DUBLIN
COMMISSIONER
FOR STARTUPS

A core objective of the Programme for a Partnership Government (2016) is the creation of 200,000 jobs by 2020.[1] *Startups will play a crucial role in this regard, since employment growth is disproportionately driven by young, high-growth firms. Enterprise Ireland has suggested that startups account for two-thirds of all new jobs created in Ireland.*[2]

The Office of the Dublin Commissioner for Startups welcomes the opportunity to make recommendations on Budget 2017, based on consultation with some of Ireland's most promising startups. This submission includes five specific recommendations to address the key obstacles that our startups identify as impediments to their success and ability to create jobs.

Please note: This document includes a number of quotes from Irish startups. While the quotes are not attributed here, the CEOs and founders behind them are available to discuss them further upon request to this office.

We look forward to discussing this submission in more detail with the Department of Finance.

Sincerely,

Niamh Bushnell
27th September 2016

[1] Programme for Partnership Government (2016). http://www.merrionstreet.ie/MerrionStreet/en/ImageLibrary/Programme_for_Partnership_Government.pdf
[2] See https://www.enterprise-ireland.com/en/News/PressReleases/2016-Press-Releases/Enterprise-Ireland-supported-companies-created-record-21-000-new-jobs-in-2015.html. Accessed 23/9/2006/

Budget 2017 Submission

A key overarching theme of the recommendations below is the need to simplify all tax reliefs available to startups. Resource and time constraints mean that if a relief is difficult to understand, or requires the use of costly professional services to implement, it will not be of service to the startup community. The introduction of a package of straightforward and broadly marketed reliefs aimed at early stage companies would, of itself, be a hugely positive step forward.

Our four specific recommendations addressing the key obstacles identified by our startups are as follows:

1. Employee Share Remuneration
2. The Employment and Investment Incentive (EII) Scheme
3. PAYE Equalisation for the Self-Employed
4. Capital Gains Tax Relief for Entrepreneurs

1. Employee Share Remuneration

The *Programme for a Partnership Government* commits to 'explore the mechanisms through which SMEs can reward key employees with share options in a tax-efficient manner'.[3] Share remuneration is crucial for startups since it enables them to attract top-tier talent in a highly-competitive marketplace. Large multinational companies will always be able to pay more in terms of basic salary, but a startup can compete if it can attract talented employees by offering them a share in the company's potential to be high growth.

Companies in which employees have an ownership stake also create more jobs, generate higher profits, and pay more tax.[4] In the UK, employees of eligible startups are only charged the 10% entrepreneurial Capital Gains Tax rate on the disposal of shares. Again, this is highly-favourable by comparison to the most competitive Irish rate of 33%, and it is important that we aim to match the UK in this area. Feedback from several startups suggests

[3] Programme for a Partnership Government (2016), 37.
[4] Inter-University Centre for European Commission's DG Markt (2014), 'The Promotion of Employee Ownership and Participation', 9.

that they have been unable to avail of the Revenue-approved schemes, and that their staff are therefore taxed on share options at the marginal rate of 52%.[5]

Overall, the existing share-based remuneration regime is prohibitively complicated for startups. A streamlined system for companies under five years old is absolutely critical if these companies are to remain competitive in the marketplace for talent.

Entrepreneur Feedback

'There is currently so much mystery attached to the ESOP. It's a dark art here in Ireland and it shouldn't be. It should have a simple framework and be less time consuming and expensive to implement. Government policy needs to help entrepreneurs to make their businesses real and more scalable more quickly, without spending lots of time trying to understand legislation. We've got to attract key talent into our companies and a straightforward Employee Stock Ownership plan is a key missing piece right now'.

2. The Employment and Investment Incentive (EII) Scheme

The Employment and Investment Incentive Scheme (EIIS) has proved successful in many respects, and much of the investment fall-off observed during the recession has been recovered.[6] There are still several aspects that could be improved however, particularly for investments in young, high-risk startups. This Office made a first submission to the Department of Finance on EIIS in July 2015 and followed in September 2016 with an updated view and additional data. Both can be found on our website, and the key recommendations are repeated here.

[5] Department of Finance Tax Strategy Group (2016), 'Taxation of Share-Based Remuneration', 4-10.
Irish Tax Institute (2016), 'Budget 2017 Submission', 12-13. Available from http://www.taxinstitute.ie/Portals/0/Tax%20Policy/Institute%20Submission/2016/FINAL%20SUBMISSION.pdf.
[6] Data from http://www.revenue.ie/en/about/publications/bes-scs-shares.html.

Firstly, the managed funds like BDO and Cantor Fitzgerald that avail of the scheme tend to invest in mid-cap companies between three and five years old, making them quite risk-averse. The scheme also attracts investors in projects that are already low-risk by their nature, notably windfarms. This is perfectly understandable from the perspective of the investor, since the effective impact of the scheme is to narrow the relative gap between the net returns achievable on higher and lower risk companies.[7] It is therefore important to offer an enhanced incentive for investors in very young companies.

Under the current scheme investors are allowed a 30% tax relief in the year of the investment, and another 10% in year four. We recommend a preferential rate of 50% tax-relief for investors in companies less than three years old, up to a maximum of €150,000 per company. The estimated cost to the Exchequer would be €5 million per annum, or 22% of the costs associated with EIIS in 2015. As detailed in the appendix to our more detailed submission on the scheme, it is quite possible that the additional economic activity generated could result in a negligible net cost given the potential employment benefits. The entire relief should be made available in year one to simplify the scheme, make it more attractive, and to free up investor funds. The key benefit would be an increased number of well-funded early stage companies that can drive employment growth and the speed of Irish innovation.

Entrepreneur Feedback

'As an early stage technology startup seeking investment with an inherent risk of failure, it's almost impossible for us to compete on the same terms with more established firms or low risk projects with a secured revenue stream like windfarms. If young companies are to get the capital we need it is vital that policy recognises that not all companies under seven years old are the same, and that it differentiates between companies that are genuinely very high risk and companies that are not'.

[7] Imagine company A has a 2% risk of failing each year and a 4% annual return, while company B offers twice the rate of both risk and return (4% and 8% respectively). If the investor uses EIIS the net rates of return rise to 14% for company A and 18% for company B, but the probability of company B failing remains twice as high as company A.

3. Capital Gains Tax for Entrepreneurs

The introduction of a revised entrepreneur tax relief scheme in 2016 was very welcome. However, the rate of capital gains tax applied to entrepreneurs is still too high given the much more attractive schemes available elsewhere. At present, Irish entrepreneurs pay 20% for qualifying gains up to €1 million over the vendor's lifetime. By contrast, the UK scheme offers a capital gains tax rate of 10% to entrepreneurs on gains of up to £10 million. The *Programme for a Partnership Government* has committed to essentially matching this scheme for new startups in 2017 (by reducing the rate to 10% and increasing the cap to €10 million). It is crucial that this new measure is extended to companies under five years old, as well as companies established from 2017. Unless the 10% rate is applied retrospectively it will not address the core problem for many Irish startups, namely the clear incentive to start or move their businesses elsewhere.[8]

A further issue, illuminated by our conversations with startup founders, concerns the condition that the existing entrepreneurial relief is only valid if the executive has held 5% of the company's stock for three years prior to sale. Many founders lose out on the relief due to ownership dilution as new funding is raised for business expansion.

A case in point is the recent sale of a Dublin-based software company, where one of the two co-founders was diluted from a 15% ownership stake to a 4.3% ownership stake over four funding rounds. This is a very standard level of dilution. Having co-founded the company, which now employs sixty people in Ireland, this person found out only recently that they could not avail of this relief. This condition clearly also discourages founders from giving share equity to other key employees.

CGT relief is a good example of a policy that needs to be simplified and made more transparent if it is to offer a genuine incentive for startup founders/entrepreneurs.

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[8] Laura Lynch (2016), 'Revised Entrepreneur Relief: s35 Tax Relief 2015', *Irish Tax Review,* vol. 29, no. 1. Available from http://www.mazars.ie/Home/News/Publications/Articles/Revised-entrepreneur-relief-s35-Finance-Act-2015.
Chartered Institute of Taxation (2011), 'Entrepreneurs' Relief: A Summary for CIOT Members of this Important CGT Relief', 1-4. Available from https://www.att.org.uk/sites/default/files/files/Entrepreneurs_Relief.pdf.
Programme for Partnership Government (2016), 37.
http://www.merrionstreet.ie/MerrionStreet/en/ImageLibrary/Programme_for_Partnership_Government.pdf

Entrepreneur Feedback

'The current CGT system gives almost no incentive to the startup community in Ireland to remain here. As one who has been through it I would look to other locations if I was doing anything again. There is close to zero differentiation between a startup and any other business with the current system (in fact older businesses arguably are much better at hiding profits). It is no accident that the only 2-3 billion euro plus valuation Irish technology firms are all headquartered out of the jurisdiction'.

4. PAYE Equalisation for the Self-Employed

We welcome Minister Noonan's commitment to achieving full tax equalisation for the self-employed, and encourage policymakers to delay no longer in demonstrating their support and belief in the value of an entrepreneurial culture in Ireland by fulfilling this objective in the 2017 Budget.[9]

[9] Michael Noonan (2015), Budget Statement 2016, 11. Available from http://www.budget.gov.ie/Budgets/2016/Documents/Finance_Budget_speech_2016_final.pdf.