Ibec
For Irish Business

Budget 2015

Less tax more investment

Post Budget Analysis

Overview

Following seven tough budgets, Budget 2015 contains a number of very positive measures for job creators and the wider economy. Government has clearly listened to the needs of business and delivered a suite of reforms which will support growth and jobs. It is also important that at a time when the international economy is slowing again the Minister has delivered an expansionary budget which will help maintain momentum in Ireland's economic recovery. Ibec had set out five key recommendations for Budget 2015 and government acted on each of them.

This is a good budget for the economy. It will support business and consumer confidence and crucially it improves personal spending power for 2015. Given the recent improvements in GDP, Government was right to abandon austerity and to focus on the central objective of getting the deficit comfortably below the 3% mark.

The income tax reform package is a major positive. This has been one of the central planks of Ibec's *An Ireland that works campaign*. The higher rate cut and band increases are well targeted at the labour market and will help the incentive to work. The major disappointment on the income tax front is the continued discriminatory tax treatment of the self-employed. We are delighted to see the abolition of the pension levy. This was a grossly unfair tax on the assets of savers and its abolition was long overdue.

The international tax package was one of the major positives of Budget 2015. The Minister took on board the concerns of business and achieved an appropriate balance between reform and enhancement. The changes to the residency rules had been well flagged in the run-up to the budget but it was positive to see a sensible transition period provided. The enhancements to the IP regime, including the introduction of a new and exciting knowledge development box, the R&D tax credit and the special assignee relief programme are all to be applauded. This package will help make Ireland a more attractive location for mobile investment and crucially it removes the recent growing uncertainty in relation to the corporation tax regime.

There are positives for indigenous business in the form of improvements to the Employment Investment and Incentive Scheme (EIIS) and the Seed Capital Scheme. There is a modest improvement in the 2015 Exchequer capital investment budget and we will see further details on the medium-term infrastructure investment plans over the coming weeks. Minister Howlin stressed the importance of putting more private finance to work for investment and we are likely to see further commitments on new PPP projects.

In summary, Ibec believes that Government has delivered a sensible budget. It will be positive for jobs and growth and will help us push on with the recovery momentum in 2015. Government has started the process of income tax reform and has already addressed those areas in which we were most out of line with our competitors. The outcome on international tax is very positive in terms of the package enhancements and it restores much needed certainty to the regime.

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Overview

Ibec recommended and Budget 2015 delivered

1 The Public Finances	End to austerity
2 Consumer taxes	A reduced marginal income tax rate
3 Personal taxes	Retention of 9% rate
4 Investment	Infrastructure and business finance
5 International tax	IP, Mobile skills and tax credit

1. Public finances and economy

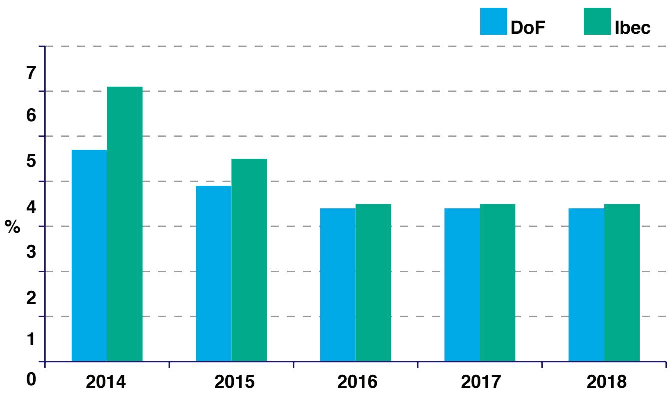
Ibec's pre-budget recommendations:

Given the stronger than expected growth in the economy, Ibec recommended that budget deficit targets could be met without a fiscal adjustment in Budget 2015. Ibec expected that without any austerity measures the Budget deficit in 2015 should fall well under the 3% target and with sufficient room to account for any downside risks.

Budget 2014 changes:

Underlying the Department of Finance's budget projections is a more optimistic outlook for Ireland's economy. It adjusted its GDP growth forecast for 2015 from 2.7% to 3.9% though it remains under Ibec's forecast of 4.5%. For the medium-term (2016 to 2018) it expects growth rates of 3.4% which is broadly in line with Ibec's projections.

Figure 1: Real GDP, annual growth rate

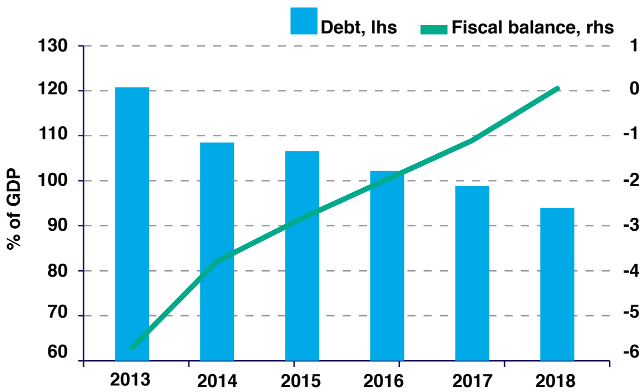


Source: DOF, Ibec

As a result of the improved outlook the Government has been able to introduce an expansionary budget for the first time in eight years. The total budget package amounts to €1,050 million which consists of net €630m expenditure measures and net €420m in tax measures.

Under these circumstances the Department of Finance estimates that the deficit will be 2.7% (€5.3 bn) in 2015 down significantly on its previous expectations. The 2.7% matches Ibec's recommended pre-budget deficit target. For the medium-term the Department of Finance expects that the fiscal balance will continue to improve and achieve a surplus by 2018. The debt-to-GDP ratio is expected to fall below 100% in 2018.

Figure 2: Fiscal deficit and gross debt, % of GDP



Source: DOF, Ibec.

What this means for your business:

Ibec believes that the income tax package and increased spending is likely to have a positive short-run impact on domestic demand which will support business. In recent years budget adjustments have dragged on growth, particularly in the domestic economy; the substantial adjustment in Budget 2015 will have positive feedback effects on overall economic activity, supporting domestic demand and Ireland's recovery. It will also have positive feedback effects on tax revenue and will contribute to an improved fiscal position in the coming years. Budget 2015 comes at the right time for Ireland. Though Ireland's economy is performing positively the downside risks especially externally are high. One of the major risks to Ireland's recovery is the weak growth outlook in the eurozone. Therefore it is very welcome to see Budget 2015 deliver a domestic stimulus.

2. Consumer taxes

Ibec's pre-budget recommendations:

Ibec warned that increases in VAT or excise rates or any broadening of their base would hurt domestic consumption. The success of the 9% VAT regime for tourism showed that targeted reductions in taxation can be positive for the economy and the Exchequer. Therefore, Ibec recommended that the 9% VAT rate for the tourism sector should be retained and recent excise rates on alcohol reduced. Ibec also suggested that excise on oil should be collected on a duty deferment basis in line with the collection of carbon tax.

Budget 2014 changes:

- Excise duty on tobacco products will increase by 40 cents equivalent
- Introduction of 30 day deferral of excise payment on mineral oil

What this means for your business:

Ibec welcomes the fact that there are no major changes to consumer taxes and excise duties and that following a number of recent increases alcohol excise duties were untouched. This is important as it does not put an additional tax burden on consumers.

The retention of the 9% VAT rate for the tourism sector is positive. Tourism in Ireland continues to be a major and growing economic sector with overseas visitors spending over €3.2 billion p.a. Keeping this measure supports employment in the hospitality and broader tourism sector.

Excise on oil will be collected on a 30-day duty deferment basis which improves the security of supply, reduces the administrative burden on the state, and mitigates the unsustainable burden on the oil industry and hence on the wider economy.

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3. Personal taxation

Ibec's pre-budget recommendations:

Ibec had four main recommendations for the budget under the heading of personal taxation:

1. Lower the marginal rate of tax and increase the entry point: The marginal tax rate decreases the incentive to work at the margin. In addition it kicks in at a level which is amongst the lowest in the OECD. This means that Irish workers at modest wages are paying more tax than their OECD counterparts and it is costing companies more and more to reward employee performance. Ibec recommended that the marginal rate of tax should be reduced below the 50% threshold over time, beginning in Budget 2015 and additionally that the entry point to the higher rate of tax should be raised over time so that workers are not paying the top rate on modest wages.

2. Abolish the pension levy: The private-sector pension levy is a uniquely unfair and unacceptable tax. In Budget 2014, the Government reversed an earlier decision that the pension levy would end in 2014. Moreover, the Government increased and extended the levy in a way that caused a reasonable fear that the levy may be here to stay. The levy damages wider policy efforts to increase pension's coverage and demonstrates the disjointed approach of Government to pension's policy in Ireland. Ibec recommended it be abolished in Budget 2015.

3. Equalise USC for self-employed: The USC surcharge for the self-employed is an anachronism when government is trying to encourage entrepreneurship elsewhere in the tax system. Ibec recommended this should be allowed expire at the end of 2014. The marginal rate of 55% for entrepreneurs' disincentives people from entering self-employment, starting up their own business or expanding relatively small operations. With multiple schemes operating to try to encourage self-employment this USC surcharge is likely to have both significant deadweight loss on its own but additionally adds to deadweight loss from other schemes.

4. Set out a long-term vision for taxation in Ireland: As part of a 'post-BEPs' strategy Ibec recommended the Government set out a long term vision for Irish taxation. This vision on taxation should allow for clear and substantial discussion on changes over the long-term in how the tax system in Ireland operates with a focus on shifting the burden of taxation away from work.

Budget 2015 changes:

Budget 2015 was a good one for the domestic economy. The marginal rate of income tax was reduced from 41% to 40% with the entry point to the marginal rate increased from €32,800 to €33,800. These measures will cost €292 million in 2015 and €405 million in a full year.

In addition there was significant increase in the structure of the Universal Social Charge (USC). The entry point to the USC was raised to €12,021, meaning that 80,000 people were effectively removed from the tax base as they are not liable for income tax, PRSI or the USC. Additionally people earning the minimum wage or less were removed from the higher 7% rate of USC.

The USC changes are set out in the table below with the 2014 rates and bands in parentheses.

Income band	Rate
All income earners less than €12,012 (€10,036)	0%
Those earnings over €12,012	
All income up to €12,012 (€10,036)	1.5% (2%)
€12,013 to €17,576 (€10,036 to €16,016)	3.5% (4%)
€17, 577 to €70,044 (€16,016 +)	7% (7%)
€70,044 +	8% (7%)

A new 8% USC rate was introduced for single incomes in excess of €70,000 effectively keeping their marginal rate of tax at 52%. The Minister also signalled that the pension levy which Ibec has strongly opposed will be reduced this year and will be removed completely by the end of 2015.
Finally, and the only disappointing aspect of the overall income tax package from a business point of view, the 10% rate of USC for self-employed income in excess of €100,000, which had been due to expire at the end of 2014, was retained and the rate was increased to 11% on the portion of income over €100,000.

Collectively the changes to income tax will benefit nearly all workers with many low income earners (below minimum wage) now effectively exempt from income tax or close to it. Middle-income earners, as a function of paying a higher proportion of their income in tax, will benefit the most.

3. Personal taxation

What this means for your business:

The changes to personal taxation in Budget 2015 are very welcome from a business point of view and will have significant effects in taking some pressure off wages and making it easier for those employers in wage increase mode to reward employees without significantly adding to labour costs.

During the recession the cost of living environment has remained fairly benign with the price level in September 2014 1.7% below where it was in the corresponding month in 2008. As such, wage pressures which have emerged in the past year have done so due to the erosion of take-home pay through increases in taxes and charges. For some sectors of the economy these pressures are simply unaffordable. GDP is still down almost 7% from peak with turnover in some sectors e.g. retail down significantly more. The reduction in the income tax burden will ease emerging wage pressures somewhat for those businesses which are still in survival mode.

Domestic demand will also benefit from the reduction in personal taxation. The average married two-earner working household will gain between €500 and €1,000 from the changes to taxation in this budget while a single person around the average industrial wage will gain just under €400. This increase in disposable income will boost spending in the domestic economy.

The tax package will give households almost €500 million in new spending power and the Department of Finance estimates that along with other structural reforms will create 15,000 jobs over a three year period.

Ibec is pleased that the pension levy will be wound down by the end of 2015. In 2014 these charges will have cost private sector workers more than the property taxes and water charges combined. In the long-term this measure would have affected the pension adequacy of many private sector workers.

The only disappointment from an Ibec point of view in the tax package was the retention of the USC surcharge on the self-employed and particularly the increase from 10% to 11%. This now means that the marginal rate of tax for entrepreneurs remains higher than for those in employment. This remains an obvious disincentive to entrepreneurship and small business growth when so much of government policy is pointing in the other direction. The deadweight loss effects of this in terms of its damaging effects on entrepreneurship are likely to be substantial and its retention will leave a sour note on what was a positive budget for the small business community.

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4. Enterprise and infrastructure investment

Ibec's pre-budget recommendations:

Ibec argued that Budget 2015 should deliver measures to enhance investment in enterprise and much needed infrastructure. Business investment can be supported by rebranding and enhancing the Employment Investment Incentive Scheme (EIIS), enhancing tax supports for venture capital investment in SME's and start-ups and by reforming the capital gains tax regime and R&D tax credit to encourage reinvestment and innovation by enterprise. Ibec also argued that the JobsPlus scheme should be expanded as it had been successful at helping to alleviate the serious issue of long term unemployment.

Ibec's submission on the public capital programme suggested that infrastructure investment should be increased to 4% of GDP by 2020 to deal with emerging bottlenecks as the economy and population grows over the coming years. Ibec argues that Government should work with the private sector to take advantage of low financing costs and explore innovative financing models for projects such as social housing which would help alleviate the pressure on house prices in key areas and provide much needed jobs and homes.

Budget 2014 changes:

The EIIS scheme was expanded and the amount of finance that can be raised by a company increased to €5m annually. The qualifying sectors for the scheme were expanded to nursing homes, medium-sized enterprises in non-assisted areas, and internationally traded financial services. In addition, the required holding period for shares was increased from 3 to 4 years. The Seed-Capital scheme is also to be rebranded to the 'Start-up relief for entrepreneurs' (SURE) scheme.

The home renovation incentive scheme, which Ibec pushed for in advance of its introduction in Budget 2014, is being expanded to include rental properties. In addition, the Minister undertook a comprehensive review of agri-taxation with significant changes to the taxation of the agriculture sector including measures on income tax, CGT, CAT and VAT. There were no changes to the wider CGT regime with the rate remaining untouched and the entrepreneur's relief announced in Budget 2014 still requiring state aid approval from the EU.

The JobsPlus scheme, an employment subsidy which has proven effective at reducing long-term unemployment, has been doubled in size to 6,000 which is welcome due to the serious challenge remaining with long-term unemployment.

Minister Howlin announced an increase of €210 million in capital spending for 2015, to over €3.5 billion with further unspecified increases in 2016 and 2017.

He also announced that a detailed capital expenditure review with Government priorities for the coming years will be published before year-end. The major announcement made on Budget day was on the provision of social housing. Some €2.2 billion will be invested in social housing between now and 2017 of which €1.5 billion will come from the Exchequer, a further €300 million in PPPs and €400 million in off-balance sheet financing. This is expected to provide 10,000 housing units before 2018.

In addition, there was good news from a human capital investment point of view with 1,700 additional teaching posts and funding for science and innovation.

What this means for your business:

Ibec welcomes improvements to the EIIS scheme which have the potential to help SME's find willing investors, take on extra employees and expand their operations. The changes are a positive step while use of the scheme is likely to pick-up as the economy improves and the high-earners restriction is removed. Challenges still remain, however, with the scheme's branding and risk characteristics, with the changes announced unlikely to make the scheme attractive to non-traditional investors.
The expansion of the Home Renovation Incentive is welcome. This scheme has been successful thus far with €190 million worth of works financed under 3,000 contractors. Its expansion has the potential to improve the standard of rental stock but also will have some Exchequer benefits through its impact on the black market and employment in the construction sector. The lack of changes in CGT were unsurprising given that changes announced last year are still awaiting European clearance, while the failure of Government to introduce a streamlined tax credit for SMEs must be marked down as a missed opportunity to encourage innovation in Irish SMEs.
On the capital expenditure side, Ibec welcomes the intention to launch a new infrastructure strategy but there is some concern that funding allocations may not go far enough in alleviating bottlenecks faced over the next decade.

Funding for social housing will boost the construction and related sectors while providing a vital social need. The adoption of new and innovative funding channels was closely in line with Ibec's pre-budget position and the commitment to work with the private sector is particularly welcome. The €2.2 billion spend over three years will contain a substantial off-balance sheet element and will provide a boost to employment in construction while also taking pressure off house prices in some areas. Finally, the additional funding for education is welcome from an employer point of view and is an important commitment to investing in Ireland's human capital.

5. International tax

Ibec's pre-budget recommendations:

Ibec has long argued that we needed a radical overhaul of our corporation tax offering. Other jurisdictions, particularly the UK, had stolen a march on us in recent years as our offering stood still. We pushed for certainty around the rate and the regime more generally; an improved intellectual property tax offering; enhancements to the R&D tax credit; and more competitive personal tax rates, particularly for mobile skills through reform of the special assignee relief programme (SARP).

Budget 2015 changes:

Budget 2015 has seen some very significant changes to Ireland's corporate tax regime. The Minister needed to balance the challenges posed by reputational issues with the imperative to enhance the competitive offering. This package got the balance right. It sends out a strong signal to prospective and existing investors that Ireland offers a very attractive and competitive offering for mobile activity.

The key developments are:

- Changes to Ireland's company residency rules to ensure that all companies incorporated in Ireland are tax resident here: this change will come into effect from January 1st 2015 for new companies and January 1st 2021 for existing operations.

- A new 'knowledge development box': this new regime will be introduced in 2016 at the latest and possibly earlier, following a public consultation over the coming months.

- Enhancements to taxation of intangibles (Section 291A): the Finance Bill will reduce the current 80% cap on claims and will also add customer lists to eligible expenditure.

- Removal of base year for R&D tax credit: the 2003 base year will be removed entirely from the scheme and the change will be introduced in the Finance Bill.

- Improvements to the Special Assignee Relief Programme (SARP): the upper salary threshold is being removed; there are positive changes to the residency rules; and the requirement to have been employed abroad by the employer is reduced to just six months.

What this means for your business:

The international tax package is very ambitious and sends out a strong signal that Ireland intends to play to win in the competition for mobile investment. It contains all of the measures which Ibec had recommended in its various pre-budget submissions. The company residency rules would have changed anyway as a result of the OECD BEPS work on intangibles and government has decided to act proactively in order to give certainty to business. The grandfathering period is sensible and offers companies sufficient time to restructure between now and January 2021. The announcement of the 'knowledge development box' is a positive statement of intent and will position Ireland very strongly for the next wave of mobile business investment. Business now has an important opportunity to shape this regime through the upcoming public consultation and Ibec will continue to engage strongly with the Department of Finance on this important issue. It is also positive to see that business will not be left with an extended hiatus prior to the introduction of the new regime and we could well see it in place within a number of months. The more immediate enhancements to the tax treatment of intangibles through reform of Section 291A also addresses some of that scheme's shortcomings.

Ibec has long argued that the retention of the 2003 base year for the R&D tax credit scheme was a particular difficultly for those companies with significant R&D activity in that arbitrary year. We are delighted to see this unnecessary restriction removed and this will provide equal incentive for all companies to undertake additional R&D activity. The change will help bring new mobile R&D projects to Ireland as the ability to benefit from the scheme is a key determinant in project location decisions.

The final significant enhancement in the mobile investment offering is the improvements to SARP. Ibec had engaged extensively with government on this and reflected the frustration of our members in relation to the previous scheme which clearly was not working. The removal of the earnings cap is a crucial change which will open up the scheme to a range of further senior roles, while both the residency rule and the employment duration condition changes will also remove some of the flaws in the old scheme. It is essential that Ireland has an effective regime to bring decision makers and mobile talent into Ireland and government must continue to improve this scheme to ensure that it is working for business.

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