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Ireland versus UK: How taxes compare for business owners and employees

Since the British vote to leave the European Union two years ago there has been much talk of the impact on British business and also of the threats and opportunities that it presents to Irish business. If we look beyond the rhetoric however, just how do the two jurisdictions compare for business and how ready is Ireland to meet the challenges that Brexit poses?

Similarities but Differences

There are of course great similarities between the tax regimes in both jurisdictions with Irish schemes very often largely mirroring their UK equivalents. There are some worthy reliefs for business in Irish tax law and in some cases the Irish treatment is more favourable than in the UK.

In comparing the two jurisdictions however it is hard to escape the conclusion that in recent years we have fallen behind the UK in this area. In addition to significant cuts to UK Corporation Tax (with the promise of more to come) blunting the competitive advantage of the 12.5% Irish rate, the UK has a particular edge in areas such as:

- Tax rates on income and capital gains
- Tax treatment of shareholder dividends
- Share-based remuneration
- Entrepreneur Relief on the sale of a business
- Close Company Rules
- Treatment of the Self-employed under the National Insurance system

In the context of Brexit, there is also the concern that subsequent to its exit from the EU, the UK may use the tax system to generate a competitive advantage and in particular that it may have greater flexibility to introduce tax incentives for business that are not subject to State Aid regulations or EU approval. This would surely have serious implications for Ireland.

Tax Rates

Capital tax rates were increased significantly in Ireland during the recessionary years; the headline rate for business disposals now stands at 33%, in contrast with a rate of 20% in the UK. This is a significant difference and, while both jurisdictions allow for a special 10% on some business disposals, as we will see below the UK relief is potentially more lucrative and easier to claim.

The headline rates of Income Tax – 20% and 40% - are the same in both jurisdictions, although the UK does have a 45% rate for incomes above Stg£150,000. One could therefore be forgiven for assuming that there was little difference in this area.

When you cut through the complexities of the two systems however it becomes apparent that for middle-income earners the treatment in the UK is more benign; in the first instance a single person becomes liable to the 40% rate in Ireland once their earnings exceed €34,550 per annum in contrast with their UK counterparts who may earn Stg£46,350 (approximately €52,000 at current exchange rates) before doing so. Furthermore, in the UK National Insurance contributions are reduced to 2% on all earning above that level.

As the table below, comparing the Irish and UK tax treatment of an employee earning between €50,000 and €85,000 this has two significant outcomes, namely:

- By the time an individual is earning Stg£46,350/€52,000, the effective rate of tax in Ireland is already higher than in the UK;
- As the individual's salary increases above this level, the marginal rate of tax in the UK is 8 to 10 percentage points lower than in Ireland.

This acts as a penalty on successful entrepreneurs in Ireland but it also impacts on employees, who see half of any bonus or salary increase (for example from a promotion) gone on taxes, thereby adding to the challenges of staff incentivisation for employers.

	Band 1 – Average Earner		Band 2 – Earns a Staff Bonus		Band 3 – Earns a Promotion	
	Ireland	UK	Ireland	UK	Ireland	UK
Gross Salary	**€50,000**	**£44,600**	**€70,000**	**£62,500**	**€85,000**	**£75,900**
Deductions - Tax, USC, PRSI/National Insurance	€13,450	£10,890	€23,200	£18,230	€31,000	£23,860
Net Salary	€36,550	£33,710	€46,800	£44,270	€54,000	£52,040
Effective Rate of Tax	**26.9%**	**24.4%**	**33.1%**	**29.2%**	**36.5%**	**31.4%**
Marginal Rate of Tax on each increase between bands			48.75%	41%	52%	42%

Shareholder Rewards: Taxation of Dividends

In addition to being impacted by higher tax rates on salaries, the owner of an SME may also feel a little hard-done by when the taxation of dividends in the two jurisdictions is contrasted.

In Ireland they are treated in the way as any other income and so potentially liable to Income Tax, USC and PRSI of up to 52%.

In the UK however a special rate of tax applies to dividends so that most shareholders with taxable income of less than Stg£150,000 per annum will only pay a tax rate of 32.5% on dividends, rising to 38.1% if their annual income does exceed this amount. This is considerably lower than the Irish rate and, notwithstanding that they are not deductible against taxable profits for Corporation Tax purposes, makes dividends a more attractive option for UK business owners.

Incentivising Employees

Attracting and retaining key staff is always a key challenge for any SME and in this regard share-based remuneration has long played a role. A well-designed share incentive plan can help incentivise performance and encourage loyalty among key staff. This is an area in which Ireland had fallen behind in recent years, in particular for SMEs, but last October's Budget took some steps to remedy this as, to some fanfare the Minister for Finance announced the introduction of a new Share Options Scheme, Key Employee Incentivisation Programme ('KEEP').

KEEP v EMI

This was certainly a welcome development and the new scheme does have some attractive features. It is largely modelled on the UK's EMI Scheme but unfortunately it falls short of its UK counterpart on some key criteria.

While a CGT rate of 33% on any uplift in the value of the options is certainly better than Income Tax of up to 52%, it is regrettable that the Minister did not emulate his UK counterpart in making it easier for them to qualify for the 10% rate under Entrepreneur Relief; to get the relief, shares issued under KEEP will have to meet the same conditions as any other shares unlike the UK where EMI shares nearly always qualify automatically.

The UK scheme also carries the added advantage for the employer company of allowing a Corporation Tax deduction for the discount below market value enjoyed by the employee when the option is exercised.

KEEP also has added complexities for companies that trade across different countries because of the requirement that shares be issued in an Irish resident company (or at least one that is trading in Ireland). For example, even excluding PLCs and large multi-nationals there are a large number of American companies with Irish trading subsidiaries that could qualify for this scheme; the requirement to issue the shares directly in the Irish trading company and not in a US holding company may however not suit them and may serve to make the scheme less attractive for their employees. This can also complicate matters for Irish companies with overseas subsidiaries; this seems particularly unfair at a time that Irish companies will be seeking to break into new markets post-Brexit.

Other Share-Based Schemes

Both Irish and UK legislation allows for a form of share-based profit-sharing schemes; these schemes can be costly to administer but may appeal to larger, more established SMEs. The two schemes ('Approved Profit Sharing Schemes' in Ireland, and 'Share Incentive Plans' in the UK) have broadly similar rules and limits, although again the UK scheme does have added features, in particular the option for employees to subsequently roll these shares into Investment Savings Accounts (ISAs), thereby gaining additional tax benefits.

Overall, it must be concluded that the whole area of share-based remuneration is more sophisticated and advanced in the UK and that we are playing catch-up. This is a core issue and not one in which we can afford to lag behind.

Close Company Rules

The concept of a Close Company is integral to tax legislation in both jurisdictions; in broad terms, most privately owned businesses are classed as Close Companies.

This gives rise to a number of special rules and restrictions; many of these are understandable, being designed to discourage owners from treating the company's assets as their own by, for example taking excessive payments or loans from the company. Unlike its UK counterpart however, the Irish legislation has taken this a step further by imposing additional taxes on certain income of Close Companies, principally:

- A 20% surcharge on post-tax investment income such as rents, interest or dividends;
- A surcharge of 7.5% on the post-tax profits of professional service companies carrying on a wide range of businesses such as auctioneers, management consultants, engineers, quantity surveyors or computer programmers.

These surcharges will apply unless the company then distributes the income to its shareholders by way of dividend; ostensibly the reason for this is to discourage people from using companies to earn income that would traditionally have been earned by individuals and so subject to Income Tax. This is surely an outdated mindset and results in additional complexities or tax burden for SMEs.

Raising Capital

Raising capital is near the top of the agenda for any start-up or expanding business. The flagship schemes in both jurisdictions are quite similar – in fact, the Irish regime arguably has an edge in the start-ups area with the SURE Scheme allowing for a refund of tax paid in prior years by owner-managers investing in their own business, albeit that it is only available to what might broadly be classed as 'first time entrepreneurs' and even at that, subject to conditions which can be difficult to meet in practice

In terms of raising finance from external sources, the UK does have a greater variety of schemes including in particular schemes that allow Venture Capital Trusts to invest in businesses.

The main flagship schemes, however – EIIS in Ireland, EIS in the UK – are very similar in terms of conditions and funding limits; a company can raise up to €15m (EIIS) or Stg£12m (EIS), subject to a maximum in any 12-month period of €5m/ Stg£5m. Both these schemes constitute 'State Aid' under EU law however and so are subject to approval and ongoing monitoring by the EU; the revamped Irish scheme, introduced in late 2015 has run into particular difficulties in this regard with the result that it is now highly restricted, with a number of applications stuck in a backlog awaiting approval and the scheme subject to yet another government review!

This brings to mind the concern noted at the outset that the UK might not be subject to such restrictions in the near future and may have greater flexibility to offer additional incentives in this area.

Selling the Business

Having worked hard to build the business, very often making significant sacrifices in the form of reduced salaries and pension provision along the way, the entrepreneur looks forward to some payback on the sale of the business and would welcome some tax relief in recognition of this.

The Irish tax system does contain some reliefs on the disposal of SMEs. For example, Retirement Relief can allow a shareholder in a family business to claim a CGT exemption on proceeds of up to €750,000. This relief can also facilitate the transfer of businesses to the next generation in a tax-efficient manner. It is therefore a welcome inclusion in the tax code, although it is subject to stringent conditions including that the vendor has owned the shares and worked in the business for at least 10 years.

Entrepreneur Relief

Retirement Relief, while potentially valuable is therefore only available in restricted cases; on the other hand, Entrepreneur Relief should be more widely applicable. This latter relief comes in the form of a reduced 10% rate of CGT on qualifying business disposals; it was introduced in 2016 and was loosely based on a similar scheme introduced in the UK in 2008.

Welcome and all as its introduction was, the UK version is far superior. For starters, the maximum lifetime proceeds that qualify under the Irish scheme is only €1m, in contrast to the UK where the limit is Stg£10m. There have been some suggestions that the limit for the Irish scheme may be similarly increased but movement in this area is likely to be slow.

Furthermore, the conditions for the Irish scheme are more onerous, as:

- You are required to work in the business on a substantially full-time basis, in contrast with the UK scheme where

merely being an employee or director will suffice, regardless of hours worked or salary paid. This is particularly relevant in the case of non-executive directors;

- This 'working test' must be met, and you must own the shares for at least three years, in contrast with the UK where the requirement is only one year;
- Assets owned personally but used by your company do not qualify for relief under the Irish scheme but in certain circumstances may do so under the UK scheme;
- If the company ceases to trade, the UK scheme allows you a further three years to make a disposal of such shares, in contrast with the Irish scheme where it must be trading at the time of disposal, which is too onerous and adds an unnecessary layer of complexity to cases where businesses are ceasing.

Investors' Relief

Since 2016 the UK has expanded the scheme to cover investors who are not employees or directors of the company, although the holding period is longer, at three years. This is a significant change as, in addition to giving favourable tax treatment to investors, it can potentially help open up another source of start-up or expansionary capital for businesses.

National Insurance

Finally, there is that old bugbear of business people, the lack of a safety net for them should their business fail and they find themselves out of work, or should they suffer a serious illness that renders them unfit to continue working. After taking the risk of going into business, this is very inequitable. The UK system is far from perfect either and in particular it is difficult to claim Jobseekers' Allowance but it does allow for more benefits than the Irish system, including crucially some forms of illness benefit.

This is an area that is of course under review in both jurisdictions and it is to be hoped that the changes introduced address these inequities; this will however most likely come at a cost in the form of higher National Insurance contributions and, as the UK Chancellor discovered when he attempted to introduce some changes in this area last year, is likely to generate some controversy along the way.

Conclusion: Some Things Done but More to Do

It would be wrong to describe the Irish tax code as hostile to business but, as we have discussed above there are some deficiencies and unless these are addressed and the Irish system regains its competitiveness relative to the UK, they may ultimately impact negatively on this country. For example:

- In the start-ups area, people may conclude that there are better supports and a more favourable tax regime for businesses that are based in the UK and may choose to set up there instead of in Ireland;
- Post-Brexit we may see the UK focus more aggressively on tax policy as a means of gaining a competitive advantage, in particular as they may have greater flexibility if not subject to EU State Aid restrictions in this area;
- More generally, a pro-business environment can encourage a greater level of entrepreneurialism and creativity; the Irish system needs to retain an edge in areas such as taxation of entrepreneurs, incentivisation of employees and supports and buffers through the tax and national insurance regime for business people who fall on tough times.

Since the mid-1950s, tax policy has been a cornerstone of Irish policy for economic development; in recent years however, we have fallen behind somewhat and the challenge now, and one that is starkly highlighted by developments in the UK, is to get back ahead of the game.

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