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CGT Entrepreneur Relief Public Consultation
Room 3.3
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To: CGTERconsultation2019@finance.gov.ie

24 May 2019

Dear Sir/Madam

Re: CGT Entrepreneur Relief

We welcome the opportunity to provide input to the Public Consultation on CGT Entrepreneur Relief. Ireland's high capital gains tax (CGT) rate of 33% by international standards, makes the analysis of measures such as, CGT Entrepreneur Relief¹ even more important.

Ireland's high CGT rate

CGT is unquestionably the tax that matters most to investors and serial entrepreneurs and influences their behaviour. Ireland's targeted CGT Entrepreneur Relief is targeted at reducing the high CGT burden on the sale of a business in Ireland to a limited extent. Feedback we have received from members and directly from entrepreneurs² is that the current design of the relief is one of the key contributing factors to holding back our indigenous entrepreneurial ecosystem. The existing relief provides little incentive to grow a business beyond a certain level in Ireland and generate more employment. It is uncompetitive when compared with the UK.

Increase the €1m lifetime limit

CGT Entrepreneur Relief allows for a lower 10% CGT rate on business gains, but this is subject to a lifetime limit of €1m. In the UK, the equivalent relief applies to Stg£10m. This means that the overall effective tax rate on a gain of €10m in Ireland is 30.7%, compared with 10% in the UK.

¹ Revised Entrepreneur Relief, Section 597AA TCA 1997.

² Feedback provided by the "Start-up Policy Project" facilitated by Dogpatch Labs, 17 May 2019.

Entrepreneurs tend to be ambitious and mobile and consider multiple locations when establishing their companies. Entrepreneurs have cited CGT relief as one of the key motivating factors for relocating to the UK from elsewhere in the EU, in preference to Ireland.³

The Programme for a Partnership Government⁴ promised to increase the cap to €10m gains for new start-ups. We recommend that the €1m lifetime threshold for Entrepreneur Relief needs to be increased to a minimum of €10m to compete effectively with other countries for international capital.

Remove restrictions on external ‘angel investors’

Entrepreneur Relief requires that an individual must spend at least 50% of his/her time working for the company continuously for three out of the five years prior to the disposal to qualify for the relief. Typically, ‘angel investors’ mentor and support several companies at the same time and therefore, they cannot possibly satisfy this working time requirement. Consequently, the relief locks out these important external investors, who not only invest money but provide experience and industry expertise, which are vital factors when we consider the deficit in managerial capability in Irish businesses as highlighted by the OECD.⁵

The current restrictions on Entrepreneur Relief rule out the possibility of external investors benefiting from the 10% rate. Therefore, any investor who makes a gain will have to pay one-third of that gain over to the State in CGT, and this is a real barrier to investment in Ireland. If the conditions attaching to CGT Entrepreneur Relief were changed, it could make the difference between angels, venture capital investors and others deciding to take the risk of investing in an Irish company or not.

We recommend that the legislation be amended to permit much-needed external ‘angel investors’ avail of Entrepreneur Relief.

Technical issues with the existing relief

There are technical issues with the current Entrepreneur Relief legislation⁶ (as interpreted in Revenue’s Operational Manual),⁷ which are limiting its use in five common situations:

1. Where there is a dormant company in a group
2. Where a group is party to a joint venture
3. Where a company/group holds investments or leases trading premises
4. Where a holding company of a trading company is liquidated
5. Where EII funds are raised by a company

³ Feedback provided by the “Start-up Policy Project” facilitated by Dogpatch Labs, 17 May 2019.

⁴ Programme for a Partnership Government, May 2016.

⁵ OECD Ireland Country Report, March 2018.

⁶ Section 597AA TCA 1997.

⁷ Revenue Operational Manual 19.06.02B – Capital Gains Tax Revised Entrepreneur Relief.

We have outlined in the attached Appendix how these limitations are impacting the availability of Entrepreneur Relief, together with our detailed recommendations to address these difficulties.

Need for both CGT Entrepreneur Relief and Retirement Relief

The consultation paper suggests that when considering the reform of Entrepreneur Relief, other possible changes could also be considered, such as abolishing Retirement Relief, in favour of an expanded Entrepreneur Relief. We would have serious concerns regarding any proposal to abolish Retirement Relief, in particular in the context of related parties. These are two distinct reliefs operating to encourage behaviours of two different cohorts of business owners.

CGT Retirement Relief is required to foster the timely transfer of family businesses from one generation to the next and from one entrepreneur to the next, when the transferor is approaching retirement age.

In contrast, CGT Entrepreneur Relief recognises the importance of encouraging and developing Irish high-growth companies. It is a key incentive to embolden entrepreneurs to invest, sell, move on and to re-invest in new business ventures and create employment. In the majority of cases, the sale or part-sale of a company is a positive decision. The business does not stop with the sale, it simply continues with new funding and under new ownership and governance structure. The purchase and sale of businesses is an indication of health in an economy and is to be encouraged. It provides a vibrant environment for investment and creates confidence in that ecosystem.

The critical importance of maintaining both reliefs for these two different cohorts within the domestic economy was recognised by the Department of Jobs, Enterprise and Innovation, Enterprise Ireland and IDA Ireland in their joint submission to the *Department of Finance Tax and Entrepreneurship Review* in July 2015.⁸ It is clear that CGT Entrepreneur Relief and Retirement Relief address very different policy objectives for the indigenous sector and should be maintained.

The Institute would welcome the opportunity to attend the stakeholder consultation event on 6 June 2019 to engage further on proposals to improve CGT Entrepreneur Relief. Please contact Anne Gunnell at agunnell@taxinstitute.ie or on (01) 6631750 if you wish to discuss matters raised in this submission.

Yours truly



Marie Bradley
Institute President

⁸ Tax and Entrepreneurship Review, Department of Jobs, Enterprise & Innovation, Enterprise Ireland, IDA Ireland, 14 July 2015

Appendix

CGT Entrepreneur Relief - Technical Issues

There are technical issues with the current CGT Entrepreneur Relief legislation⁹ (as interpreted in Revenue's Operational Manual),¹⁰ which are limiting its use in five significant situations:

1. Where there is a dormant company in a group
2. Where a group is party to a joint venture
3. Where a company/group holds investments or leases trading premises
4. Where a holding company of a trading company is liquidated
5. Where EII funds are raised by a company

1. *Where there is a dormant company in a group*

According to Revenue's Operational Manual, Entrepreneur Relief is not available in situations where a dormant company is present in the group. This is a very significant limitation to the relief because a subsidiary company can commonly become dormant over time.

This might happen where the company has ceased to trade or where the trade has been transferred to another group company and the company cannot be wound up or liquidated due to company law legislation for the protection of creditors. A group company could have dozens of trading subsidiaries, out of which only one is dormant, yet the relief is completely denied to the entrepreneur in this situation.

Institute Recommendation: We recommend that the legislation is amended to remove restrictions to Entrepreneur Relief in situations where a group holds a dormant company.

2. *Where a group is party to a joint venture*

One of the conditions of Entrepreneur Relief is that all subsidiaries must be minimum 51% subsidiaries for the relief to apply. If a group is party to a joint venture and holds less than 51% of the joint venture company, this again can result in full denial of the relief.

Institute Recommendation: We recommend that the legislation is amended to remove restrictions to Entrepreneur Relief in situations where a group has a shareholding in a joint venture company of less than 51%.

3. *Where a company/group holds investments or leases trading premises*

When either the holding of investments or the leasing of trading premises takes place within a group company, this can exclude an entrepreneur from claiming Entrepreneur Relief.

⁹ Revised Entrepreneur Relief, Section 597AA TCA 1997

¹⁰ Revenue Operational Manual 19.06.02B – Capital Gains Tax Revised Entrepreneur Relief

In the current low interest rate climate, it is common for businesses to invest cash generated from trading activities rather than leaving it on deposit. This results in them holding investments.

Similarly, many companies who expect high growth in the short-term will often buy or lease premises that exceed their current needs but will meet their future expectations. These businesses will occasionally rent the excess space out to a third party until they need to expand into the space.

Both these activities are efficient from a commercial perspective. They improve cash flow, while utilising the companies' assets to their full potential. Yet they can impact on this important tax relief.

We would ask that consideration be given to either apportioning relief in circumstances where there is a mix of investments and qualifying activities (similar to the Retirement Relief provisions¹¹) or to allow the relief in full where non-trading activities are below a certain *de minimus* level. This is the approach adopted in the UK, where Entrepreneur's Relief is available on the sale of shares in a holding company, provided non-trading activities in the group do not comprise of more than 20% of the group's overall activities.

Institute Recommendation: We recommend that the legislation be amended to allow for either an apportionment of relief when a company holds investments or earns rental income or alternatively full relief to be claimed, provided such activities fall below a certain level.

4. *Where a holding company of a trading company is liquidated*

The legislation does not specify whether Entrepreneur Relief is available on a liquidation. Revenue's guidance on Entrepreneur Relief only refers to situations where the liquidated company is carrying on a qualifying business at the date the liquidator is appointed.

However, it is unclear whether Entrepreneur Relief can apply on the liquidation of a qualifying holding company, for example;

- (a) where the trading company has been sold and a holding company is being liquidated to access the sales proceeds; or
- (b) the trading company continues to trade and holding company is being liquidated for administrative / commercial purposes.

Institute Recommendation: We recommend that the legislation is amended to ensure that the existence of a holding company does not prevent a claim for Entrepreneur Relief in a liquidation scenario.

¹¹ Section 598 TCA 1997

5. Where EII funds are raised by a company

A founder of a company funded using shares issued under the Employment and Investment Incentive (EII) may be denied Entrepreneur Relief on disposal of their shares in certain circumstances.

This issue arises because Entrepreneur Relief requires the vendor to own 5% of the ordinary share capital of a company. Often, EII shares do not have voting rights and have limited dividend and winding up entitlements. However, such EII shares may be considered to be ordinary share capital for tax purposes, as section 2 TCA 1997 defines ordinary share capital as “*all the issued share capital (by whatever named called) of a company, other than capital the holders of which have a right to a dividend at a fixed rate, but have no other right to share in the profits of the company*”.

This means, for example, if a founder shareholder owned 100 €1 ordinary shares but the company also had 500,000 €1A ordinary shares in issue from a previous EII scheme, a disposal of the founder’s shares may not qualify for Entrepreneur Relief, as the legislation is silent on whether to consider the number of shares in issue or the nominal value of the shares in issue, when applying the 5% shareholding test.

Institute Recommendation: We recommend that the legislation be amended to confirm that shares which qualified for relief under Part 16 TCA 1997, with the exception of shares qualifying for SURE, should be ignored for the purposes of meeting the 5% shareholding test for CGT Entrepreneur Relief. Clarification would also be welcome on whether it is the number of shares or the nominal value of shares that is relevant when determining the 5% test.