Budget Submission 2019

New focus on indigenous enterprise and higher education

Ibec
For Irish Business

Contents

05 Foreword

06 Key priorities

08 Executive summary

10 Introduction

11 Budget 2019: The context

13 Recommendations

- 14 Supporting indigenous industry
- 18 Providing certainty to the FDI model
- 24 Quality of life and competitiveness

32 Annex 1

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Foreword

Budget 2019 needs to focus on indigenous business. Ireland is in a new phase of its economic development. Strong growth is evident across the economy and feeding its way into households and businesses as we move towards full employment. The transformation of the economy over recent years has been remarkable.

Prosperity brings with it greater choice and more room for manoeuvre. As we face into the run-up to Budget 2019, it is important that the State makes the correct choices. Ibec believes the Government's plan to run a €19.5 billion current account surplus over the next three budgets is prudent and sensible. But prudence must be matched with purpose if we are to meet successfully the significant challenges that are looming.

After a decade of underinvestment, Ireland's public infrastructure does not have the capacity to meet the needs of our growing population. The problems associated with deficits in housing and transport are spilling over into the wider economy and feeding into rising uncompetitiveness.

The domestic situation is complicated further by an increasingly uncertain international backdrop. With the US now engaged in a dispute over tariffs with the EU, which could boil over into a trade war, and uncertainty surrounding the outcome of Brexit, these external headwinds are real.

The choices the State makes in Budget 2019, therefore, take on more significance. In this submission, Ibec sets out in detail the measures we would like to see implemented and which we believe will yield long-term dividends for Ireland.

In the first instance, the Government needs to bring a new focus to indigenous business. As Ireland's tax and industrial base has become dangerously concentrated, we must make a step-change in how we treat our indigenous business sectors through the tax system. In particular, Ibec is calling for a new 12.5% capital gains tax rate for entrepreneurs.

Furthermore, although education has been central to Ireland's business model, the country is falling further behind its counterparts in higher education, as international rankings show. In the light of this worrying trend, Ibec believes the 'rainy day' fund should be redirected towards an increased €250 million investment in the higher education sector in 2019.

Fergal O'Brien,
Ibec Director of Policy and Public Affairs

Key priorities

Intensify focus on competitiveness

Ibec believes the Government's outline plans to run a current surplus of €19.5 billion over the next three budgets to be prudent and sensible. Given strong current growth rates, there is a risk of overheating the economy, whilst a number of significant challenges to Ireland's competitiveness are emerging. Running a current surplus will help take heat out of the economy. However, it is imperative that prudence be matched with purpose if the emerging challenges are to be tackled successfully over the coming years. In particular, in Budget 2019, Ibec believes the Government needs to take action in two key areas: State supports for indigenous business and greater investment in higher education.

01

Respond to US tax reform

In the light of US tax reform, companies are beginning to look at their future options regarding investments. There are significant implications for our continuing ability to attract high-value Foreign Direct Investment (FDI) in the period after 2020, Ibec believes it is vital that Budget 2019 provides certainty by re-committing to the FDI driven growth model, the 12.5% corporate tax rate and the importance of the R&D tax credit. Other measures sought include an extension of the industrial buildings allowance to include the construction of data centres and the introduction of capital allowances for a number of areas of advanced manufacturing including industrial robotics.

04

02

State support for indigenous business

Ireland's tax and industrial base is dangerously concentrated and over-reliant on a small number of corporate taxpayers. A step-change is needed in our approach to fostering indigenous business, who are not supported adequately by the State. Ibec's Budget proposals include: a new 12.5% capital gains tax rate for entrepreneurs; adopting the Swedish model in the treatment of share-based remuneration in new business; and reducing the rate of stamp duty on equity to diversify funding options. In addition, it is important that a Brexit contingency is put in place including a multi-annual framework for Brexit mitigation starting in Budget 2019 for 5% of the value of current annual indigenous export sales to the UK. Other measures should include the introduction of direct supports for companies re-investing in plant and machinery for new product lines to new markets.

03

Redirect the 'rainy day' fund to higher education

The current funding model for higher education is unsustainable. Following reductions in public expenditure on education over the last decade and with rising student numbers, Ireland is set to fall further behind its competitors in the international rankings for higher education unless decisive fiscal action is taken. Ibec believes monies from the 'rainy day' fund should be redirected to higher education investment. In particular, 2019 Exchequer funding for the higher education sector should increase by €250 million in addition to that already set aside.

Executive Summary

Ireland has entered a new phase of economic development. Despite strong economic growth bringing renewed private affluence to households and businesses, significant challenges remain in delivering the public infrastructure and services to match an expanding economy. This will be the major challenge for the current and future Governments.

Ibec believes the overall budgetary approach outlined by the Government over recent months is both prudent and sensible one from fiscal and economic standpoints. Running a current surplus of €19.5 billion over the next three years will allow Government room to invest the significant sums needed to expand capacity in the economy without adding to the existing risk of overheating and competitiveness erosion.

Ibec believes the 'rainy day' fund should be drawn down to provide much needed resourcing for higher education.

Taking some heat out of the economy by 'spending' money on a dedicated fund has some appeal in principle. However, the proposed structure of the fund to act as a 'fiscal buffer' is misguided. In the first instance, the NTMA already carries out this function through the retention of cash balances and liquid investments (currently €23.8 billion). Building a 'rainy day' fund is a more expensive way of achieving the same objective. In addition, a fund of €3 billion would make little material difference to the country's economic trajectory in the event of a crisis as such a measure would equate to only 0.5% of total domestic demand or about three months of social welfare payments.

The fund should be earmarked for a specific purpose. Ibec believes that money should go into the fund over the coming years as outlined (€500mn in 2019) and then be drawn down to provide much needed resourcing for the higher education sector. In addition, any future overruns in corporate taxation should be dedicated to the fund. In this way the fund would both help take heat out of the economy but also act as a more strategic nest egg for our future. Despite the need for prudence, there is room for targeted measures to help prepare our business model for the significant challenges on the horizon. In this submission Ibec makes a suite of recommendations which, taken together, would represent a strong response to external threats to the economy.

Firstly, a step-change is needed in the State's support for indigenous business. Despite real progress in recent years indigenous businesses are quite simply not supported strongly enough by the State. This has left Ireland's tax and industrial base dangerously concentrated and over-reliant on a small number of taxpayers. A step-change in how we treat our indigenous industries is required by delivering radical reform of the tax system. This includes the introduction a new 12.5% capital gains tax rate for entrepreneurs with no limit on lifetime gains; following Sweden's lead in ambitious treatment of share-based remuneration in new firms; reducing our rate of stamp duty on equity to diversify funding options; and introducing a pre-approved accelerated capital allowance for firms investing to prepare for Brexit.

Secondly, while Ireland continues to offer a very attractive investment proposition for international companies, US tax reform has the potential to change the equation for decisions of when and how US firms invest abroad.

Summary of Ibec recommendations

01 Improve investment supports for indigenous firms

02 Put in place a Brexit contingency

03 Respond to US tax reform

04 Help companies attract and retain highly skilled workers

05 Unlock SME growth potential through innovation

06 Improve how we support labour market participation

07 Take smart steps to increase the supply of housing

08 Fund Ireland's education and training system adequately

09 Help business improve its environmental sustainability

10 Support efforts to improve workplace wellbeing

Over the next two years, companies will be working out the implications of it for their future investments. A core part of the Irish regime's attractiveness in the future will be the level of long-term certainty underpinning the State's offering.

It is important that the State and broader political system continue to support this. At the same time, we must update our offering for mobile investment by improving the operation of the R&D tax credit; incentivising the next wave of FDI through accelerated capital allowances for robotics; and broadening the industrial buildings allowance to include data centres.

For Ibec members, the cost of housing and childcare, allied to high marginal tax rates are the main barriers in attracting and retaining talent.

In addition, in every sector of the Irish economy, companies are dealing with increasing challenges to competitiveness due to an inability to retain and attract key talent. Quality of life, household mobility and value for money in housing are becoming key determinants of Ireland's ability to compete internationally. Feedback from Ibec's members suggests that the cost of housing and childcare, allied to high marginal tax rates, are the main issues in attracting and retaining talent.

The new 10-year capital plan and the Government's Ireland 2040 initiative will help ease some of these pressures but there is more that can be done in Budget 2019. It is imperative for the labour market that workers on the average wage are kept out of the top rate of tax as wages continue to increase. We must also do more to incentivise top talent to choose Ireland through better tax treatment of share-based remuneration. When it comes to attracting and retaining talent there are also other broader material considerations. Business recognises that sustainability, and a cleaner, more resilient environment are increasingly crucial pillars of quality of life. This can be achieved while ensuring competitiveness is done in a cost-effective manner.

Ibec recommends the introduction of a number of direct supports to aid de-carbonisation and competitiveness enhancing measures in the broader economy. In this context, long-term certainty must be brought to the tax treatment of electric vehicles and planning for bus and rail transport. In addition, Ireland must also be more ambitious around areas such as renewable heat technology, capital allowances for natural gas in our transport fleet, and the energy retrofit of existing building stock. These must be supported in order to maximise the benefits for the environment and minimise the impact of carbon transition on living standards.

Finally, Ibec believes the tax system requires further changes to ensure an adequate supply of development land and housing. The future tax and fiscal policy for the construction sector should be underpinned by stability and certainty. In Budget 2019, Ibec would like the Government to introduce a new site value tax to replace the existing commercial rates and the vacant sites levy. In addition, the Government should introduce a permanent reduction in VAT for large-scale build-to-rent developments to provide a level playing field with competing commercial developments.

Introduction

This November will mark the 60th anniversary of the First Programme for Economic Expansion being laid before the Dáil. It, and events which followed, including the advent of universal second level education and membership of the European Union, have formed the backbone of Irish industrial policy for over half a century. It would be wrong to think that Irish industrial policy has not evolved since 1958 but it is likely that it will need to evolve in very different ways over the coming decades.

The impact of technology is reshaping the global economy, and political populism is threatening the future growth of global trade and investment. The coming years will be pivotal ones; changes to our external environment from sources such as US tax reform, Brexit and the prospect of further turbulence in the eurozone will have a major say in Ireland's continuing prosperity. Recent events have made clear that the open global trading environment on which the success of Ireland's business model has been based is contingent rather than fixed.

At the same time Ireland has a significant opportunity in being at the crossroads of many of the major trends; from intangible assets to digitisation. In Ibec's document 'Ireland: A model of substance', we outlined how Ireland is a leading example of the benefits of being a small, open, skilled and highly globalised economy. The country's flexibility and openness to global trends mean that Ireland has potentially the most to gain from global trends in intangible assets, digitisation and technological change in industry. This will only happen if we seize the opportunity. Ireland can continue to be a frontier economy but must ready our industrial model for a global economy which is increasingly driven by rapid technological and political change.

At home, competitiveness pressures are clearly emerging in many sectors. Ireland's labour market is now closing rapidly on full employment. An inability to pass on exchange rate pressures and increases in core business costs are putting considerable pressure on firms' margins; this will inevitably impact on investment in high-growth sectors. The growing risk of economic overheating means the Government will need to be increasingly prudent in how it taxes and spends. In the coming years, we will need to run continued surpluses on the current side of the State's budget while also finding the resources to invest in capacity in the key areas outlined in the recent Ireland 2040 plan. Business supports the Government in this goal.

It is in this context the key recommendations which follow are made. As always, Ibec has costed its proposals and will remain within a reasonable envelope of new measures which will ensure that Government adds to the capacity of the economy while making sure that existing competitiveness pressures are not made more severe.

Budget 2019: The context

Economic growth benefitting households

It is clear from all leading indicators that the economy is continuing to grow at a rapid pace despite growing global uncertainty. In 2017, analysis by Ibec suggests that the economy moved past 'the recovery' and into a new normal. The economy grew by 7.8%, domestic demand (excluding the impact of imported IP and the aircraft leasing industry) grew by 3.9% and all indicators now point clearly to growth benefitting households.

In the labour market, which remains the best indicator of the business cycle in Ireland, employment is now higher than its boomtime peak in absolute terms. Real household incomes and wages grew at the fastest pace in Europe in 2017 and early figures from 2018 suggest that this strong employment and wage growth is now spreading across all sectors of the economy – average wages grew by 2.7% annually in Q1 of 2018 and in all sectors. Because of this strong growth in incomes and growing household confidence, preliminary figures suggest that the value of consumer spending grew by 3.2% in 2017. The trend in recent years has been for upward revisions when final figures are arrived at mid-year as more tax and spending information is analysed. As such we expect that consumer spending will have grown by around 4% last year in value terms. We expect that consumer spend will grow again by over 4% in 2018 in value terms. This would take the total spend of households in the economy above €100 billion for the first time.

External threats and an economy close to capacity

While the improvement in economic conditions is unquestionably good news, it is also becoming increasingly clear Ireland needs to prepare itself for the prospect of material threats from both global and domestic forces.

Changes in the global environment with regards to trade and taxation provide clear external risks to our growth in the medium-term. Brexit and the prospect of a trans-Atlantic trade war obviously pose significant risks to Ireland in the immediate future. In addition, feedback from Ibec members makes it very clear that firms are beginning to review their options regarding corporate investment as a result of US tax reform and in the run-up to the transposition of the anti-tax-avoidance directive (ATAD) by January 2019.

Brexit and the prospect of a trans-Atlantic trade war pose significant risks to Ireland in the immediate future.

The continued benefits of recent global corporate restructuring for the Exchequer have played a key role in an almost doubling of corporate tax receipts since 2014. This risk cannot be ignored when delivering budgetary policy into the future. Budget 2019 must see us make strategic choices by not building our current spending base on uncertain revenues and continuing to update our attractiveness as a place to invest or grow a business. We must also be cognisant of the repeated warnings of the National Competitiveness Council that despite some improvements in competitiveness during the past decade Ireland's economy is still characterised as a "relatively high-cost location". As a small open economy, the cost base facing our indigenous firms remains extremely vulnerable to external price shocks through exchange rate changes, interest rates or energy prices which have provided a major boost to our cost competitiveness in recent years. Continuing tailwinds from these sources are far from guaranteed.

The damaging impact of cost escalation for our domestic sectors was one of the key lessons of the past two decades and must not be allowed to repeat itself. Already, we are seeing signals that this may be occurring in the broader economy. We expect that it will be one of the major challenges facing the business community over the coming years.

The recent Ireland 2040 plan provides a strong template with which to improve quality of life and address many of our competitiveness challenges but, as we reach full employment, having the skills available to deliver on that promise will be key.

Budget 2019 must reflect that fact by keeping a lid on current spending pressures and targeting measures at increasing labour force participation, innovation and our economic capacity.

Growing investment, keeping current spending in line

The full year Exchequer returns for 2017 showed a surplus for the first time since the crisis with the Exchequer taking in €1.9 billion more than it spent in 2017. Excluding the €3.4 billion once-off gain from the sale of some of the State's stake in AIB, however, the underlying net position remains marginally in the red with a small deficit of €1.5 billion (0.5% of GDP).

The plans as outlined in the Summer Economic Statement for 2019 would see Ireland in a group of countries which would be matching an unemployment rate which was lower than the average of other developed countries with a primary surplus which would exceed that of other advanced countries. This represents sound budgetary policy.

It is Ibec's view that the Government's plan to run in effect a balanced budget in 2019 with a current surplus in the region of €19.5 billion over the three years to 2021 will allow room to invest significant sums in expanding capacity in the economy without adding to the existing risk of overheating.

> Government's plan to run a balanced budget in 2019 with a current surplus of €19.5bn over 3 years to 2021, will allow room to invest in significant sums in expanding capacity without adding to the risk of overheating.

For some time now, Ibec has identified a lack of investment in the economy as a major constraint to the new phase of economic expansion which is currently underway. The launch of Project Ireland 2040 in February is a welcome development in this context. The 10-year investment plan will see capital spending exceed 4% of economic output in line with Ibec's assessment of the country's long-term infrastructure need. Together with the National Planning Framework, it will allow us to plan for a bigger population and for better distribution of economic activity across the regions. In order to deliver the plan, however, the Government will need to keep a very tight leash on the expenditure side of the budget once the cost of various demographic pressures is considered.

RECOMMENDATIONS

Business priorities for Budget 2019

Supporting indigenous industry

Overview

Some notable successes aside, there is a strong argument that we have not done enough over the past 60 years to fulfil the promise of the First Programme for Economic Expansion to 'foster in every way' the development of Irish indigenous business. If we are to follow through on the economic promise of the last six decades, then it is evident we must go further than industrialisation by invitation and develop our indigenous enterprise base.

We have made some real progress in recent years. In order to survive the downturn firms have invested in new product, engaged in capital deepening and become leaner. The impact of this and better price competitiveness in the Irish economy can be seen in the fact that Irish exports over the eight years to 2017 were between five and six times more responsive to growth in global demand than they had been between 2001 and 2008. As a result, for the first time in 2015 agency figures showed Irish owned exporters accounting for a greater share of agency supported employment than foreign MNEs. We must now go further.

All available evidence shows that Irish indigenous firms are well below 'best in class' when it comes to management, innovation and exporting—three of the main drivers of business growth and productivity. Improving management practices, helping firms innovate or export earlier will increase the productivity and growth of Irish indigenous firms. We also have low start-up rates compared to the majority of our European neighbours – the second lowest in the EU15 and one-quarter that of the UK. We must do more to help people starting out on the journey of building a business.

All available evidence shows that Irish indigenous firms are well below 'best in class' when it comes to management, innovation and exporting—three of the main drivers of business growth and productivity.

To change this, we need to address what is within our control. Irish firms face a number of ongoing challenges to their growth which include high legacy debts and costs, a small domestic market, a lack of diversified funding options, barriers to innovation and challenges accessing and competing for skills. A key role, therefore, for the tax system is to mitigate part of the risk borne by entrepreneurs. This would make it more attractive for owners of capital to invest as well as grow new export markets and for small Irish business to become companies of choice for talented people.

01

Recommendation

Improve investment supports for indigenous firms

Why?

Ireland's broader investment tax environment for indigenous business is an outlier in its lack of attractiveness by international norms. We have the third highest capital gains tax rate in the OECD, a stamp duty regime on shares which is the highest in the world (twice that of the second highest) and an R&D tax credit which is far too complicated and onerous for smaller firms to engage with.

In addition, feedback from our members and users of the EIIS, the state premier investment incentive for indigenous business, has shown that changes to the EIIS to make it compliant with state aid rules has increased the complexity of the scheme to the extent that firms and users of the scheme are finding it very difficult to operate the scheme (resulting in incomplete applications). The drop-off in applications in Q1 of 2018 (down by 47% year-on-year) is a clear indicator of the material impact this is having on confidence in the scheme and consequently in investment in Irish business.

This perverse treatment of investment by indigenous business cannot be allowed to continue if we are serious about growing internationally competitive companies.

Measures for Budget 2019

In Budget 2019 the Government should:

- Send a signal of intent to serial entrepreneurs by radically improving the CGT entrepreneurs' relief by introducing a 12.5% rate with no lifetime cap on gains. Cost €60 million
- Introduce a simplified pro-forma R&D tax credit scheme for SMEs which allows smaller firms to overcome funding constraints on their innovative activity. Cost €10 million
- Renew confidence in the EII scheme by improving processing times, matching the UK's €2 million annual limit on investment (currently €150,000 in Ireland) and ending the uncertainty caused by the current system of split relief (based on employment levels or R&D expenditure) with full relief given in the investment year. Cost €5 million
- Match the Swedish enterprise management incentive scheme for smaller firms. The Swedish Government received European Commission clearance to abolish tax on stock options at companies that are younger than 10 years, have fewer than 50 employees, and revenue and a balance sheet of below €8 million. No immediate cost in 2019 but rising toward €5 million in future years
- Remove, the limit on grants to any individual in any year to "50 per cent of the annual emoluments", increase the €3 million cap on options in use under the KEEP scheme. No cost in 2019
- Ensure better guidance for firms on share buybacks or redemptions, the definition of holding companies and excluded activities (i.e. Fintech) under KEEP. Make sure the scheme aligns favourably with the UKs EMI scheme. No cost in 2019
- Reduce the level of stamp duty on equity to UK levels (0.5%) over a period of three years in order to increase liquidity, make raising capital easier for Irish firms and reduce the cost of raising capital significantly. Cost €40 million in net terms.

02

Recommendation

Put in place a Brexit contingency

Why?

In the context of Brexit, companies will need support to diversify, innovate and re-align their business models. The education system will need support to provide the capacity for up-skilling. Supporting our domestic industries will mitigate the worst impacts of Brexit domestically. While progress has been made on issues surrounding trade questions at the European level there is significant uncertainty surrounding the outcome. In this context, there must be a stronger delivery on Brexit preparation and mitigation domestically. Yes, there are still major uncertainties which make it difficult to plan ahead for Government but the time for preparation is now. Ibec members will be making key decisions in advance of March 2019 and the Government can play a greater role in supporting them.

This does not just extend to the agrifood-sector but also to the wider domestic economy with tourism, forestry, traditional manufacturing, retail and energy, transport, utilities and telecoms all impacted either directly through loss of trade or otherwise through disruption of their supply chain. It is worth remembering that the need for diversification not only applies to exporting companies but also to those importing.

36% of Irish consumer goods are imported from the UK along with 23% of material goods which go into the production of finished goods here.

Increases in tariff or non-tariff barriers, regulatory divergence or transport delays will impose significant costs on all areas of the Irish economy past the initial export shock. Companies will clearly need to diversify not just their export markets but also their sourcing strategy in response to these issues.

36% of Irish consumer goods are imported from the UK along with 23% of material goods which go into the production of finished goods here.

The recent European Commission state-aid ruling clearing the way for a new Brexit support of up to €10 million to facilitate the restructuring of SMEs in Ireland was welcome. It is, however, extremely limited in scope (to SMEs in extreme financial difficulty and with strict criteria on equity attached), the criteria attached mean that it will be of little use to firms until they are already in a situation near liquidation and far after diversification efforts would need to have taken place. In the event of a hard Brexit, support for a broader temporary state aid framework, moving past a focus just on restructuring, will be needed.

Measures for Budget 2019

In Budget 2019 the Government should outline a Brexit strategy on assistance for firms to prepare for Brexit.

TABLE 1 Three strands to a Brexit Strategy for Budget 2019:

Strand 1: Cost €65 million, reclaimed over the next seven years	Strand 2: No immediate cost	Strand 3: €50 million
Put in place a multi-annual framework for funding Brexit mitigation beginning in Budget 2019. The resources required will be in the region of 5% of the value of current annual indigenous export sales to the UK.	Continue work to put in place a broader temporary state aid framework to help Governments provide short-term assistance to companies.	Ensure price differentials with NI/UK are not exacerbated by policy.
Measures under strand 1	Measures under strand 2	Measures under strand 3
Introduce direct supports for companies looking to re-tool and re-invest in plant and machinery to produce product lines for new markets. This should take the form of a pre-approved accelerated capital allowance scheme for projects which are deemed necessary under a clear Brexit related contingency plan. Provision must be in line with those already available for energy efficient equipment, with allowances available to be claimed at an accelerated rate of 100% in year 1.	Introduce an enterprise stabilisation fund with assistance from EU colleagues. This would enable short-term financing similar to the supports that were introduced in 2009 that helped firms through the financial crisis and an increase in 'de minimus' levels of state aid.	Ensure further price differentials do not emerge between the Republic and Northern Ireland due to increases in taxes on groceries, tobacco or other excises such as online gambling which have the potential to drive cross-border/ unlicensed activity. Reduce alcohol excise by €50 million in Budget 2019 to reflect changes in the exchange rate.
Allow companies claim VAT as an input credit at the same time as declaring their liability in order to minimise cashflow needs. This VAT deferral licence regime already exists in the Netherlands. A review of Section 56 of the VAT regime (particularly the rules on group registrations) could provide a better solution in the long run.	Work to improve the terms and conditions under the current Brexit Loan Scheme which has interest rates of 4% and loan terms of only 3 years maximum.	Retain the 9% VAT. This will help the tourism industry which has been hit by the continued fall off in UK visitors.
Introduce additional marketing and innovation supports for companies looking to reformulate, re-package or innovate their product lines for new markets.	Review double tax agreements with high growth developing countries with a view to reducing withholding tax (particularly on royalty/licensing fees) facing companies trading with those markets.	
Introduce trade support measures, including further export trade financing and export credit guarantees to support the continued development of international export markets. This must also include supply-chain supports to companies in the non-tradeable sector.		

Providing certainty to the FDI model

Overview

There is a great amount of uncertainty in the global tax and trading environment. While Ireland's record of stability and consistency had advantages in this context it does not mean that our FDI offering can remain static while all else around it changes. Ireland's industrial policy over the past 50 years has been incredibly successful at turning us from the 'sick man of Europe' to one of the continent's richer countries. Despite a common perception to the contrary, our FDI model has also evolved considerably during that time.

Ireland's industrial policy over the past 50 years has been incredibly successful at turning us from the 'sick man of Europe' to one of the continent's richer countries.

The net effect has been pretty substantial, over the 13 years to 2016 Ireland was amongst the top countries in the world for Greenfield FDI investment (that is real plant, machinery and capital investment) on a per-capita basis.

The only non-oil exporting country with a comparable consistent record for substantial investment is Singapore. However, our FDI journey hasn't been without challenges. For example, between the end of the dot-com bubble and 2010, the Irish FDI model went through an enormous change. Most notably a number of technology manufacturing plants closed their doors. FDI employment dropped after 1999 and did not recover until 2011.

We must prepare for further challenges and opportunities which will come from emerging technological and political change. The key to this will be to ensure consistency and certainty in the regime.

03

Recommendation

Respond to US tax reform

Why?

The global FDI model is continuing to change and adapt to the post-BEPS world. In Ireland, this has meant increased investment in R&D capacity, data analytics, robotics and shared services. This is the acceleration of a longer-term trend. OECD data shows that of over 40 OECD cities, Dublin attracted the 6th most inward cross-border R&D investment projects over a nine-year period between 2003 and 2011. Dublin is increasingly competing for R&D projects successfully with cities 10 times its size, such as London, Tokyo, and Paris. This climb up the value chain is the direction in which it is likely the FDI part of our development will continue for the foreseeable future.

In this context, feedback from Ibec members makes it very clear firms are beginning to look at their future options regarding corporate investment in the advent of US tax reform and in the run-up to the transposition of the anti-tax-avoidance directive (ATAD) by January 2019. While this is unlikely to have an impact in 2019 there are significant implications for our continuing ability to attracting high-value FDI in the period after 2020, those implications could potentially be both positive and negative from an Irish point of view. As a result, it is important that we are positioning our FDI model for a world where the impact of the headline rate of tax alone is more muted than in the past, and companies are increasingly looking at the broader context.

Respond to US tax reform

Measures for Budget 2019

- Provide certainty to the regime by re-committing to an FDI driven growth model, the 12.5% corporate tax rate and the importance of the R&D tax credit. No cost
- Make sure digital tax proposals continue to be progressed through the multilateral OECD framework and a firm stance is taken against the unilateral EU proposals. No cost
- The 5% limit on qualifying outsourced expenditure to Third Level Institutions, under the R&D tax credit, and the restrictions on outsourcing to related parties should be removed. This would be consistent with the treatment under the Knowledge Development Box and in line with other jurisdictions. Cost €60 million
- Ireland has the second lowest density of industrial robots in the EU15[1], despite them being strongly linked with increased productivity. In order to encourage investment in high-value manufacturing accelerated capital allowances for a number of areas of advanced manufacturing (including Computerised/computer aided machinery and robotic machines) should be introduced. France, for example, operated a similar scheme for robotics and 3-D printing (for SMEs) allowing for provision over a two-year basis. Cost €35 million, reclaimed over the next 7 years
- The industrial buildings allowance should be extended to include the construction of data centres to encourage the sector to continue its growth despite recent setbacks. Cost €120 million
- Transposition of the Anti-Tax Avoidance Directive should be completed in the upcoming Finance Bill, but the state should extend the introduction date of the new exit tax regime until January 2020. No cost
- In advance of a new exit tax regime, the new ATAD compliant exit tax should be introduced at a rate of 12.5% in line with the current corporation tax rate. Cost before uncertain but potentially revenue raising
- Extend Ireland's participation exemption to dividend income upon the introduction of CFC rules. No net cost
- Re-evaluate funding and strongly consider re-directing funding or providing complementary funding to higher Technological Readiness Levels (TRLs) matching that which is already provided to the Lower TRLs, to give Ireland its own world-class Centre of Advanced Manufacturing Excellence of scale. No net cost in 2019

[1] http://bruegel.org/2017/12/the-growing-presence-of-robots-in-eu-industries/

04

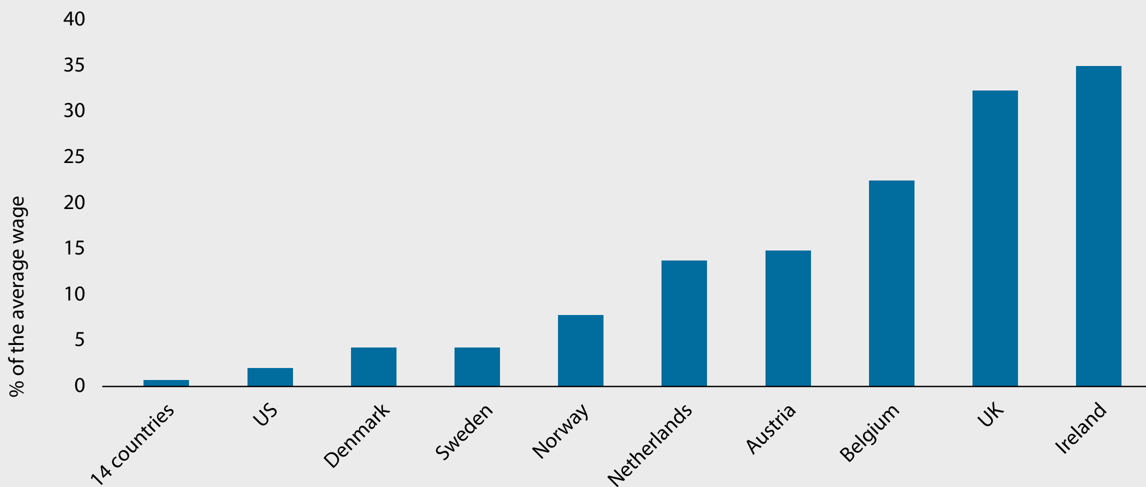
Recommendation

Help companies attract and retain highly skilled workers

Why?

The narrowness of the income tax base in Ireland is a feature of our system and means that the balance of the burden for the state's tax takes falls on a relatively small number of households. Recent work by the European Commission[1] has shown that the Irish personal income tax system "is relatively progressive but narrow and at the cost of relatively high marginal rates".

FIGURE 1 Tax Entry Threshold by Country:



Note: The tax entry threshold refers to the percentage of average wage at which average tax rate for a single earner without children exceeds 0%. The 14 countries are Switzerland, the Czech Republic, Germany, Greece, Spain, Finland, France, Hungary, Italy, Japan, Poland, Portugal, Slovenia, Turkey.

1 https://ec.europa.eu/info/sites/info/files/eb028_en.pdf

Help companies attract and retain highly skilled workers

International evidence has shown that tax systems with a broad base and low marginal tax rates provide the best outcomes for employers, employees and the economy. The high marginal tax rates necessitated by the extreme progressivity of our system no doubt have distortive effects for Ireland with marginal rates of almost and over 50% for large cohorts of workers being a real challenge for Irish firms creating high-value jobs and rewarding skilled workers. In addition, as the pay and income recovery now clear in the economy broadens a failure to keep average workers out of the top rate of tax will continue to cause serious labour market issues.

Recent research in Denmark has provided clear evidence that mobile skilled workers are affected by marginal tax rates at the top of the earnings distribution (Kleven et al, 2013). The evidence points to a very large elasticity of migration with respect to tax. A 1% increase in the marginal tax rate reduces inward migration of highly skilled workers by between 1.5% and 2%. Another solution which would help Ireland attract more skilled workers is having a favourable treatment of stock options. Currently, Ireland's treatment of these schemes is less favourable than other locations, particularly the UK. In its submission to Government in 2016, Ibec outlined a number of measures which would make these schemes more attractive and although some progress has been made, it has been minimal.

These measures can be delivered without risking fiscal prudence. Tax indexation is done automatically in most developed countries. A fiscally neutral overall tax package would be of the order of €600 million given that the exchequer yield from non-indexation of the income tax system is of the order of €600 million on a full year basis.

Measures for Budget 2019

In Budget 2019 the Government should:

- Increase the entry point to the 40% rate of income tax by €1,000 to keep ahead of wage growth. Cost €168 million
- Remove USC and PSRI liabilities on revenue approved stock option schemes. Cost €10 million
- Reduce the income tax liability of unapproved schemes to the ordinary rate of tax. Cost €20 million
- Reduce the higher marginal rate of tax for those earning over €70,000 by 1% and commit to reducing the all-in marginal rate for all employees to 47% over the coming years. Cost €136 million
- Extend the 30-day period in SARP to 90 days to reflect HR realities in most firms availing of the scheme. No cost
- Review the tax legislation and in particular penalties for employers in the run-up to the introduction of the PAYE modernisation scheme. No cost

05

Recommendation

Unlocking SME growth potential through innovation

Why?

Budget 2019 must look at boosting Ireland's capacity for innovation and exploitation of spill-overs. SMEs may experience greater challenges than larger companies to dedicate and develop internal resources needed to engage successfully with universities and to capitalise on their research outputs. These enterprises will require additional state support to build the absorptive capacity and to participate in any research collaboration. The OECD have highlighted that the productivity gap between indigenous SMEs and larger multinational organisation is widening. Too many SMEs miss opportunities to fully realise the potential of research activity in higher education institutions, and too few have the knowledge and skills to develop, value and exploit the situation.

Measures for Budget 2019

- Introduce funding for a targeted, paid internship programme for PhD students, aimed at installing innovation expertise directly into the SME operation to identify new product and process development opportunities, highlighting development and commercial opportunities to increase innovation within the business. A critical feature of the programme will be that the internship provides a supporting link to higher education consultancy services, business and legal schools, research programmes, spin-out companies and state-backed innovation supports. Cost €8 million
- Building on the successful Trade Mission in Ireland and Meet the Buyer Events, Budget 2019 should provide seed funding to foster linkages between indigenous and multinational firms on projects of common interest and co-selling opportunities which have the potential to enhance the productivity and innovation potential of both firms. This should not be limited to firms in the exporting sectors. Cost €2 million

Quality of life and competitiveness

Overview

When it comes to the affordability of accommodation and a good quality of life there are obvious social reasons why these are desirable. There are also strong reasons why these issues are having a growing impact on business. The traditional industrial model of the 20th century typically saw capital locate close to raw materials and transport routes. Workers and businesses serving them were then attracted to these towns and cities. That model is no longer dominant in the 21st century. The move toward a digitised intangible economy means companies are now more reliant on intellectual rather than physical capital. Ireland is at the vanguard of this trend.

In addition, both Irish and non-Irish workers are much more mobile than in the past. The cost of accommodation, quality of life and workplace attractiveness is a key factor in the decision of workers to locate in Ireland. The highest value firms are often choosing to locate where talented workers (and in some cases superstar workers) want to live rather than the other way around. As such quality of life, household mobility and value for money in housing is a growing determinant of our ability to compete internationally.

Feedback from business is consistent; the high cost of housing, childcare, allied to high marginal tax rates on second earners and long commutes is the number one issue in getting more workers into the labour force or indeed to continue living and working in the country. As the labour market tightens this issue will only become more acute.

06

Recommendation

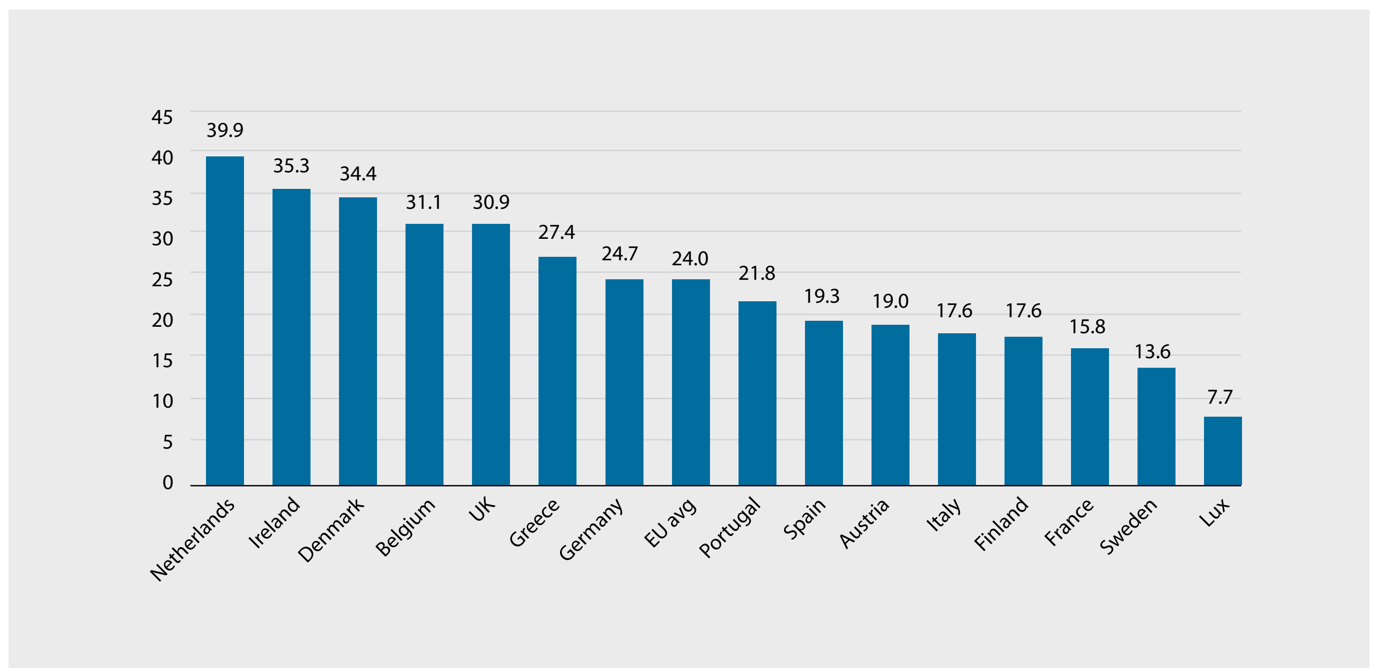
Improve how we support labour market participation

Why?

At a time when organisations are facing into a new "war for talent" which will see advanced economies experiencing a shortfall of 40 million educated workers by 2020, employers face a significant recruitment issue while Ireland fails to harness our full economic potential. Despite the strong improvements in the labour market, Ireland's participation rates still haven't recovered since the crisis and are still lower than they were in 2007. These rates are currently the 6th lowest in the EU-15, which is largely driven by lower female participation rates. An increase in female participation could help boost growth and mitigate the downward pressure on labour supply and the impact of a shrinking workforce and skills shortage. Childcare costs in Ireland are among the highest in the OECD. This is largely because, in other countries, childcare costs are heavily subsidised by the State. While Ireland has a relatively low-level State funding for childcare, we have the second highest direct payments to parents of any OECD country because of child benefit. These payments also have a negative effect on female labour market participation due to their income effect. Changes to this paradigm are necessary if we want to increase female labour force participation.

In addition, other groups in the labour market are increasingly finding it difficult to access the labour market. Eurostat data (2011) shows that Ireland had the second highest gap in employment levels for persons with a disability (relative to other workers) in the EU. People with disabilities are twice as likely to be unemployed (26.3%) as a person without disabilities (12.9%).

FIGURE 2 Employment differential (% Points) between those with and without difficulties in basic activities



Improve how we support labour market participation

The Government's 'Comprehensive Employment Strategy for People with Disabilities' aims to ensure that people with disabilities who want to work are supported and enabled to do so. The strategy expects that the employment rate of people with disabilities will increase by 15% from its 2011 level, with an increase in the employment rate from 33% to 38% by 2024. This will require work on multiple fronts including in terms of fiscal incentives such as the wage subsidy scheme.

Measures for Budget 2019

- Means test child benefit and redirect the savings (potential €300-€500 million) to begin a process of expanding the Early Childhood Care and Education scheme to include children aged 1 to 3 years and increased in duration to 4 hours. Using these payments in a more targeted way would improve the incentive to work and increase the productive capacity of the economy. No net cost
- The Early Childhood Care and Education scheme should be supplemented by a formal out-of-school hours care system to address the needs of working parents and the atypical work day. No net cost
- The Wage Subsidy Scheme for persons with a disability should be increased from its current level at 55% of the minimum wage to 70% of the minimum wage level. The Government should give a commitment to index it at that level over time as part of the Low Pay Commission process. Cost €5 million
- The minimum number of hours worked under the wage subsidy scheme should be reduced from 21 hours to 15 hours to reflect the needs of many persons benefitting from the scheme. Cost €2 million

07

Recommendation

Take smart steps to increase the supply of housing

Why?

Last year 14,449 new houses were built, but this is only 40% of what is needed to accommodate our growing population. Ireland's housing market is not functioning at present. The rise in house prices and rents experienced across all parts of Ireland has been a consequence of a significant imbalance in supply and demand following the crash. This has also resulted in a lack of affordable housing in urban areas where the need is greatest. This has clear knock-on implications for households, employers and the economy. Housing is central to our overall competitiveness. Housing increasingly is an issue faced by employers in the recruitment and retention of staff. As we approach full employment we will need to attract/reattract workers living abroad which will become more difficult as housing costs move further out of line. The traditional industrial model of the 20th century typically saw capital locate close to raw materials and transport routes. Workers and businesses serving them were then attracted to these towns and cities. That model is no longer dominant in the 21st century. The move toward a digitised intangible economy means companies are now more reliant on intellectual rather than physical capital. Ireland needs a smoothly functioning property market and policy intervention is needed to ensure this.

Measures for Budget 2019

- Any major upturn in construction related tax revenues over the coming years should be ringfenced if we are to avoid the mistakes of the past. This revenue should be used to both invest in infrastructure that opens more land for residential development and invested in direct build social housing where the need may arise. No immediate cost
- Replace recurring commercial property taxation (e.g. commercial rates, vacant site levy etc) with a land value tax No net cost
- Introduce a permanent reduction in VAT to 9% for large-scale residential build-to-rent developments in order to provide a level playing field with competing commercial developments. Cost €10 million
- The State must be more ambitious in its approach to direct building. The State continues to spend heavily on Housing Assistance Payments (HAP) and other housing supports which are an inefficient use of resources. Increased direct building and greater use of long-term leasing arrangements would deliver much better value-for-money. No net cost
- Review the work visa and apprenticeships systems to ensure they can support the employment demands of the industry. No net cost

08

Recommendation

Fund Ireland's education and training system adequately

Why?

The current funding model for higher education is unsustainable. Public expenditure on education fell significantly in recent years. At the same time, student numbers increased and are expected to rise even further as the number of people of college-going age is set to grow. This was recognised in the Cassells Report which highlighted that future funding should come from three sources: employers, students and Government.

The State, individuals and employers all have a role to play. Therefore, the increased Exchequer funding, an effective student contribution mechanism and an employer contribution must happen concurrently as part of an interlocked solution.

Skills shortages are becoming increasingly apparent across a broad range of sectors, most notably in ICT, engineering and financial services. The education system's ability to meet this demand has been undermined by years of under-investment during the economic crisis.

As part of its response to this challenge, the Government introduced the first of three increases to the national training levy in Budget 2018. This has highlighted two major concerns for business.

In its current configuration, the levy is little more than an 'earmarked tax' which bears little relation to business upskilling priorities. The Government has given a commitment that the final two levy increases will be subject to the implementation of the necessary reforms to ensure that employers have a greater role in determining the priorities and strategic development of the National Training Fund (NTF). However, a major reorientation of the Fund will be required to develop demand-driven schemes that would enable business to source relevant state-supported training services for existing and potential employees. The ostensible reason for increasing the levy was to address the higher education funding deficit. In fact, the increase is an attempt at a short-term fix due to the absence of a credible and more sustainable solution.

Measures for Budget 2019

- Produce a credible response to the under-funding of tertiary education and develop a sustainable model based on contributions from the state, individuals and business. In 2019 Exchequer funding for the third-level education sector should increase by €250 million in excess of that already set aside for demographic pressures. Cost €250 million, funded from the rainy day fund allocation
- Discontinue NTF supported programmes which are not meeting explicit employer-defined upskilling or reskilling or fund them from alternative Exchequer sources. Not net cost
- Replace the existing system with a new NTF supported cost reimbursement scheme which would enable employers to choose suitable training services from individual accredited education and training providers. No net cost

09

Recommendation

Helping make Irish business more sustainable

Context

In 2018 we are already witnessing the effects of climate change. Global average temperatures have increased by almost 1˚C since pre-industrial times. The atmosphere and oceans have warmed, snow and ice cover has diminished, sea levels have risen, and entire species are on the brink of extinction due to habitat destruction. Failure to address climate change and its main driver - increasing greenhouse gas emissions- will place our environmental, social and economic well-being at great risk. Ireland is committed to delivering a low carbon economy by the year 2050 as part of the EU's collective efforts to mitigate climate change. Ibec supports this ambition. It makes good business sense to have a sustainable, resilient economy. Businesses throughout the country are reducing their environmental footprint and investing in low carbon technologies, renewables, energy efficiency and waste reduction. Additional state support is needed to make these investments more cost-effective and attractive for business. Increased state support is also needed to drive an extensive energy efficiency retrofitting programme of our built environment, and to decarbonise the transport sector.

Why?

Ireland has legally binding greenhouse gas (GHG) reduction targets for the Effort Sharing sector with milestones at 2020 and 2030. The former is commonly viewed as a 20% GHG emissions reduction by 2020 but it actually entails a cumulative reduction in emissions over the eight-year period 2013-20. Any cumulative deficit at the end of 2020 must be compensated by the purchase of compliance credits from other member states. Otherwise the Exchequer will be liable to financial penalties imposed by the European Commission. Ireland's 2020 target was always seen as extremely challenging because of the structure of our economy and the dispersed pattern of population settlement. However, the last few years of strong economic growth has seen a worrying reversal of previous progress made towards our 2020 climate target. The EPA's annual forecasts show a worsening cumulative shortfall, even allowing for additional mitigation measures that are planned but not yet implemented.The price per tonne of international compliance credits is a matter for inter-government negotiation, but the aggregate Exchequer cost is likely to run into hundreds of millions of Euro. Much of that money could instead have been usefully spent inside the Irish economy if domestic decarbonisation policies to date had been more ambitious. However, these financial liabilities and missed opportunities pale into insignificance with the cumulative shortfall that the EPA is currently projecting for the 2021-30 compliance period. The Government must immediately and significantly ramp up Exchequer funding for cost-effective domestic mitigation efforts in order to ensure that any mitigation strategy also underpins the competitiveness of Irish Industry.

Helping make Irish business more sustainable

Measures for Budget 2019

- An extensive retrofit programme will be required between now and 2050 to increase the energy efficiency and sustainability of existing building stock. It is estimated that it will cost in the region of €25bn. The National Development Plan 2018-2027 set aside €3 billion for such activity. For 2019, Ibec recommends a substantial increase in the funding for SEAI retrofit programmes, including a doubling of the €35 million Energy Efficiency Fund. Cost €35 million
- Ibec welcomes the recent NDP to allocate funding for the promotion of bus and rail transport within and between our congested urban areas. We urge the Government to ensure that these projects don't get delayed through planning uncertainty. Accounted for in NDP funding allocation
- The National Development Plan 2018-2027 set aside €300 million to support the deployment of renewable heat technologies in the industrial and commercial sectors. €7m was set aside in last year's budget. However, the scheme is still not up and running. Ibec recommends that at least €25 million be allocated for the first year of the scheme's roll out in 2019. Accounted for in NDP funding allocation
- Introduce a new accelerated capital allowance (ACA) tax incentive for companies, with the aim of encouraging investment in refuelling infrastructure and equipment for natural gas. The ACA should allow companies to write off 100% of the purchase value of qualifying vehicles and refuelling equipment, including CNG compression equipment, against their profit in the year of purchase. Cost €20 million
- Last year Ibec made recommendations to the Department of Communications Climate Action and Environment (DCCAE) on the design of the next support scheme for renewable electricity. We continue to recommend that if premium cost renewable technologies or community schemes are to be supported, exchequer funding should be used to subsidise the excess cost rather than through the PSO levy. This is necessary to protect the competitiveness of Irish industry but also to promote uptake of clean technologies. Cost dependent on scheme design
- A 0% benefit-in-kind (BIK) rate was introduced for electric vehicles for a period of 1 year as was electricity used in the workplace for charging vehicles. Ibec recommend that both provisions be extended for a period of 5 years to facilitate greater uptake of electric vehicles. No cost in 2019
- The excise rate for Natural Gas and biomethane as a propellant is currently set at the current EU Minimum rate. While Budget 2015 committed to keeping this in place until 2022, Ibec recommends that the rate be further extended out to 2025 to incentivise the uptake of compresses natural gas in the transport sector. No cost in 2019

10

Recommendation

Support efforts to improve workplace wellbeing

Why?

The consequences of nutritional, physical and mental ill health are far-reaching for Irish society, in terms of reduced economic performance along with increased health and social welfare expenditure. With 68% of the 15 to 64-year-old Irish population in employment, it provides the perfect opportunity to positively encourage and support healthier lifestyle choices by employees. The Government should explore the provision of support to businesses in Ireland that undertake undertake initiatives outlined below.

Measures for Budget 2019

- Support by employers for employee wellbeing through gyms, sports club memberships, and personal fitness equipment should be removed from BIK in the same manner as membership of professional bodies and the bike-to-work scheme. Cost €2 million
- Follow the lead of other jurisdictions in introducing direct support for workplace wellbeing initiatives. For example initiatives to or materials/equipment which relate to programmes which raise health awareness, encourage behavioural change or promotes employee participation in wellness programmes should be creditable against companies' corporate tax bills. This could include, talks, subscriptions, demonstrations, competitions, or classes for example. Cost €3 million
- Review the treatment under income tax of benefits provided by workplace wellness programs (for example 'quit bonus' or other incentives to participate in wellness activities) which may be taxable as income to the employee. No cost

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Annex 1

Ibec fiscal space calculation

	€, Million
Net fiscal space (after NDP spending, carryover from Budget 2018, demographics, and establishment of special purpose fund for higher education)	800
Ibec asks	Net cost after revenue raising measures
Recommendation 1: Improve investment supports for indigenous firms	115
Recommendation 2: Put in place a Brexit contingency	115
Recommendation 3: Respond to US tax reform	215
Recommendation 4: Help companies attract and retain highly skilled workers	334
Recommendation 5: Unlocking SME growth potential through innovation	10
Recommendation 6: Improve how we support labour market participation	7
Recommendation 7: Take smart steps to increase the supply of housing	10
Recommendation 8: Fund Ireland's education and training system adequately	250 (drawn down from ring-fenced fund for higher education in 2019 – already accounted for in fiscal space)
Recommendation 9: Help business improve its environmental sustainability	55
Recommendation 10: Support efforts to improve workplace wellbeing	5
Total gross spend	1116
Other measures assumed, not included	
Yield from increased funding of competent authority and revenue compliance	60
Yield from expiration and revaluation of tax expenditures (LPT)	150
Total net spend	906
Total use of net fiscal space (not double counting drawdown from ring-fenced fund for higher education)	656
GGB % of GDP	-0.1%
Structural balance, % of potential GDP	-0.4%
Medium term objective, % of potential GDP	-0.5%

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About Ibec

Ibec is Ireland's largest lobby group representing Irish business both domestically and internationally. Its membership is home grown, multinational, big and small, spanning every sector of the economy. Together they employ over 70% of the private sector workforce in Ireland. Ibec and its trade associations lobby government, policy makers and other key stakeholders nationally and internationally to shape business conditions and drive economic growth. It has over 230 professional services staff in seven locations including Brussels and has 42 different trade associations in the group.

www.ibec.ie

Contact us

Gerard Brady
Head of Tax and Fiscal Policy
Gerard.brady@ibec.ie
+ 353 1 605 1644

Alison Wrynn
Economist
Alison.wrynn@ibec.ie
+ 353 1 605 1603

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