have a detrimental effect on the Irish economy as a whole but it may disproportionately impact on parts of the SME sector, particularly tourism, food and beverage and agri-business. These are sectors that are of particular importance outside the main urban centres.

SMEs rely heavily on trade with the UK and the potential return of tariffs would be most unwelcome, not to mention the chaos that could be wreaked by a return of a hard border with Northern Ireland, should UK/EU negotiations fail to avoid such outcomes. It is therefore important that the government has in place a package of measures to support the SME sector at this challenging time. While taxation is only one part of such a package, it is an important one.

Tax Challenges

While the Irish tax system contains a range of incentives for business, some of the flagship schemes have either become outdated or unworkable in recent years. The recessionary period from 2008 also left its mark on some of these incentives.

- *EIIS:* One big bugbear for SMEs is that the government's flagship Employment Incentive & Investment Scheme (EIIS) has become unworkable or inaccessible for a large number of businesses, as a result of unfavourable changes introduced since 2015. Furthermore, recent reports of the scheme's compliance with EU State Aid guidelines being questioned by the European Commission, coupled with the announcement of a further review of the scheme, have led to uncertainty for business, as well as a backlog of applications awaiting Revenue approval.
- *Finance Act 2017:* Legislative changes were introduced in Finance Act 2017 ostensibly as a measure to counter schemes that the Revenue Commissioners considered to be contrived to convert extractions of income from companies to capital. These changes have had too broad an impact, with the result that bona fide commercial transactions such as redemption of shares from a retiring shareholder and even Management Buyouts have become more challenging to structure.
- *Tax Certainty:* Above all, when it comes to taxation, the SME sector is hindered by uncertainty, with changes such as those referenced above impacting disproportionately on smaller firms. Notwithstanding the various reviews being undertaken at EU and OECD level, the multinational sector enjoys a far greater degree of 'tax certainty', and as a result can plan ahead with greater reassurance. The government should strive to give SMEs a similar degree of tax certainty.

Michael O'Scathaill, Crowe

Capital Gains Tax

One area where the government could make a real difference with a small number of targeted measures is Capital Gains Tax. The recession period saw significant increases in capital tax rates, with the headline rate of CGT rising from 20% to 33% between 2008 and 2012. While this was driven by a need to close a significant Exchequer deficit at the time, high CGT rates can impact negatively over time by discouraging the sale and purchases of assets.

In addition to impacting directly on Exchequer returns, this can also impact negatively on economic growth, as people are discouraged from selling or transferring assets that could be put to more productive use by new owners. This can especially apply to farm and business assets. In our experience, the potential CGT liability that might result from making commercial business decisions acts as a disincentive for business owners.

The Department of Finance's own Tax Strategy Group recently reviewed CGT. The group examined the impact of reducing the rate of CGT from 33%, as well as exploring a broadening of the Entrepreneur Relief, which would be targeted at facilitating business activity. But the group's report did not make a recommendation as to which option should be adopted, which is a disappointment.

> ***'A tax system that provides certainty is critical to enable SMEs to prosper'***

Given the economic uncertainty facing small and medium businesses, a clear recommendation for measures targeted at supporting business activity would have been the best option. Not clearly stating this in the report is a missed opportunity to provide direction on a tax strategy that will support small and medium businesses as they seek to grow their businesses in an increasingly uncertain business environment.

Business owners deserve certainty and clarity on the availability and application of taxes to their businesses. Doubt and uncertainty on the continuation or application of current rules is an unnecessary impediment to planning business strategies.

Capital Gains Tax changes must be directed at business assets that generate economic activity rather than at all capital assets. A reduced capital gains tax rate of no more than 20% on the realisation or transfer of business assets including shares in trading companies should be introduced.

The current rate of 33% should be retained on passive investments. While some might argue that having two rates makes the tax system more complex, companies have been dealing with different tax rates on trading and passive income for many years.

Investors' Relief

In addition to rates on assets that are productive in driving economic growth, consideration should be given to introducing new targeted reliefs. Investor's Relief was introduced in the UK in 2016 and covers passive investors i.e. those who don't work in the business at all but who are willing to invest in it.

Investors' Relief not only provides a tax benefit to investors, it also potentially helps companies to raise funds from passive investors, such as angel investors and high net worth individuals looking for investment opportunities. In light of the difficulties currently being experienced with EIIS, the government should consider introducing a form of this relief to open up a new avenue of funding for the SME sector.

Investors' Relief only applies to investments in unlisted companies but there is no minimum shareholding requirement or minimum investment amount required. In the UK, the lifetime limit on which Investors' Relief can be claimed is £10m. This threshold does not impact on the entitlement of an investor to also claim Entrepreneur Relief on other investments, where relevant.

Conclusion

The SME sector plays a critical role in driving economic growth. It provides a counter balance to what some commentators view as an over-reliance on tax revenues from large multinational companies operating in Ireland. A tax system that supports entrepreneurship and provides certainty is critical to enable Irish SMEs to prosper. By outlining a clear, bold strategy and introducing a series of relatively modest measures, the government can greatly assist in this regard. BP