# Budget 2016—getting the balance right?

It's being described as a post-recession, pre-election Budget, but what does that mean for family businesses, and in particular, how relevant has it been for the next generation joining family businesses? Tax partner in PwC Private Business Services, **Teresa McColgan** explains below.

### *Tax concerns for next generation family business leaders*

The next generation generally has enough on its plate getting involved in the family business and would rather focus on "more commercial" matters than tax. So their concerns will be to ensure that tax doesn't cause them any problems on a day to day basis (that compliance under the applicable tax heads is managed effectively), that they minimise tax costs appropriately and that they identify and avail of opportunities for tax reductions and reliefs. These will be the tax priorities regardless of whether the responsibility taken on is the transition to management of a stable business or the restructuring of a growing and/or diversifying business. Similar concerns will arise in relation to the tax implications of ownership changes and employee reward strategies.

### *Post-recession, pre-election Budget*

So what does this post-recession, pre-election Budget 2016, and the Finance Bill [1] that followed it, mean for business and the next generation who will be responsible for it? The post-recession aspect is reflected in the fact that the Minister had capacity to invest in the economy, by way of increased spending and tax cuts. The fact that an election is imminent has no doubt influenced the Minister's decisions on how and where to spend and who should benefit from the tax cuts. In trying to achieve an appropriate balance that would go some way to meeting the demands of a wide and diverse group of stakeholders, it was almost inevitable that the Minister would plump for a number of small steps in different areas, holding out the prospect of further development of the various relieving measures if the government is re-elected, rather than any significant changes for business.

### *Focus on improving take home pay while being mindful of new international tax environment*

In that context, it is no real surprise that the tax reduction measures focused on reducing the personal tax/use burden of a significant number of people, and that a light touch has been applied to making significant changes for business, other than those required in the context of international tax environmental changes such as the OECD Base Erosion and Profits Shifting (BEPS) project mentioned later below. Nonetheless, measures that result in workers having more take-home pay, and that potentially stimulate spending in the local economy, are generally good for Irish business.

The improvements in the take-home pay for workers, particularly low to middle income earners, as a result of the USC reductions is good news for the incoming generation as it seeks to recruit, retain and reward good staff. In addition, more spending power generally should help to spread the recovery more widely across the economy. For incoming business owners seeking to attract employees with specialist skills to help grow and diversify their businesses, however, our continuing high marginal incoming tax rate is not competitive, and may result in such key hires being attracted to other, lower, tax jurisdictions.

Business owners will also be disappointed that the extra 3% USC burden borne by the self-employed has not been addressed, so that their marginal income tax rate remains at 55%.

### *Earned income tax credit*

The self-employed have long been unhappy that they could not benefit from an allowance similar to the PAYE tax credit (worth up to €1,650 pa) that is available to their employees, and a request to bridge that gap was a common theme in many of the submissions made during the Public Consultation on Tax and Entrepreneurship process managed during the year by the Department of Finance. While many would

[1] Finance Bill as initiated at the time of writing

be of the view that not enough was done in the Budget for entrepreneurs, a number of welcome measures have been introduced, including a new earned income tax credit of up to €550. If an individual also has employment income, the maximum aggregate of the reliefs is €1,650.

### *Employment and Investment Incentive Scheme (EIIS) relief*

Of interest to businesses seeking external investment, Finance Bill 2015 introduces the legislation needed to implement the changes flagged in Budget 2015. These relate to the extension to four years of the minimum holding period for shares, and the increased levels of finance that can be raised by a company (€5m in a 12 month period, €15m lifetime limit), within the parameters of State Aid compliance. Finance Bill 2015 also widens the range of qualifying activities, for which funding may be raised, to include capacity extension of qualifying nursing homes.

### *Reduced CGT rate on business disposals*

Another common theme in the entrepreneurship submissions was the need for a more benign capital gains tax (CGT) regime for business disposals, to encourage investors and serial entrepreneurs to support the establishment of businesses here. The response has been the introduction of a new 20% rate that will apply to the first €1 million (aggregate lifetime total) of gains on chargeable business asset disposals by individuals.

The conditions attaching to the relief include the requirement for the assets to have been held for at least three years prior to disposal. The relief applies to assets held directly by unincorporated business owners as well as to shares in qualifying trading or holding companies. Where the assets are such shares, the vendor must own at least 15% of the share capital of the company. In addition, if it is shares in a trading company that are being sold, the vendor must have been a full-time working director for the three years immediately prior to the disposal.

The relief has been criticised as not going far enough in the context of the UK equivalent relief under which the lifetime limit is STG 10m and the tax rate 10%, but it is worth remembering that when the relief was first introduced in the UK, the limit was STGIm and the rate 18%.

If angel investors are supporting next-generation business owners, it will make sense for their investments to be made through an appropriate holding company structure to allow them maintain access to this relief.

### *Extension of relief for start-up companies*

This relief was due to expire at the end of this year, but has been extended for a further three years. As a result, start-up companies setting up new businesses in 2016, 2017 or 2018 can potentially benefit from the measure which provides relief from corporation tax in the first three years of trading. In broad terms, the relief can apply for each of those three years for which the corporation tax liability, absent the relief, would be no more than €40K, but it is limited to the employer PRSI contributions made for the year for which relief is claimed.

Next generation family business participants who are seeking to develop their businesses by diversifying into new activities should consider the potential to avail of this relief. If early profits are anticipated, and if there is likely to be an appropriate level of employer PRSI contributions, it may make sense to establish the business in a new entity so that it can qualify for this relief.

### *Knowledge development box (KDB)*

While the introduction of the KDB was flagged in last year's Budget in the context of the Roadmap for Ireland's tax competitiveness, the changes in the international landscape in the interim mean that what is actually being brought in is likely to be of more relevance for indigenous Irish business than the Foreign Direct Investment (FDI) community to which it had been expected to appeal. Our new KDB, which is the first international such incentive to be compliant with OECD guidelines, operates by applying a reduced 6.25% rate of corporation tax to qualifying profits. The relief rewards real research and development (R&D) activity carried on in Ireland, as it applies to profits arising from intellectual property (IP) resulting from qualifying R&D carried on here.

Given the level of significant costs that need to be incurred in order to acquire and develop IP that will generate real returns, the relief may be of limited application, but could be highly attractive for next generation businesses that are planning substantial R&D investment here.

### *Small benefits relief*

It's good to see Finance Bill 2015 formalise a Revenue concession under which employers could provide non-cash, tax free awards to employees. The amount that can be provided tax-free has been increased to €500. Under the previous practice, the limit was €250, only one award per employee could be made in any tax year, and the benefit applied to any form of noncash award. The requirement for a single, one-off award has been retained in the draft legislation, but as currently drafted the benefit must take the form of a voucher, so businesses that have availed of this arrangement in the past to provide benefits such as Christmas hampers need to be mindful of the change and structure their awards accordingly.

### *Other measures relevant for business owners*

Other measures introduced in the Budget/Finance Bill that may be relevant for business owners include:

- The removal of employer PRSA contributions from the scope of USC
- The simplification and reduction of motor tax applying to commercial vehicles

- Exclusion from the scope of PAYE of reimbursement of vouched expenses incurred by nonresident nonexecutive directors - the restriction to non-resident directors is very limiting and is not helpful for the majority of Irish owned businesses.

***Succession planning***

Apart from the increase (from €225K to €280K) in the lifetime threshold that primarily applies to gifts and inheritances taken from a parent, there was very little in the Budget or Finance Bill on succession other than for the agribusiness sector.
For the agri sector, Minister Noonan announced in his Budget speech that there would be a continuation of the measures targeted at encouraging the transfer of farms to the next generation. This involves the extension of stock reliefs and the Stamp duty relief for Young Trained Farmers to 31 December 2018. He also announced the introduction of a new tax credit for Succession Farm Partnerships - an initiative to encourage the lifetime transfer of family farms. This involves an additional tax credit of €5K to be shared by the partners.

***Property related measures***

There were minimal changes in relation to property taxes, but those that were made have been welcomed. These include the deferral of the revaluation date from 2016 to 2019 for Local Property Tax, and the extension of the Home Renovation Incentive (HRI) to end 2016.

Under the HRI, a tax incentive of up to approx. €4K per property is available to homeowners and landlords of residential properties wishing to renovate them. The relief is granted by way of an income tax credit of 13.5% of qualifying expenditure.

***International tax developments***

The international tax environment is changing rapidly, and its impact is being felt here. It stems from the reaction of the OECD to political and economic pressures in relation to the contribution, or perceived lack thereof in some quarters, from business. In 2013 the OECD issued its Action Plan regarding Base Erosion and Profit Shifting (BEPS), and earlier this month detailed plans were published for each of fifteen areas covered. The essence of the project is to seek to align taxing rights with real value generating activity.

The main themes include substance and transparency. With regard to substance and inward investment, it is certainly arguable that FDI located in Ireland is based on substantial operations having been established here by foreign multinational companies. With regard to transparency, the most significant change coming through in Finance Bill 2015 is the introduction of Country by Country

Reporting (CbCR). While the burden of CbCR is heavy for those affected, the scope is limited from the perspective of Irish family businesses, as it applies only to groups with annual turnover of at least €750m.

### *Risk of complacency*

The risk is that complacency on existing substance from an FDI perspective and the lack of relevance of CbCR could lead many Irish businesses to conclude that the BEPS project is not relevant to them at all, and this is not the case. Most Irish businesses expect future growth to come through overseas expansion, and therefore need to be mindful of international tax changes attributable to the substance theme mentioned above.

### *Potential issues*

In particular, there are likely to be changes in the base level of activity in another jurisdiction that could trigger a taxable presence there, and we are likely to see tax treaty changes to deal with this as well as the introduction of anti-abuse provisions. Another area that may require consideration by Irish businesses is the availability of tax relief for interest costs, particularly where group financing issues are handled centrally and charges made to local operations from the centre. Restrictions on interest deductibility are likely to be a feature of BEPS prompted legislative change in coming years, and, depending on individual group fact patterns, Irish businesses may need to be aware of and plan for these changes.

OECD transfer pricing documentation requirements, and VAT collection obligations in consumer jurisdictions for digital economy supplies, are among the other issues that will also need to be considered.

To quote PwC Ireland's BEPS policy leader, Peter Reilly, "... *in years to come, the Department of Finance are likely to have significant decisions to make in relation to Ireland's implementation of the BEPS proposals, such as when to make changes, the interaction with the EU and how to encourage the continued development of both the FDI and Irish domestic business sectors."*

Irish family businesses will need to watch this space…..

### *Conclusions*

The recent trend of the Department of Finance and Revenue officials consulting with relevant stakeholders, before implementing change in such areas as entrepreneurship and nonexecutive directors' expenses, is to be welcomed, and PwC has been involved in preparing a number of the submissions made. While the suggestions made by representative bodies and professional firms may not all have been taken on board or developed as fully as might have been hoped, there have been some changes that are positive for growing businesses seeking to incentivise employees and/or grow their businesses internationally.

Budget 2016 has not radically changed the tax environment for Irish family businesses or their owners, but there is a sense of gradual change in a number of areas, some locally prompted and some stemming from developments in the evolving international tax arena. Businesses seeking to grow internationally need to keep abreast of the changes that may affect them.

***For more on Budget 2016 and its implementation through Finance Bill/Act 2015, and to use our Calculator to see how the Budget changes affect your pocket, please visit http://www.pwc.ie/budget.***