Irish ProShare Association

Mr Michael Noonan, T.D.
Minister for Finance
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

12 June 2013

Re: Irish ProShare Association (IPSA) Pre-Budget Submission 2014

Dear Minister,

Thank you for the opportunity of allowing IPSA prepare the attached Submission. We realise that many pre-Budget Submissions cross your desk annually so this year we have tried to be as brief as possible while also giving background to each recommendation. The ideals of IPSA are to promote all forms of Employee Share Ownership and Employee Financial Involvement, and there is now a wealth of evidence showing just how successful Employee Ownership has become. Based on this evidence we believe that the implementation of our Submission will enable recovery in the economy.

In the United Kingdom for the first quarter of this year, companies that operate Employee Share Ownership plans have grown by 50% more on the average growth rate of FTSE 100 companies (The UK's largest companies). We have, as well, from many different countries clear evidence of stability in companies that are part owned by their employees: ownership significantly improves employee commitment which in turn drives that stability while significantly increasing productivity. This same research also shows a substantial body of evidence of considerably reduced absenteeism in these companies, again leading to improvements in output.

The U.K. government appointed Graeme Nuttall as their Independent Advisor on employee ownership, and 'The Nuttall Review', published in July 2012, was commissioned to "*identify the barriers to employee ownership and help find barriers to knock them down*". Of the Review's 28 recommendations, 22 have been accepted by the UK government and are currently in the process of being implemented. To quote Deputy Prime Minister, Nick Clegg, "*Businesses that are owned by their employees produce more, grow faster, keep their workforce happier, and pay staff more fairly. Graeme's report makes clear that sharing ownership means sharing success"*

IPSA believes that the implementation of Nuttall type proposals in Ireland can provide a major incentive for all companies, particularly SME firms; generating and sustaining employment in the process. We understand that the Government has finite resources. We believe our Submission can significantly improve this situation. We urge you to take account of what we have set out below. My fellow Council members and I would be delighted to meet with you to discuss the attached Submission.

Yours faithfully,

____

Gary Boyle
Chair, IPSA

6 – 9 Trinity Street, Dublin 2 Telephone: +353 1 254 4326 Email: cormac.brown@brownlombard.ie
www.ipsa.ie

Irish ProShare Association

Irish ProShare Association, 2014 Pre-Budget Submission

1. Introduction

The Irish ProShare Association (IPSA), the group which represents the voice of employee financial involvement (EFI) in Ireland, believes that in the current challenging economic environment EFI has a vital role to play in economic recovery. EFI is linked to higher productivity levels, greater employment stability, growth, and company survival. Economic growth, competitiveness and high performance are a central part of the DNA of employee owned companies. These facts are borne out by an ever increasing body of incontestable evidence, which we passionately believe can no longer be ignored.

Recovery continues to be a challenge and is hindered by record levels of Government and personal indebtedness. While the Government is searching for new initiatives to make significant contributions to future economic growth and recovery, it would be a mistake if this work did not include the need to increase employee ownership in Ireland. Internationally, over the last decade, financial investments in shares in employee owned businesses have considerably outperformed those in conventionally owned businesses. Economically, we cannot afford to miss the opportunity that more employee ownership offers. It could and should play a bigger role in the growth agenda as employee financial involvement can increase the efficiency and profitability of organisations without significantly adding to their costs, or, indeed, adding to the Government's cost of running the country.

2. The Nuttall Review

July 2012 saw the release, in the United Kingdom, of 'Sharing Success: The Nuttall Review of Employee Ownership'. This review was undertaken by Graeme Nuttall at the behest of Norman Lamb, Minister for Employment Relations, Consumer and Postal Affairs. It contained 28 recommendations and provides plenty of food for thought and a new framework to consider employee ownership in an Irish context. IPSA welcomes the findings of the Nuttall review and believes that many of its recommendations are equally relevant in an Irish context. Namely, the Government should:

- Promote employee ownership;
- Engage in raising awareness and consult with employers and employees to gain a full understanding of the current position and future direction of employee ownership.

The specific recommendations in the Nuttall review on the role of employee ownership for start-up companies and expanding companies are particularly relevant. However, given the requirements of the Irish economy an 'Irish Nuttall Review' equivalent would have to go further by addressing those issues that are specific to the economic recovery and Irish business as set out in points 3 and 4 below.

3. Attracting top talent to Ireland

Background: Encouraging senior overseas executives to relocate to Ireland is a crucial and often overlooked component in attracting investment. Ireland has one of the highest marginal tax rates in the OECD as a result of recent budget changes. Senior personnel often have a number of destinations to choose from in deciding where to relocate, and Ireland's high marginal tax rate acts as a disincentive to locate here. Without the presence of incentives to attract senior personnel, there will always be a ceiling on growth potential. The targeted use of share-based measures can be used to offset the severity of the high personal tax regime and help encourage senior overseas executives, and the resulting investment that they bring, to locate here.

Issue: IPSA welcomes the decision to include share based remuneration within the scope of relief under the Special Assignee Relief Programme ("SARP") in the Finance Act 2012. However, the restriction in the SARP to existing employees only is a major drawback to the scheme and limits their ability to attract the right talent.

IPSA Recommendation: An alternative regime needs to be designed and introduced in the 2013 Finance Bill to rectify some of anomalies of this important scheme.

4. High Potential Start Up ("HPSU") companies

Background: The 2010 Innovation Taskforce Report is a key document which outlines a strategy to build Ireland's smart economy by encouraging more successful start-up companies to create the next generation of entrepreneurs. A number of the task force recommendations have been implemented and much of the recent Jobs initiative was inspired by the report. Since the report was published, Enterprise Ireland has clearly had a stronger focus on early-stage companies. In 2011, Enterprise Ireland supported 93 new high potential start-up projects that are expected to create in excess of 1,500 jobs in the next three years. These are ambitious companies, with highly innovative products, and the potential to create significant added value and employment. IPSA has in the past year been engaged in an extensive dialogue with privately owned and HPSU companies, and also enterprise development units based in our leading Universities. From this dialogue it has emerged that many private companies, and specifically HPSUs, would consider utilising share incentives as a key tool to expand and generate additional employment if there was some degree of tax efficiency incorporated to offset the risks involved.

Issue: Skills shortages have been reported across a number of sectors, particularly in specialised high skilled niche areas within ICT and engineering. This can be particularly problematic for HPSUs who often require employees with a specific skill set. HPSUs often find themselves in competition for this limited pool of talent with their multinational counterparts. Effective tax efficient employee incentives can attract and retain skills across all firm types, but can also allow indigenous SMEs to offer employees more attractive ownership incentives, aligned with the potential for a future sale.

IPSA Recommendation: IPSA requests that growing private companies, particularly HPSUs, be exempted from Employer and Employee PRSI, as well as the Universal Social Charge on all employee equity incentives in order to maximise job creation opportunities.

5. Implement 2010 Innovation Taskforce Recommendations

Background: The 2010 Innovation Taskforce Report also contained a number of recommendations around share based remuneration that could help to increase the number of start-up companies and address many of the specific challenges they face:

- ***Founder share option***

Issue: In order to motivate the original entrepreneur to continue applying their unique skills and expertise, it is necessary that such an entrepreneur maintain an adequate level of equity. Such measures protect founder entrepreneurs in the early stage of firm development and increase the chance of commercial success. For these reasons, the venture investor often decides it prudent to 'reflate' the founder with share options. Reflation, however, using share options, is currently unattractive because the tax cost arising on exercising share options could be twice that arising on shares directly owned.

IPSA Recommendation: The introduction of a "Founder share option" would ensure that founder entrepreneurs are not diluted by subsequent rounds of capital venture funding. The share option would be eligible to more favourable tax treatment than options granted in established companies. This option would 'reflate' founder entrepreneurs so that they are not diluted by subsequent rounds of necessary venture capital funding.

- ***Capital Gains Tax***

Issue: A reduced rate of Capital Gains Tax is needed where the proceeds from a sale of one innovative company are re-invested in another innovative company. If entrepreneurs who have built a successful innovation based, export-focussed, high growth firms exit, it's in the national interest that they, along with key investors, recycle their personal expertise and capital into new innovative ventures.

IPSA Recommendation: A reduced effective rate of Capital Gains Tax or a type of roll over relief should arise on the sale of shares in an innovation-based export led company, where the proceeds on disposal of those shares are reinvested in another qualifying company. Such a scheme would encourage reinvestment within the State and support funding for start-ups and growth SMEs.

- ***Entrepreneurial tax credit***

IPSA Recommendation: An entrepreneurial tax credit that could be granted to Founders in certain circumstances should be introduced. This incentive would provide a tax credit or rebate to an entrepreneur in a qualifying company where new jobs are created by their company. By "qualifying company" we mean a start-up which is based on innovation and has clear export opportunity.

6. Transfer of employee shares to Pension funds

Issue: Many employees have unrealised capital gains linked to shares that have been issued to them in the share capital of their employer company. The shares may have either been granted under one of the Revenue approved plans or issued to them as part of their remuneration package. Successive reports have highlighted the issue of inadequate private sector pension provision and this has been exacerbated in recent years with pressure on incomes resulting in reduction of pension contributions.

IPSA Recommendation: This shortfall may be remedied in some cases if employees are allowed to transfer shares issued to them in the share capital of their employer company to their pension fund without crystallising a capital gains tax charge. The pension would obviously be taxed on the way so the Exchequer would not lose out in a significant way. Such a proposal could be incorporated in the reform of pension legislation that is currently being carried out.

7. Legislation regarding the Taxation of Share-based remuneration schemes

Issue: The current legislation is lacking clear instruction on the taxation of numerous share based remuneration schemes. Unfortunately, over the years many Statements of Practice ("SOP") and Revenue guidelines have been issued, without any coherent effort being made to consolidate these guidelines and SOPs into one piece of legislation.

IPSA Recommendation: We encourage the Government, in consultation with the Revenue Commissioners, to rectify the uncertainty caused by the current system.

6 – 9 Trinity Street, Dublin 2 Telephone: +353 1 254 4326 Email: cormac.brown@brownlombard.ie
www.ipsa.ie

8. Publication of Precedent Restricted Share Deeds and Rules

Issue: The Revenue currently publishes precedent agreements for Approved Profit Sharing Plans and SAYE schemes. The program that is most attractive for privately companies is the granting of restricted shares which is commonly known as the clog scheme. Many private, (especially HPSU) companies, who would be interested in implementing such a restricted share scheme, do not have financial resources to pay professional advisors to draft and implement such a scheme.

IPSA Recommendation: IPSA encourages the Minister to request the Revenue to produce a toolkit that could be used by private companies for implementing a restricted share plan. It should be noted that the non-availability of an "off the shelf" solution was considered to an impediment to wider employee share ownership by the Nuttall Review and such toolkits are currently being prepared.

9. Employee Share Ownership Trusts: Section 519 of the Taxes Consolidated Act 1997 (Schedule 12, paragraph 11(2)(B))

Issue: A number of ESOPs are currently experiencing problems with the 15 year rule as a direct result of the current global economic upheaval. The rule was originally brought in to enable employees leaving a company to have shares appropriated to them for up to 15 years in certain circumstances where an ESOT is leveraged and the shares are pledged as security for borrowings. In the case of one ESOP no appropriations have been possible since 2008 due to the collapse in share prices and cessation of dividend payments in its founding company resulting in difficulties with the repayment of that ESOP's loan. These difficulties mean that no shares can be released for appropriation prior to the ending of the 15 year period granted under the legislation.

IPSA Recommendation: IPSA asks the Department of Finance to understand that this and similar problems that have emerged around the 15 year rule are not those of beneficiaries selfishly trying to extend their tax breaks because of increased share prices but rather are an attempt to salvage some small residual value for beneficiaries who have lost out hugely in the global economic crisis. We request that the legislation be changed to allow leavers to retain their beneficiary status for the life of the ESOP.

In conclusion

Taxation matters have an impact on employee ownership! IPSA recommends that Government adopt a more proactive policy, similar to the approach adopted in the United States regarding employee ownership taxation by creating meaningful incentives in the tax regime to encourage increases in employee ownership. This has happened in the United States because Federal and State authorities recognise that employee ownership helps to grow GDP and can increase tax revenues. Measures to reduce the tax burden on employee ownership should be implemented here for the same reasons.

The Government has been proactive in its use of the 2010 Innovation Taskforce as a framework for designing Ireland as a global innovation hub. However, there remain some crucial recommendations yet to be fully implemented, recommendations which would tap into the potential of employee financial involvement. Employee ownership has a role in driving innovation, attracting top talent and promoting growth in new enterprise. Government policy in recognising these benefits should facilitate the growth of employee ownership in an effective tax efficient manner.

We appreciate your time in considering our proposals above and look forward to engaging with you to address any questions or clarifications you may have. Thank you.

6 – 9 Trinity Street, Dublin 2 Telephone: +353 1 254 4326 Email: cormac.brown@brownlombard.ie
www.ipsa.ie