Irish ProShare Association

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

October 8th

Re: IPSA Pre-budget submission 2013

Dear Minister,

Thank you for the opportunity of allowing the IPSA prepare the attached submission, which we trust you will find articulates our strongly held belief in the importance of Employee Financial Involvement (EFI), Gainsharing and Employee Equity participation.

In the current uncertain economic environment we firmly believe that EFI is a tool that can greatly assist driving economic growth for enterprise. The basic premise of EFI is that employees take part with management in setting specific targets for the business or enterprise to achieve. In attaining these targets, the resulting gains or savings can be shared in part with employees. Studies have shown that there is a measurable increase in productivity in organisations where EFI is promoted because employees have a heightened sense of commitment in achieving agreed targets. Through employee share ownership and employee equity participation, there is a similar increase in employee commitment and achievement of objectives.

We urge you to take account of what we have set out in our submission for Budget 2013. My fellow Council members and I would be delighted to answer any queries you may have in relation to the attached, so please do not hesitate to contact IPSA at your earliest convenience.

Yours faithfully,

Gary Boyle.
Chairperson

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Irish ProShare Association, 2013 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 the economic recovery. EFI is linked to higher productivity levels, greater employment stability, growth, and firm survival. Economic growth, competitiveness and high performance are a central part of the DNA of employee owned companies.

Recovery continues to be a challenge and is hindered by our 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.

2. Nuthall Review

July 2012 saw the release, in the United Kingdom, of 'Sharing Success: The Nuttall Review of Employee Ownership'. It contained twenty eight recommendations and provides plenty of food for thought and a new framework to further discuss employee ownership in an Irish context. IPSA welcomes the findings of this review and believes that many of the recommendations are just as relevant in Ireland as to the UK. Namely, the Irish government should promote employee ownership, engage in awareness raising, and conduct consultations to gain a full understanding of the current position and future direction of employee ownership. The specific recommendations in the Nuthall review on the role of employee ownership for start-ups and expanding companies are particularly relevant. However, given the requirements of the Irish economy an 'Irish Nuthall 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 & 4 below.

3. Attracting top talent to Ireland

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. We welcome the decision to include share based remuneration within the scope of relief under SARP (Special Assignee Relief Programme) 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. 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

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 entrepreneur's. 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, 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.

The IPSA has in the past year been engaged in an extensive dialogue with privately owned companies, including HPSU companies, and 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.

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 skillset. 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.

On this basis, the 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

The 2010 innovation taskforce report 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.

(i) A founder share option

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.

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.

(ii) Capital Gains Tax

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 is in the national interest that the entrepreneur(s) and key investors recycle their personal expertise and capital into new innovative ventures. 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.

(iii) Entrepreneurial tax credit

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. Employee PRSI

The decision by Government that employers PRSI was not to be applied to employee share schemes was very welcome. That decision removed an unbudgeted cost of employment in respect of historical grants, while at the same time encouraged employers to favour employee equity as a form of remuneration, which has the added advantage encouraging and endorsing employee ownership. We feel, however, that a similar decision is required on the employee side. The abolishment of PRSI for employees for all share based reward would act as an incentive for employees to actively participate in the ownership of their employers and facilitate a genuine interest in the future growth and expansion of those businesses.

7. Pension adequacy

Aside from their home most employees biggest financial investment is their pension plan and for those lucky enough to hold shares in their employer, their employee shares. Consideration should be given to affording employee equity stakeholders the opportunity to consolidate their investments in a tax efficient manner by way of transfer of their equity to their pension plan. The equity might be retained as is, or otherwise, by the pension scheme. This would have the dual benefit of enhancing the funding of personal pension plans, the fund value and thus the potential for higher taxable personal pensions in payment for our aging population and in retaining the employee equity stake in their employer**.**

8. Legislation

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 issued, without any coherent effort being made to consolidate these guidelines and SOPs into one piece of legislation. We encourage Government, in consultation with Revenue, to rectify the uncertainty caused by the current system.

9. Conclusion

Taxation matters to the impact on employee ownership. We recommend that the Government adopt a more proactive policy, similar the approach the United States has to 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.

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.