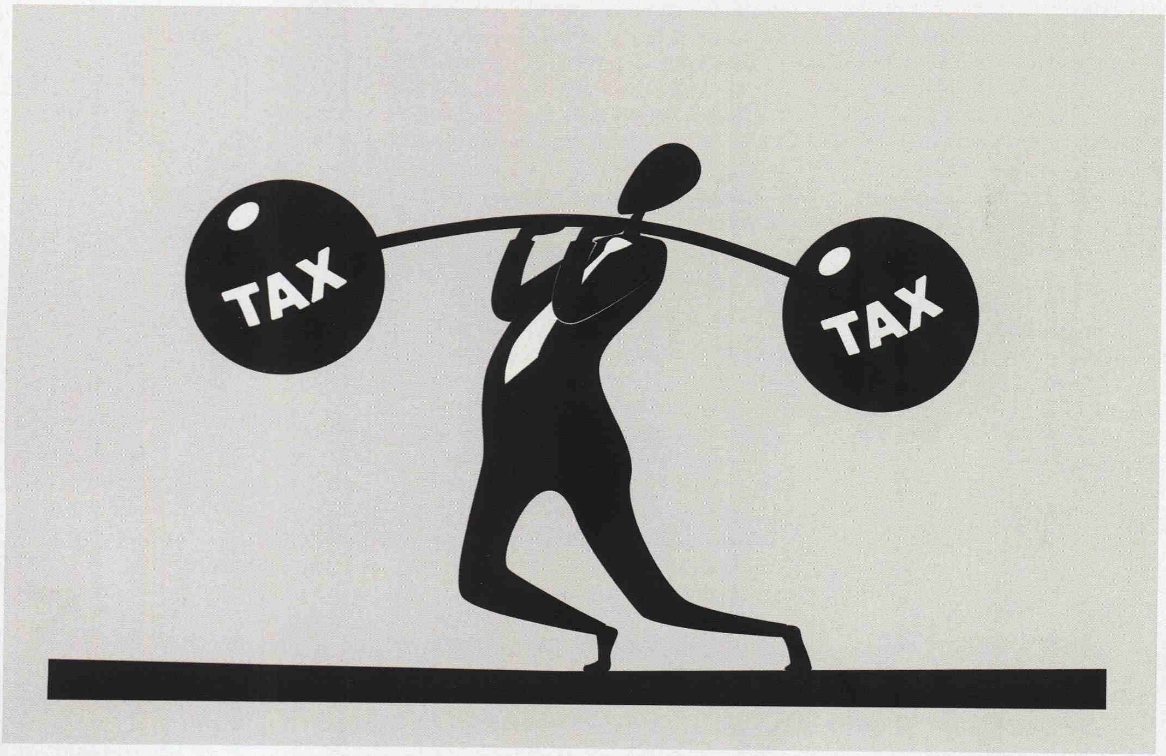
Capital Concerns

Capital taxes and the general tax burden have increased sharply in recent years. Ahead of Budget 2014, **Chris Sparks** asks leading tax experts about when raising taxes becomes counter productive



The influence of the Labour Party in government since 2011 has been keenly felt, with a ratcheting up of taxes on wealth. More of the same is on the menu for Budget 2014, which will be announced in mid-October. Taxes on income and consumption have also increased sharply in recent years as the government seeks to narrow the fiscal deficit, as raising taxes is always an easier political choice than cutting spending.

But at what stage does increasing the tax burden become counter-productive in terms of actual Exchequer revenues and depressing economic output? **Kevin McLoughlin**, Head of Tax in **Ernst & Young**, notes that the rate of Capital Gains Tax (CGT) in the US is currently between 0% and 20% for long-term capital gains while the UK offers a low rate of 10% for entrepreneurs.

"Therefore, Ireland's relatively high rates for these capital taxes have the potential to hinder genuine economic investment," says McLoughlin.

According to **Frank Greene**, Head of Tax in **Mazars**, the Capital Acquisitions Tax (CAT) rate of 33% is a disincentive to the creation and passing on of wealth. "Unlike Capital Gains Tax, which normally arises from a transaction where cash is received, CAT is levied on wealth and can lead to the forced sale of assets to pay taxes," says Greene. "It is time to review the CAT legislation and consider the UK system, where all lifetime gifts are tax free provided the person making the gift survives for seven years. This system facilitates the earlier transfers of wealth to the next generation rather than on death.

Greene adds that due to the difficulties in the Irish economy over the last six years, most assets show capital losses and very few business sales are taking place. "A significant proportion of the wealth in Ireland is stuck in deposit accounts and until some of this is invested in productive assets, then the tax take from capital taxes, irrespective of the rate of tax, will remain low. In difficult circumstances, tax incentives should be used to support business, employment and investment, and they are required now more than ever before."

According to **Colm O'Callaghan**, Tax Senior Manager with **PwC**, in a recent PwC survey of family businesses, 43% expressed the view that the government does not recognise the importance of the sector for the broader economy. "This is reflected in a lack of real tax initiatives designed to support the SME sector or any novel approaches to stimulate indigenous business activity," says O'Callaghan.

He likes the UK idea of a 'Growth Voucher' scheme that supports the provision of expert advice on key business processes and issues that can significantly improve business performance. "Other pro-SME business tax initiatives being considered in the UK include employee ownership schemes," says O'Callaghan. "These would not only help companies to be more resilient during times of economic downturn but would also foster job creation and help the funding costs of companies."

O'Callaghan's view is that CGT and CAT rates have started to be counter-productive in terms of generating increased tax revenues for the Exchequer. "CGT Retirement Relief is to be curtailed with effect from January 2014 for individuals aged 66 and over. This is likely to have the opposite effect to that intended. Would-be successors are also beginning to reconsider whether it is worth inheriting businesses or assets given the increased CAT rates and the reduction of the CAT thresholds."

Gordon Hayden, Director of Taxation Services at **Smith & Williamson**, is more sanguine about Ireland's capital taxes regime. "When one looks at tax rates in neighbouring countries and in the developed world, in general it appears that Ireland's tax rates are not out of sync," he says. "The early flagging of changes to CGT and CAT reliefs in 2014 gives time for taxpayers to take action, and this is to be commended.

"The current capital tax rates have not curtailed transactions or transfers in the context of succession planning. However, we believe once rates creep towards and breach 40%, the result will be not only a decrease in transaction levels but also in tax revenues.

"In relation to income tax, middle-income earners have taken the brunt of tax increases and reductions in reliefs. Hopefully, this trend does not continue in the forthcoming budget."

Conor O'Brien, Head of Tax at **KPMG**, contends that analysis of tax rates should take account of the dynamic effects on behaviour and the broad effects on other sources of taxation through the impact on economic activity generally. "Unfortunately, a great deal of analysis seems to ignore these two crucial effects. CGT and CAT rates have long passed the point where the dynamic and broad effects are damaging for Ireland. Our 33% CGT rate is internationally uncompetitive," says O'Brien.

A**idan Byrne**, Tax Partner at **Baker Tilly Ryan Glennon**, gives credit to the government for maintaining the 12.5% rate of corporation tax. "This is no mean feat considering the pressures from other EU member states in recent years," says Byrne. "Combined with making Ireland an attractive base internationally to conduct business, and incentivising investment for domestic businesses, that has somewhat stimulated the economy into action."

However, Byrne anticipates that the rates for CGT and CAT will increase to 40%, in line with other jurisdictions such as the UK and France that operate high succession taxes. "The government needs to realise that raising capital tax rates

continued on page 45

isn't necessarily going to increase tax revenues," says Byrne. "Instead, it will actively discourage lifetime succession planning and transfer of businesses to the next generation. At the moment, we're advising our clients to review their assets prior to the changes to Retirement Relief coming into effect from January 2014. Acting now may result in big savings for many SME directors."

According to **Pat Cullen**, Tax Partner in **Deloitte**, it can be argued that the government has gone far enough in raising tax rates and shutting down tax reliefs. He notes that a personal tax rate including PRSI and USC of 55% for entrepreneurs is extremely high relative to other countries, while in recent years CGT and CAT rates have been raised from 20% to 33%, an increase of 65%.

As all asset classes have been under pressure in terms of valuations over the last few years, it is difficult to establish whether the reduction in the yield from CGT and CAT relates to the reduction in asset values or to increases in tax rates, or both. "The evidence from our clients would suggest that there is an increased reluctance to dispose of assets and pass assets to the next generation where the relevant tax rates are 33%," says Cullen.

"With the introduction of the cap on tax reliefs for higher earners, there is now little appetite among high earners for investing in those areas which generate tax reliefs," he adds. "Excluding the Employment Investment Incentive relief from the cap for high earners, as has happened in the UK, would make sense."

At **Crowe Horwath**, Tax Partner **John Byrne** says the maximum rate for CGT and CAT should be less than 30%. He adds: "Serious consideration should be given to increasing the annual exemption for individuals, which has remained at €1,270 for too long. In the UK the annual exemption is around €12,800. A personal exemption at this level would be of benefit to retired individuals, who may have to supplement pension income that is now much lower than they expected."

Alan Lawlor, a Partner in **Wallace O'Donoghue**, believes that an effective 52% tax rate applicable to taxpayers on income in excess of circa €34,000 per annum is the absolute limit of what could be regarded as a fair level of personal taxation. "Any further increases would act as a disincentive to work and further encourage black economy activity," says Lawlor. "Tax incentives were introduced in the first instance by government to stimulate economic development. While many of the tax-based property schemes ran well beyond their sell by date, it may now be worthwhile to consider if a carefully selected and narrow range of new reliefs could be introduced to give some impetus to our fragile economic recovery."

Lawlor argues that more tax increases in Budget 2014 will act as a brake on consumer confidence. "This deflates asset values, which has a direct impact on CGT and CAT payments to the Exchequer. There comes a time when even if assets can be sold, property owners will be dissuaded when the tax costs of doing so are too high."

Abina Kenneally, Tax Partner in **Quintas**, expects capital tax rates to be raised in the upcoming budget and probably in Budget 2015 too. "The rate was up to 40% in 1997, which is not that long ago," says Kenneally. "I would suggest that capital tax rates over 36% will see people stop and think before selling assets or transferring them to the next generation. Instead, they will hold on to them and as a result the overall spend of the nation will suffer. The availability of Retirement Relief and Business Asset Relief has a major bearing on transaction volumes. Any curtailment of these reliefs in Budget 2014 will have a serious impact on the passing of assets to the next generation."

Ronan McGivern, Taxation Director in **Russell Brennan Keane**, describes the treatment of taxpayers over the last number of Finance Acts as appalling. "It must be remembered that all of the incentives that taxpayers invested in were legitimate tax reliefs and incentives that successive governments introduced or extended," says McGivern. "Investors who legitimately availed of such reliefs and incentives are now being punished and to a certain extent vilified. The manner in which successive governments have sought to abolish tax incentives and reliefs has bordered on retrospective legislation in certain instances, which is a very unwelcome precedent."

McGivern's view is that raising capital taxes beyond 35% will be counter-productive and reduce the yield. "There are arguments for reducing these tax rates in order to encourage transactions, with related benefits in the form of VAT receipts, payroll taxes and stamp duty. A prime example of this is in relation to the CGT relief for the acquisition of land and property introduced in Finance Act 2012. The exemption applies for property acquired before 31 December 2013 that is held for more than seven years.

"There are other ways of increasing the yield from CGT and CAT without increasing the rate, such as amending allowances, reliefs and thresholds. I feel that we will see movement in this area as it generates less attention than headline rate changes."

Survey continued on page 48

'You can't underestimate the importance of maintaining a clean compliance record'

What taxation issues are of most concern to SMEs and what trips up business owners in a Revenue audit? **John Kinsella** hears the views of leading tax experts

Aidan Byrne

Baker Tilly Ryan Glennon

A large number of our director clients are experiencing cashflow problems in their businesses. We have found that in the current climate banks are unwilling to provide the credit facilities of yesteryear and are exerting increasing pressure on already cash-strapped businesses to reduce gearing levels. This in turn is having a knock-on effect on the management of tax liabilities and also feeds in at a personal level for our director clients.

Businesses are suffering, as many directors have significant personal loans arising from investing in their companies. More and more, we are engaging with our director clients to devise the creative solution they need to ensure that these personal debt repayments can be structured and facilitated in a tax-efficient way through the use of company profits.

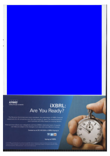
The importance of being tax compliant and maintaining a clean compliance record simply cannot be underestimated. With increased taxpayer transparency online due to ROS and the recent advent of filing tax returns through iXBRL format, there is no place to hide anymore. We have noticed in particular a recent spike in Revenue aspect queries in respect of tax creditor figures declared on corporation tax returns. We expect this ongoing vigilance by Revenue to increase as time goes on and therefore it is essential that SMEs are thorough in the figures stated on their tax returns.

If a Revenue audit occurs, our advice is fail to prepare and prepare to fail. We would encourage SMEs to undertake a tax 'health-check' so that any potential underlying issues can be identified early and resolved. Revenue auditors tend to view such acts as a positive step towards remaining tax compliant. Over and over, we see lack of disclosure to tax advisors, thus damaging credibility if certain issues are uncovered during the course of the audit.

Gordon Hayden

Smith & Williamson

The increased administrative burden placed on clients by the self-assessment system is without a doubt the number one concern among SME clients. There is a common feeling that they are expected to get it right all of the time, under threat of severe penalties even in the event of genuine human error. Clients also



perceive a lack of flexibility when dealing with Revenue when trying to resolve issues or agree specific terms.

At the personal level, the increased burden of personal taxation on middle-income earners ranks highly. In addition, there is genuine concern at the increase in add-on taxes, such as the property tax, and increases in indirect taxes such as VAT. Furthermore, there is a fear that savings and pensions will be targeted in the upcoming Budget.

It is clear that Revenue is increasing audit activity. **We see Revenue scrutinising specific areas such as benefits-in-kind and travel and subsistence, with a particular focus on owner-managers**. We would advise SMEs to revisit Revenue guidance material and perhaps carry out a review of two months' travel and subsistence claims. This will highlight any potential exposures and enable the SME to take remedial action on a voluntary basis.

One cannot help but notice the large number of cases working their way through the appeals system. There has been an interesting development in the UK with the introduction of a mediation process which has the objective of settling cases earlier, thereby reducing cost and administrative burden. One wonders if such an approach might yield results in Ireland by providing Revenue and taxpayers with an alternative way of resolving disputes.

Eamonn Griffin

RSM Farrell Grant Sparks

The biggest issue facing our SME clients is the difficulty in procuring bank finance on fair and reasonable terms. As a consequence, there is ongoing worry about meeting tax payments on time, with consequent enforcement risks or difficulties with tax clearance certificates. On a personal basis, individual directors have seen their after tax income significantly reduce with consequent difficulties in meeting financial obligations, particularly as regards repayments on investment loans taken out in Celtic Tiger days.

The burden of tax compliance, both from an administrative and cost perspective, continues to cause concern. The high-earner restriction has had a major impact, as the increased level of taxation has resulted in repayment difficulties with regard to property loans taken out on the back of government-supported incentives.

On the issue of Revenue audits, we advise clients to conduct periodical external review of internal control procedures, particularly with regard to record keeping, cash management, employee remuneration and expenses.

Frank Greene

Mazars

The most significant tax issues at a business level are the high combined rates of income tax, USC and PRSI and the pressure this puts on companies. **Employment costs are at a level that can put employers off taking on new employees.** On a personal level, the high rates of taxes mean that net take-home pay has decreased over the past five years and the rewards for the risks involved in running a business are low.

The government needs to seriously look at how precise and relevant tax incentives can be introduced to support economic growth and employment. To date, the approach has been more about survival rather than dealing with the fundamental

continued on page 50

Business Plus
Sunday, 1 September 2013
Page: 44,45,46,47,48....
Circulation: 10022
Area of Clip: 491200mm²

'The government needs to seriously look at introducing tax incentives to support economic growth and jobs'

issues. With the end of the bailout in sight, hopefully the government will focus more on the support of key business sectors through targeted tax incentives.

On the issue of Revenue audits, it is generally recommended that companies should get an overall review carried out once every three years to ensure that all taxes are being correctly operated. Some specific issues that arise in audits include the following:

- disputes over whether individuals are employed or self-employed
- appropriate back-up for expenses
- PAYE/PRSI not being correctly operated on all benefits
- capital items being expensed to the profit & loss account
- incorrect VAT rates and deductible VAT on certain non-deductible items, e.g. entertainment, petrol, cars, accommodation
- VAT not being accounted for correctly on property transactions
- RCT not being operated correctly

Ciarán Medlar
BDO

While the move towards a more progressive tax system was a welcome step, taxation should not become an impediment to growth. With marginal personal tax rates now at 52% to 55%, with an entry level to these rates on income above €32,800, the tipping point on when tax rates create this impediment has already been reached.

Targeted tax reliefs should be encouraged by the government, particularly those reliefs designed to generate employment. The focus has been on limiting the benefits, which has resulted in unduly complex and cumbersome legislation. The reliefs should be such that they can be easily explained and made attractive to the intended audience. The government should take a more pragmatic approach on these reliefs, bearing in mind that Ireland is competing on a global stage for these jobs.

Higher capital tax rates do not translate into higher tax yields. When the CGT/CAT rates were reduced from 40% to 20% back in 1997, the tax yield increased significantly over the following years. It is unlikely that the increased rates on these tax heads will have any beneficial impact on Exchequer yields. Instead, they are more likely to curtail activity as the higher rates will create a 'lock-in effect' whereby people decide to retain assets.

In a routine Revenue audit, the most common risk areas tend to relate to payroll tax. These would include incorrect mileage or subsistence rates, insufficient back-up for expense claims, use of external

continued on page 52

Colm O'Callaghan
PricewaterhouseCoopers

Irish family businesses and SMEs' recent emergence from 'survival mode' will be one of the cornerstones of economic stimulus and the creation of employment opportunities over the next few years. At the corporate level, access to finance continues to be by far the number one issuing facing our Irish SME clients. **Despite the government's much-hyped and publicised initiatives aimed to assist the SME sector, no significant focus has been given to helping SMEs access finance.**

Tax relief for individuals making loan capital investments to SMEs or, alternatively, a state-backed enterprise/investment bank should be considered for the provision of capital to growing businesses. Such a model is already well established in Canada, the US and Germany and is currently under development in the UK.

For individuals, recent changes in tax and pension rules have ensured that the retirement/succession process is anything but straightforward. SMEs benefit from the energy that youth can bring but they also need the steady and experienced hands of the older generation. Notwithstanding this, CGT Retirement Relief is to be drastically curtailed with effect from January 2014 for individuals aged 66 and over.

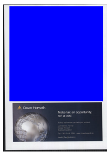
SME businesses are currently carrying significant cashflow risk associated with VAT on bad or doubtful debts. The VAT is usually recoverable when all reasonable efforts have been made, without success, to collect the debt in question, and the supplier is in a position to reduce the amount of debts in their accounting records by the amount of the debts regarded as bad. However, the reality is that the defaulter enjoys a VAT deduction without actually having paid the VAT element, while the supplier has to pay the VAT to Revenue and carries the associated VAT cost until he is either paid or meets all the tests to claim the VAT bad debt relief.

The rules are being very strictly applied by Revenue, resulting in long time lags. Similar legislation to that in the UK should be implemented to effectively put a six-month backstop, so that six months after the payment fell due:

- the defaulter would lose their deduction entitlement and must reverse any deduction taken, and
- the debt is deemed bad so the supplier can reverse the VAT paid to Exchequer.

Business Plus
Sunday, 1 September 2013
Page: 44,45,46,47,48....

Circulation: 10022
Area of Clip: 491200mm²



consultants and a misunderstanding of what constitutes business travel for mileage purposes. Given the benefits available from making a voluntary disclosure to Revenue in advance of the audit commencing, you should always carry out a comprehensive review of all relevant records on receipt of a Revenue notification.

Conor O'Brien
KPMG

The overall levels of taxation are a primary concern, whether the tax impacts on business or individuals. At the heart of the matter is the tipping point at which a tax starts becoming a disincentive. To be fair to government, it is aware of this but translating awareness into policy is undoubtedly a big challenge.

Taxing is often the soft option because it is much easier to implement than cutting expenditure and all business people will affirm that we at the edge in terms of taking the last bit of disposable income out of the economy. As for reliefs – there is no blanket answer. They can be useful in encouraging certain types of

'The top marginal tax rate needs to be cut to attract key management and the businesses that follow them'

activity for a period and can only be assessed on a case-by-case basis.

Levels of personal tax are a key determinant of our success in keeping and attracting talented people. Academic research and our direct experience, gleaned from the boardrooms of international businesses, prove that it is the top marginal rate that needs to be reduced to attract key management and the businesses that follow them. If we continue to tax individuals at the current level, we will collect less income tax in the long run.

Kevin McLoughlin
Ernst & Young

At the personal level there is uncertainty as to whether the personal tax burden has reached its limit. Successive budgets have raised income tax rates and social contributions, raised indirect taxes, and introduced new taxes and charges such as the Local Property Tax, with water rates to follow. The lack of certainty on this point adds to the current lack of confidence and causes people to defer investment and spending decisions.

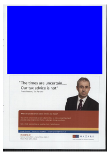
Governments in most countries are increasing taxes and enforcement efforts. There are initiatives aimed at increasing collaboration against perceived harmful tax planning. Businesses need to stay very close to these developments and assess their potential impact so as to ensure they can manage risk, cash tax liabilities and shareholder and market expectations.

The best advice for a SME faced with an impending Revenue audit is to prepare properly. Normally by carrying out its own self-review in advance of the audit, the SME will identify possible matters that have been dealt with incorrectly for tax purposes and thus be in a position to make a disclosure to the Revenue auditor at the outset. Such a disclosure, if properly made, can expedite the audit process, reduce the penalties that might be sought by Revenue and avoid publication of the tax settlement.

The type of issues that can arise in a

Business Plus
Sunday, 1 September 2013
Page: 44,45,46,47,48....

Circulation: 10022
Area of Clip: 491200mm²



SME tax audit include classification of income, claiming relief for non-tax-deductible expenditure, expenses payments, tax status of labour-only contractors, incorrect VAT rates and VAT recovery on disallowable items.

Pat Cullen
Deloitte

With the increase in tax rates over the last four to five years, such as personal tax rates increasing to 55% (when PRSI and USC are included) from 46.5% previously, together with the increase in the CGT rate from 20% to 33%, there would be a general concern with regard to the incentive for entrepreneurs to establish a business, taking account of the level of risk involved. The high level of taxation has to be looked at in the context of the unwillingness of banks to lend to SMEs without the provision of personal guarantees in many cases by the entrepreneurs.

The exposure to personal guarantees, together with the high levels of tax, means it is now much less attractive than it was five years ago to set up a new business. There is a need for similar incentives to those which apply in other countries such as the UK, where there is a reduced rate of CGT that applies to the disposal of private companies. This provides a much greater level of incentive for entrepreneurs to take the risk of setting up a new business.

The most common areas which give rise to issues in respect of Revenue audit of SMEs would be VAT and PAYE. Problems can arise where taxpayers use the wrong rates of VAT or claim refunds of VAT in respect of expenditure where they are not entitled to claim. Other issues which give rise to difficulties would be with regard to the correct taxation treatment of expenses paid to employees, credit cards provided to employees and directors and the correct application of the PAYE system to benefits-in-kind for employees.

Abina Kenneally
Quintas

Revenue is now pursuing single-person contractor operations nationwide. Primarily they are looking at mileage and subsistence rates, though they are also

continued on page 54

Ronan McGivern
Russell Brennan Keane

At an individual level, clients are very concerned about the trend over the last number of years of increasing taxes. They are also concerned with the increasing complexity of the income tax system. The restrictions of certain reliefs for high-income earners, the treatment of property reliefs and the property income surcharge have significantly added to the complexity of the system. With taxes on income of up to 55% (for self-employed), allied with the incessant targeting of perceived high-income individuals over the last number of years, changing residency is a real option for some.

Both corporate and personal taxpayers are concerned about the possibility of Revenue audits. A Revenue audit can be very disruptive in terms of management time, professional fees and also in terms of any potential settlement. It is well known that the vast majority of Revenue audits result in additional tax, interest and penalties for the taxpayer. **The length of time that it can take Revenue to bring audits to a close is also real cause for concern for taxpayers.**

Revenue audits are rarely random, so if a taxpayer is selected for an audit they need to be aware that there is a flag somewhere on the Revenue system. The operation of payroll taxes is an area that generally yields results for Revenue. Some of the issues that arise include the status of individuals as employees or self-employed contractors, the treatment of travel and subsistence payments to employees and remuneration to directors.

In relation to travel and subsistence claims there should be a company policy with appropriate approvals and sign-offs. Payments to non-resident contractors working in the state is another area that taxpayers can be caught out on. VAT is always an area of focus and can often result in additional liabilities for incorrect rates or the over-claim of input credits. Another area of focus for Revenue is reviewing wages to wives and children.

Contractors need to be aware of the risks associated with this investigation and give serious consideration, following in-depth consultation with their tax advisor, to making a voluntary disclosure, if that is deemed necessary.

Preparation is vital to ensure a successful outcome from a Revenue audit. As very few audits are random, it is imperative to carry out a careful review of relevant transactions in the period under review to ensure that they were accounted for correctly. Current areas of concern include incorrect VAT rates being applied, employee or self-employed, motor expenses and R&D tax credits. **Mileage and subsistence rates, BIK and VAT issues need to be continually assessed** as this is where we are seeing Revenue collecting a substantial amount of money.

While there have been some welcome changes to the tax regime, such as the reform of the three-year corporation tax for startup companies to allow unused credits to be carried forward, and the increase in threshold for the cash receipts basis for VAT from €1m to €1.25m, the removal or reduction of reliefs have had a negative impact on business and the economy. For individuals, the reduction in tax credits and cut-off point and the increase in the USC have had the biggest impact. The economy needs a kick-start by ensuring that all taxpayers are in a position to spend more and save a little, and this can only be achieved by ensuring that no further tax hikes are enacted.

Alan Lawlor
Wallace O'Donoghue

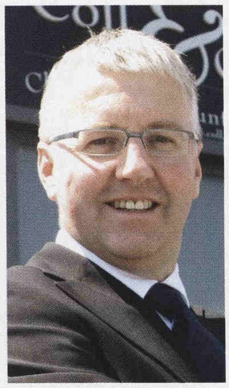
A key issue for any self-employed person is ensuring there are sufficient funds to discharge personal tax liabilities on the Pay & File date of November 14.

In terms of fiduciary taxes collected and remitted by all employers, keeping up to date is a key priority, as streamlined processes within the Collector General's office ensure that there is minimal leeway for late filers.

With the Employment and Investment Incentive, I am not sure if all eligible companies are aware that when addressed correctly this can provide a cheaper alternative to bank or venture capital finance. The BES scheme had become unwieldy and I am not sure if the changes in the EII scheme which reduce the bureaucracy involved are fully appreciated yet.

A company generating cash sales will always be aware of the imminent risk of Revenue audit at any time and will need to demonstrate that their systems accurately account for all revenues generated. Professional service companies can expect very close scrutiny of motor and subsistence expenses claimed, especially where a large majority of income comes from one client. This is certainly a hot area with Revenue at present. The golden rule is to act at all times as if Revenue could walk in the door tomorrow.

Rory Coll
Coll & Co



For the personal tax payer, the elimination of tax credits, along with the increase in tax rates/USC, has resulted in many individuals paying a marginal tax rate of 55%. This, combined with new and increased charges for water, property tax, health insurance, etc is not sustainable, particularly as a large number of these individuals are also burdened with high mortgages.

The lack of bank funding has led clients to look at the Employment Investment Incentive as an alternative source of funds. However, the scheme is

Business Plus
Sunday, 1 September 2013
Page: 44,45,46,47,48....

Circulation: 10022
Area of Clip: 491200mm²

Business Plus
www.bizplus.ie

not as attractive as BES to companies, particularly those in startup expansion mode, given the shorter three-year timeframe in which the funds must be repaid. **The restrictions on high earners availing of EIIS should be reviewed until such time as the banks are back at normal lending levels.**

A key focus of Revenue audits is in the area of VAT, which can be a minefield for many SMEs. A pre-audit compliance review can be helpful in identifying areas of risk that need to be addressed. We would always advise our clients to make a voluntary disclosure, before the commencement of the audit, as soon as they become aware of any issues during their pre-audit review.

John Byrne
Crowe Horwath

There should be a fundamental review of the close company surcharge. For many owner-managed companies which have rental income, the close company surcharge is a considerable cost, particularly where the rental income is used to make loan repayments. This surcharge on rental and investment income which requires companies to pay additional tax or to pay dividends to shareholders is penalising these companies, and does not reflect the current economic environment.

In an understandable attempt to ensure that high-earning individuals are seen to be paying a significant amount of tax, there are few tax reliefs now that business owners or entrepreneurs can avail of personally. In my view this is hindering investment. There is a view among SME clients that the administrative cost of qualifying for and utilising tax reliefs is high, the rules governing many reliefs are complex and by availing of these reliefs the possibility of Revenue scrutiny is increased.

On the issue of Revenue audits, small errors which are constantly replicated in the operation of VAT and payroll taxes can lead to significant cash settlements. Common VAT areas that I would ask clients to review in the event of a Revenue audit would be as follows:

- Has VAT been charged on all sales invoices?
- Verify that the correct VAT rate has been used on sales invoices.
- Review VAT claimed on purchases/expenses to ensure that no VAT has been reclaimed on disallowable expenditure (e.g. petrol).
- Review and confirm the VAT treatment of any property transaction.

Survey continued on page 56

Business Plus
www.bizplus.ie

Encouraging Entrepreneurs

BY HELEN O'SULLIVAN

The tax environment for entrepreneurs and investors has steadily deteriorated. The Irish Tax Institute believes that tax policy should do more to direct capital held by wealthy individuals into high-potential businesses

With only a few weeks to go until Budget Day, there is much speculation about both the size and the shape of this year's adjustment. With increasing focus on job creation and enterprise, the Irish Tax Institute believes there must be some recognition of the important role to be played by entrepreneurs and investors in driving the country's economic recovery.

In our pre-budget submission, *Developing a Culture of Entrepreneurship*, the institute made the case that the capital held by wealthy individuals needs to be harnessed for productive investment in small, high-potential businesses. The tax environment for entrepreneurs and investors has steadily deteriorated over the last five years, and we believe that unless we act to address this position it threatens to damage the incentive to build businesses and create jobs in Ireland.

In just five years, we have seen the following key changes in the tax environment for entrepreneurs and investors:

- Capital Gains Tax (CGT) and Capital Acquisitions Tax (CAT) rates have both increased from 20% to 33%.
- The CAT thresholds have effectively been halved.
- Marginal income tax rates have risen by close to one-fifth, from 46.5% to 55%.
- Reliefs and incentives previously available to investors have been scaled back or abolished completely, e.g. the patent royalty incentive, interest relief for money borrowed for investment in trading companies and CGT retirement relief.
- The High Earners' Restriction significantly limits the attractiveness of the Employment and Investment Incentive for those with the ability to invest in Irish business, and take-up has been low.

Competition For Investment

While Ireland has been increasing tax rates, a number of countries have focused on capital tax initiatives to attract business investment. The UK has introduced a 10% CGT rate on the disposal of qualifying business assets. This 'entrepreneurs' relief' has been enhanced three times since it was first introduced in 2008. Ongoing tax reform in the UK and our geographical proximity to Northern Ireland present particular challenges.

As well as the threat from international mobility, there is competition for capital from property investments. A recent report by Barclays found that Irish high-net-worth individuals are likely to hold 55% of their wealth in property, more than in any other country globally. Only 2% of wealth is held in business or entrepreneurial interests. The tax system has been used to drive activity in the property and construction sector in recent times, with initiatives such as the CGT incentive and the introduction of REITs. We believe that the job creation potential of the trading sector merits a similar focus.

Once Irish businesses start to export and get to a certain scale, many begin to grow through the acquisition of businesses, which are often overseas. If the tax environment is unfavourable and increasingly uncertain, then the investor may choose to keep their next acquisition located in its home jurisdiction.

The issue here is one of 'enterprise drain', where Ireland becomes uncompetitive as a location for the consolidation of an investor's business activities and employment base, with the consequent loss not only of tax revenues and jobs but also of the skills and knowledge of the business founders, its key employees and its investors.

Budget Recommendations

To address the issues outlined above, the Irish Tax Institute is recommending pursuing the following key tax initiatives in Budget 2014:

Business Plus
Sunday, 1 September 2013
Page: 44,45,46,47,48....

Circulation: 10022
Area of Clip: 491200mm²

'A roadmap for entrepreneurial activity and investment should be developed to address the broad fiscal climate for Domestic Direct Investment'

- Introduce a reduced CGT rate of at least half the current rate of 33% for gains realised on the disposal of business assets and shares in active trading companies. The relief should be linked to employment growth in the company and be clearly designated as a targeted measure for entrepreneurs.
- Implement a package of income tax measures to make the system more conducive to self-employment and investment, including the following:
(a) a commitment to ending the 3% additional USC on non-PAYE income in excess of €100,000 at the end of 2014, as planned.
(b) removal of the EII relief from the scope of the High Earners' Restriction, and a review of the incentive's restrictive three-year investment timeframe.
(c) an amendment to the operation of Seed Capital Relief so that the tax relief helps to finance the qualifying investment, reducing the need for the investor to raise all of the investment capital before they can make the investment.
(d) introduction of a tax relief for individuals making loan capital investments into high-potential SMEs.
- Introduce measures to assist entrepreneurs' underlying businesses and to incentivise them to hire additional employees, such as:
(a) the introduction of a progressive Employer PRSI relief which reduces the liability incrementally for each additional hire.
(b) a reduction in commercial rates for small businesses with low turnover.
- Provide an efficient means for small employers to reward their most valuable employees. There are currently no employee equity incentives which are geared towards startups and SMEs in Ireland.
- Complement the strategy for attracting Foreign Direct Investment with an ambitious Domestic Direct Investment policy (DDI). We are recommending that a comprehensive 'Roadmap for Entrepreneurial Activity and Investment' be developed, which would address the broad fiscal climate for DDI, and identify clear targets for the medium and longer term.

Tax is a key consideration for individuals with capital to invest. Irish investors who have a natural connection with this country should be given every possible encouragement to put their wealth to work in Ireland, and we hope that some steps towards achieving this will be taken in Budget 2014.

Helen O'Sullivan is incoming President of the Irish Tax Institute. The institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax.