Tax Strategy Group

Small Business

1. Introduction

The Programme for Government for National Recovery 2011 – 2016 identifies that *"The big challenge for Ireland is to develop a strategy that will allow job growth and sustainable enterprise."*

The Action Plan for Jobs acknowledges the key role that small and medium enterprises (SMEs) play in creating employment in the economy and identifies a wide range of actions to encourage the development of this sector.

The economic analysis accompanying this paper[1] identifies that:

- SMEs account for 99.8% of businesses and 69.2% of employment in the enterprise economy in Ireland.
- Within that, over 90% of enterprises were **micro enterprises** (less than 10 persons engaged) representing 26.9% of employment.
- A further 8% were **other small enterprises** (between 10 and 49 persons engaged) representing 23.4% of employment.
- Medium-sized enterprises (between 50 and 250) accounted for 1.3% of all businesses and almost 19% of employment
- Large enterprises (greater than 250 persons engaged) made up 0.2% of all enterprises and almost 31% of employment.

	Total Business Economy			
Class Size	**Active enterprises**	**Percentage of Active Enterprises by Class Size**	**Persons Engaged**	**Percentage of Persons Engaged by Class Size**
Micro <10	**180,199**	**90.4%**	**350,533**	**26.9%**
Small 10-49	**15,990**	**8.0%**	**305,296**	**23.4%**
Medium 50-249	**2,571**	**1.3%**	**245,123**	**18.8%**
Large >250	**481**	**0.2%**	**401,130**	**30.8%**
Total	**199,241**	**100.0%**	**1,302,082**	**100.0%**
SME	**198,760**	**99.76%**	**900,952**	**69.19%**

Table 1: Number of active enterprises and persons engaged by Size class 2009

Source: Business in Ireland 2009

[1] The economic analysis accompanying this paper sets out in great detail the size and structure of the small and medium-sized enterprise sector in Ireland taking into account its contribution to the economy in terms of employment, gross value added and turnover. It also outlines the main challenges facing the sector today in the form of low credit supply and weak domestic demand.

A summary of the other main findings from that economic analysis are set out in Table 2 below.

As a largely indigenous, employment-intensive sector that relies primarily on domestic demand, SMEs are particularly responsive to changes in domestic policy. In view of the high proportion of people employed by SMEs in Ireland they are especially relevant to addressing the country's unemployment concerns.

SMEs have fared particularly badly when viewed against larger enterprises (those above 250 employees), as a result of the poor economic climate over the last few years. Since larger companies and multinationals have access to funding from international sources, domestic financial sector difficulties which have resulted in tighter lending policies have had greater implications for SMEs.

They also are more dependent on demand in the domestic economy which is continuing to experience historic lows in consumer sentiment, retail sales and, the corollary, high savings rates maintained by consumers.

The tax system already contains a number of measures which benefit small businesses, particularly in the following areas:

- Simplified VAT regime
- Administrative reliefs
- Incentives to employ staff
- Incentives to facilitate company formation/capital raising

In view of the employment intensity of SMEs and the negative economic environment currently affecting the sector, this paper contains an initial exploration of a wide range of additional tax policy options which could potentially assist smaller enterprises in support of the Government's broader jobs strategy.

Table 2 - Summary Economic Assessment of the Small and Medium Enterprise Sector in Ireland

- SMEs make up the substantial proportion of the enterprise economy, with over 99% of businesses in this sector and almost ***70% of people employed by them***. Despite this SMEs make up only 52% of both turnover and gross value added in the economy.

- Despite Ireland's reputation as one of the world's most globalised economies, 64 percent of private sector workers are employed by indigenous non-exporting firms, with ***56 per cent working for indigenous, non-exporting SMEs***. These numbers highlight the importance of domestic demand for sustaining and generating employment, and suggest that an export orientated growth policy may not have as large an impact on number of people employed as might be expected.

- Large firms pay substantially more than SME's; in the manufacturing sector it can be up to 25-30% more. In establishing the importance of the SME sector to Ireland, the above outlined issues point to the need to understand the extent to which SMEs' economic weight as evidenced through their large employment numbers and majority ownership of GVA and Turnover is as a result of large exporting companies.

- The dependence of SMEs on domestic demand given their largely non-exporting structure is significant in light of high savings rates, poor consumer sentiment and retail sales index figures all pointing towards a flagging domestic economy.

- Lending to non-financial, non-property related SMEs by Irish resident credit institutions declined by €217 million (0.8 per cent), over the quarter to March 31st ,and €1.7 billion over the year ending Q1 2012 (6.3 per cent). This follows an annual decline of 6.2 per cent in 2011.

- Both the Retail Sales Index and the Consumer Sentiment Index are at historically low levels resting at 90 and 61 respectively which are half their 2005 levels.

2. Single Business Tax for Micro-enterprises

In the Programme for Government for National Recovery 2011 – 2016 the following action point is set out under the heading "Supporting SMEs":

We will direct the Revenue Commissioners to examine the feasibility of introducing – on a revenue neutral basis – a Single Business Tax for micro enterprises (with a turnover of less than €75,000 per annum) to replace all the existing taxes on sole traders and small businesses to cut compliance costs and make starting a business much less daunting.

The March 2012 Progress Report on the Programme for Government notes that:

Analysis carried out to date indicates that the measure cannot be delivered in the form described. Work is ongoing with the Revenue Commissioners to develop alternatives.

Internationally there are limited examples of a Single Business Tax (SBT) for micro enterprises. However most OECD countries, including Ireland, have challenging compliance

burden reduction targets in place, with tax regulation and administration being a major focus of their efforts.

A lot of the recent focus on this issue flows from work that has been carried out by the UK Office for Tax Simplification.

However, there are a number of issues which would need to be considered from an Irish context:

- Ireland is ranked 5th in the world in terms of ease of paying taxes compared to the UK's ranking of 24th.

- In Ireland VAT has been highlighted in a number of surveys as posing the greatest administrative problems for small businesses, but because of the EU dimension to VAT policy, it would be impossible to merge VAT within a SBT. For this reason, any proposal for a SBT would have to apply below the VAT thresholds.

- The UK Government decided not to implement the Office for Tax Simplification's suggestion of a turnover-based tax for micro enterprises.

2.1 Administrative Burden on Small Businesses

The ESRI carried out a comprehensive survey[2] of Irish businesses in 2006 to find out their views of regulation and which areas of regulation pose problems in terms of compliance costs, including administrative burdens.

In terms of areas which were considered to have a "major" direct impact on businesses, the top three areas were identified as VAT (42%), income and corporation tax (37%) and health and safety regulations (32%). In the survey 31% of micro enterprises identified VAT as a particular area of regulation which imposed a "heavy burden", with the corresponding figure for Income and Corporation Tax being 25%.

Revenue carried out a survey of small and medium sized business customers in 2008. One of the areas the survey questioned was in relation to administrative burden. Included in the responses was that where respondents, their spouses or their employees maintained the records, the majority of cases spend 1 hour or less per week doing so. Just over 73% of respondents spend less than 2 hours a week on Revenue related records.

Those surveyed were offered the opportunity to state what aspects associated with Revenue related matters they found most burdensome and why. It was found that most of the issues arise in relation to paperwork and VAT returns.

Significant further work carried out by the Revenue Commissioners since 2008[3] shows that that they have reduced the administrative burden on businesses by 25%, saving them over €85 million a year. Revenue engaged in an extensive consultation process in identifying the most burdensome areas of regulation, or red-tape, for business. Having identified 62 of the most burdensome information obligations, interviews were held with 51 businesses and agents to establish the time and cost associated with these obligations.

[2] Business Regulation Survey; Department of the Taoiseach, March 2007
[3] Administrative Burden Reduction Report: published July 2012

The main initiatives which led to the 25% burden reduction are:

- Reduced filing frequencies for VAT, Employers' PAYE/PRSI and Relevant Contracts Tax;
- An increase in the VAT registration threshold;
- Pre-population of income tax and corporation tax forms;
- Revenue's new electronic Relevant Contracts Tax system;
- Ongoing expansion and improvement to the range of electronic services on ROS.

At EU level, the European Commission launched a consultation process on 1st October 2012 to identify which are the top 10 most burdensome legislative acts for SMEs. Taxation has been identified as one of the key areas to be examined as part of the consultation process.

The Department of Finance has established an ad hoc working group with the Revenue Commissioners to progress the issue further in the context of proposals for Budget 2013.

3. Possible Measures to support Small Incorporated Companies

There are different definitions for what constitutes a small business: the EU definition for the purposes of State Aid uses criteria based on turnover and number of employees - a micro enterprise is one employing fewer than 10 persons and having an annual turnover of not more than €2m, while a small enterprise is one employing fewer than 50 persons and having an annual turnover of not more than €10m[4].

In 2010 there were 33,306 small companies (turnover < €10m) paying xxxx

expected CT liability for the current year or 100% of the previous year's liability[5]. Any balance of tax payable for the accounting year must be paid not later than 9 months after the year-end (which is the filing date for the CT return). Start-up companies with a CT liability of not more than €200,000 in their first year do not have to pay any preliminary tax, so payment of CT is not due until filing of the CT return. In practice, many companies go with the preceding year option to ensure that they do not incur interest for under-payment of preliminary tax.

In a 2011 report, the consulting firm Mazars[6] identified that working capital and cashflow are the most common reasons for businesses needing credit. In the same year, the Advisory Group on Small Business[7] stated that the practice of advance payment of taxes by firms has a direct impact on cash-flow for small businesses. Where there is an overpayment of tax, there can be a significant time lag between when preliminary tax is first paid and when any refund due is made, which may be as long as 10 months.

A possible option for further easing the burden of preliminary tax for small companies would be to reduce the preceding year basis for computing preliminary tax from 100% of the previous year's liability to 75%, i.e. a small company would have the option to pay either 90% of current year's defected liability or 75% of previous year's liability. To better target small businesses and to limit the cost, the measure could be restricted to companies with a CT liability of not more than €50k or €25k. This would be justified by the fact that a €200k threshold (reflecting €1.6m taxable profits) would include many large companies.

Revenue data indicates that companies with a CT liability of not more than €200k paid corporation tax of approximately €400m in 2010. If we were to reduce the preceding year basis to 75% for small companies, the estimated cost, depending on what threshold is set, would be as follows:

Previous year liability not more than:	Estimated Cash-flow Cost
€200k	€100 million
€100k	€60 million
€50k	€35 million
€25k	€20 million

A reduction in preliminary tax provides temporary relief and will not alter full liability to corporation tax, so that any balance of tax remains payable within 9 months of the accounting

[5] For large companies, i.e. with a CT liability in the preceding year of more than €200,000, preliminary tax is payable in two instalments:

- 1st instalment, payable in the 6th month of the accounting year, of at least 45% of current year's liability or 50% of previous year's liability, and
- 2nd instalment, payable in the 11th month of the year, bringing total preliminary tax paid to 90% of current year's liability.

The prior year option does not apply in relation to the 2nd instalment.

[6] Mazars (2011) SME Lending Demand Study

[7] Advisory Group on Small Business (2011) The Voice of Small Business

period end. Accordingly, enhancing the preceding year option has only a once off cash-flow impact on the Exchequer, although **the impact on budgetary numbers is significant**.

Advantages and disadvantages of enhancing the prior year option for small companies are as follows:

Advantages:

- Would provide a cash flow benefit to small companies at a time when credit is tight.
- Confinement to smaller companies (e.g. using a €50k threshold) would limit the cost to the Exchequer.

Disadvantages:

- Could lead to demand for the option to be extended to a wider range of companies and focus attention on further relaxation of preliminary tax.
- Impact on budgetary position is significant relative to the limited cash flow benefit provided to companies.
- Would not have any impact on companies making losses.

3.2 Close Company Surcharge on Investment and Rental Income – Increase Exemption Limit

Another issue for small companies is that many of them are undercapitalised as the difficult trading environment has seen trading losses erode their equity base[8]. A major challenge for the SME sector relates to the lack of credit available to struggling businesses. Although the close company surcharge applies only to retained investment and rental income, and not to retained trading income, it has been suggested that an easing of the surcharge would assist companies with liquidity constraints. The Commission on Taxation Report noted that the close company surcharge provisions can limit the ability of companies to reinvest and noted that during an economic downturn it is harder for businesses to make structural changes or obtain credit.

The close company surcharge applies to Irish resident companies which are controlled by five or fewer participators (shareholders, directors and their associates) or by participators who are all directors. The surcharge is designed to discourage the retention and accumulation of investment and rental income in such companies[9]. The surcharge is imposed at a rate of 20% on such income that is retained in the company and not distributed within 18 months of the end of the accounting period. The amount of distributable investment and rental income is reduced by 7.5% for trading companies. The surcharge is effectively an anti-avoidance measure that is aimed at countering attempts to avoid personal income tax on passive non-trading income retained within a company. While the direct yield from the surcharge was €19m in 2010, this does not take account of the positive impact of the measure in preventing or reducing tax leakage from personal income tax.

[8] Credit Office Reports - From Enterprise Development Agencies submission

[9] A 15% surcharge also applies in respect of 50% of any undistributed trading or professional income of certain close companies which carry on a profession or provide services to persons carrying on a profession.

The surcharge does not apply where undistributed investment and rental income is €635 or less and marginal relief is available for amounts of undistributed income up to €846. A possible option to consider would be to increase the de minimus limit, e.g. to €2,000 or €5,000. This would be in line with the Commission on Taxation Report which recommended a substantial increase in the *de minimus* limit in order to reduce the burden on smaller businesses. Estimated minimum costs for this option are given below.

Increase Exemption limit to:	Total Cost per annum
€2,000	€1m
€5,000	€2m

It is important to note that the above costs are estimated on the basis of companies currently paying the surcharge on undistributed investment and rental income on amounts up to €2,000 and €5,000 respectively. The estimates do not take account of any behavioural response to a significant change in the exemption limit. The likelihood is that more companies will avail of the higher exemption limit to retain larger amounts of investment and rental income, with a consequent impact on income tax receipts.

Advantages:

- Would facilitate retention of some investment and rental income and thereby enhance liquidity for small businesses.
- Would ease the administrative burden for small companies.
- Option could be confined to trading companies.

Disadvantages:

- Given the difference in rates between income tax (plus USC) and corporation tax, the need for a surcharge is arguably more pressing than ever and an increase in the exemption limit would dilute the effectiveness of the surcharge in discouraging income tax avoidance.
- An increase in the *de minimus* limit could also lead to demands for further concessions or even the complete abolition of the surcharge.

A variant of the above option would be to exclude a certain amount of deposit interest from being chargeable to the surcharge. Companies may from time to time deposit surplus cash from their trading activities into an interest earning bank account. A limited exemption of interest income would enable such returns to be retained for use as working capital without incurring a surcharge.

3.3 Extend three-year tax relief for start-up companies

A 3-year tax relief for start-up companies commencing a new trade was introduced in 2009 and has since been extended to companies commencing a new trade in the period up to end-2014. The relief is available to companies with a total corporation tax liability for an accounting year not exceeding €40,000 and applies for the first 3 years of trading. It reduces the corporation tax on income and gains referable to the trade by the amount of employers' PRSI paid by the company, subject to a maximum of €5,000 per employee and an overall limit of €40,000 per accounting period. Credit is given for any employers' PRSI exempted under the Employer Job (PRSI) Incentive Scheme in respect of a company's employees in determining the amount of corporation tax relief available to the company. Marginal relief is available for companies with a total corporation tax liability between €40,000 and €60,000 in an accounting period. In 2010, nearly 900 companies claimed relief under this scheme at a total cost of some €8m. Possible options for extending the relief are outlined below.

The relief only benefits start-up companies that make profits in the first 3 years of trading. If a company incurs a loss in a year, it will not get any relief for that year. Consideration could be given to allowing unused credits, due to losses or insufficiency of profits, to be carried over for use in subsequent years and whether certain conditions may be required to qualify for this.

A consequence of the change in Finance Act 2011 linking relief with employers' PRSI is that relief is not available for a start-up company with no personnel working for the company apart from an owner-director who is not an employee subject to employers' PRSI. Consideration could be given to allowing a credit of, say, €5,000 against corporation tax liability for an owner-director working on a full-time basis for the company, i.e. without the requirement for this to be based on employers' PRSI.

The possibility of extending the 3-year tax relief to small companies creating new jobs in an *existing* trade could be considered, with a tax credit (based on employers' PRSI payments) of up to €5,000 for each additional employee taken on in the relevant period (e.g. 2013 – 2015) subject to an overall limit of €40,000. A "small company" for this purpose could be defined by reference to a small enterprise under EU State Aid Rules, with the company being a stand-alone company or, alternatively, the turnover and employment limits applying on a group basis for companies in a group. While such a measure might provide a targeted incentive for employment creation in the small business sector, there would however be considerable difficulty in determining a basis for taking account of net new employment that would not be susceptible to abuse. Also, in the absence of adequate arrangements for tracking employment, there could be significant practical difficulties for Revenue in monitoring the use of the scheme and ascertaining the validity of claims for relief. Finally, in considering any new employment-focused incentive in the small business sector, account would need to be taken of various measures already in place to support employment (e.g. Job Assist Scheme).

3.4 Accelerated Capital Allowances for small companies

Expenditure is deductible as a business expense for tax purposes when it is incurred wholly and exclusively for the purpose of the trade and is revenue (not capital) in nature. Expenditure of a capital nature (as opposed to revenue) is not deductible for tax purposes. However, capital allowances are available for some capital expenditure, e.g. plant, machinery and industrial buildings. Capital allowances are a form of depreciation for tax purposes.

Capital allowances for plant and machinery are given over an eight-year period at a rate of 12.5% per annum. Accelerated capital allowances (100% allowance in year 1) are available for companies investing in energy-efficient equipment for use in a trade under a scheme which runs until end-December 2014.

Consideration could be given to reducing the write-down period for plant and machinery for small companies, say to a three-year period (estimated cash-flow cost of €15m-€20m), or to providing full write-down in year 1 (estimated cash-flow cost of €50m). This could be made subject to an aggregate limit, if necessary, to limit the cost. Accelerated capital allowances would incentivise investment in the small business sector, as well as easing the administrative burden for small companies in computing their tax liabilities. While introducing such a measure for companies would probably invite calls for its extension to unincorporated businesses, confining the measure to companies could be justified on the basis of cost and effectiveness. Ideally, it might be desirable to link the measure with an employment requirement, but again this would be very difficult to operate and monitor effectively, while it would also add to complexity.

3.5 Research and Development (R&D) Tax Credit

Options for amendment of the R&D tax credit regime are being considered separately in the Corporation Tax TSG paper but the following issues are relevant to small enterprises:

- Outsourcing Limits
- Relief for Key Employees
- Possible Alignment of R&D Tax Credit with Grant Qualification Criteria

4. Roll-Over Relief for Capital Gains Tax

There have been a number of calls for the re-introduction of roll-over relief in the CGT system particularly to provide an incentive for entrepreneurs selling a business to re-invest the proceeds in start-ups and other ventures.

'Roll-over relief' (under which the CGT payable on the proceeds of a disposal is deferred if the proceeds are reinvested so that the tax liability is not realised until the assets are eventually sold) was abolished in 2003 for all disposals, including disposals as a result of a Compulsory Purchase Order (CPO).

This relief was ended and other changes were made to CGT at that time (e.g. the curtailment of base cost indexation) as base-broadening measures to part-compensate for the significant reduction in the single rate of CGT to 20% introduced some years previously.

The CGT rate has since been increased to 30% so that the issue of roll-over relief could be looked at again, at least on a targeted basis. However, roll-over relief and other reliefs were introduced or were part of the CGT system at times when CGT rates were 40% and 60%. A CGT rate of 30% is not a penal rate, particularly in the current environment.

In its 2009 Report, the Commission on Taxation recommended that roll-over relief be re-instated only in the case of the purchase of farmland using an award made under a CPO and

not on a general basis. The re-introduction of roll-over relief on a general basis would be expensive to the Exchequer. Furthermore, gains which were deferred when roll-over relief was in effect were often never taxed.

Proponents for the re-introduction of roll-over relief on a targeted basis refer to its existence elsewhere, in particular, in the UK (Business Asset Rollover Relief). The UK scheme appears, however, to be a complex general scheme of roll-over relief and may not therefore be a particularly relevant model for consideration in this regard. It would be useful if those making the case for the targeted introduction of the relief would provide some concrete proposals for how such a relief could be introduced for specific asset disposals subsequently used for productive investment and the benefits that would accrue to the economy as a result.

Also in the UK, entrepreneurs selling their business (technically "qualifying assets") can claim entrepreneurs' relief. This is a lifetime allowance of £10,000,000 of gain that will be taxed at a reduced rate of 10%. The scheme was introduced in the UK's Finance Act 2008 as a replacement for indexation and, in particular, taper relief to both of which were abolished by FA 2008. However, it is much more akin to the UK's former retirement relief scheme (which was phased out in the UK between 1998 and 2003) than a relief to encourage productive investment.

5. Other Supports for SMEs in the Tax System

There are a number of incentives in the Tax and Social Welfare systems that promote job creation and retention. Here we will examine some of these and explore whether there is potential (or need) to amend them in order to ensure that they can contribute as much as possible to the Government's job creation targets. We also outline two incentives, the introduction of which, the group may wish to consider and discuss.

5.1 Revenue Job Assist

5.1.1 Background

Sections 472A and 88A of the Taxes Consolidation Act 1997 provide tax incentives for both employers and employees, to help the long-term unemployed to return to employment. This incentive is available to all employers regardless of the size of the business.

The relief under Section 472A, known as the Revenue Job Assist scheme, allows qualifying employees, in addition to their normal tax credits, to claim certain income deductions, including additional deductions for qualifying children, for the three year period after taking up employment.

Section 88A provides an associated tax incentive for employers. Employers may claim a double deduction when computing the profits of the trade or profession in respect of the first 3 years wages paid to qualifying employees. This double deduction may also be claimed in respect of the employers PRSI contribution on such wages.

Both incentives apply in respect of individuals who have been unemployed for at least 12 months and are in receipt of a specified social protection payment or who are in a category approved for the purposes of the scheme by the Minister for Social Protection with the consent of the Minister for Finance.

The following table shows the levels of participation and cost of the scheme in recent years:

Year	Employers	Employees	Cost €M
2008	321	330	0.2
2009	306	390	0.3
2010	342	650	0.5
2011	794	Not yet available	Not yet available

There have been calls for the scheme to be amended to make it more attractive for employers and employees. In Finance Act 2012, the scheme was amended such that individuals in receipt of PRSI credits will also qualify. Other amendments have also been made to bring the qualifying length of time in receipt of disability allowance in line with DSP practices and to clarify that periods spent on JobBridge work placements will also qualify as periods of unemployment for the purposes of the scheme.

The scheme provides a deduction from the total employment income of a qualifying individual, on a sliding scale, in each of the 3 tax years after he or she takes up employment. An additional deduction is also available in respect of each qualifying child.

The current levels of deduction available are:

	Personal Allowance	Child Allowance for each qualifying child
Year 1	€3810	€1270
Year 2	€2540	€850
Year 3	€1270	€425

An employee who is entitled to the Job Assist allowance can retain his or her medical card for three years from the date he or she returns to work. Other secondary benefits such as rent/mortgage subsidy, fuel allowance, etc. can also be retained subject to certain income limits and other conditions.

A random sampling of 18 applications for this scheme shows that the average salary being achieved is €25,283. Employers currently receive a double deduction for salary and employers PRSI when computing profits. Taking the average salary and associated employers PRSI constributions of €2,718 would result in a deduction for the employer of €56,002 against either income tax or corporation tax resulting in savings of €22,961 (at 41%) or €7,000 respectively. This deduction can be carried forward in cases where the employer incurs a loss in the relevant year.

5.1.2 Other Incentives

The Department of Social Protection provides two measures to aid employers to recruit new employees. These schemes are available in conjunction with the Revenue Job Assist, providing an attractive suite of measures for employers. The Employer Job (PRSI) Incentive

Scheme provides an exemption from employers PRSI for 18 months if an employer takes on an additional member of staff in 2012 that has been unemployed for 6 months or more. In addition, employers can avail of half-rate employers PRSI for employees earning less than €356 per week. Primary responsibility for these incentives rests with the Minister for Social Protection.

5.1.3 Possible Options

Increasing the amount of relief available to employees would be one option that could be considered to make the scheme more attractive to them. As the scheme currently stands, the following table details the approximate amount of salary required to fully absorb the tax credits provided in Year 1 (including normal credits such as PAYE credit):

Marital Status	**Salary €**
Single	20,310
Married, one earner with one child	33,880
Married, one earner with two children	35,150

The table above does not reflect any additional allowances that can be retained under the scheme such as the medical card and other secondary benefits for the three year period.

Of the random sample mentioned above, half of the claimants do not have sufficient income to fully utilise the credits currently available. Therefore, increasing the credits would not make the scheme more attractive to this cohort.

A reduction in the qualifying period of unemployment could be considered to perhaps 6 months to reflect the conditions of the Employers Job (PRSI) Incentive. However, this could carry a significant amount of deadweight cost and would remove the focus of the scheme from assisting the *long-term unemployed* back into the workforce.

Increasing the deductions that employers could take might be considered. However, it could be argued that the current reliefs available are already generous.

Given the recent increase of more than 50% in the number of employers participating in the scheme, it might be more beneficial to market the scheme more effectively to employers and employees to encourage take-up. In this regard, the Department of Social Protection with the support of the Revenue Commissioners, have created an employer pack which sets out all of the measures available to employers and employees to faciliate job creation and are currently conducting a series of roadshows to promote these schemes and job creation generally will commence on Friday October 19th 2012.

5.2 Employment and Investment Incentive

5.2.1 Background

The Employment and Investment Incentive (previously the Business Expansion Scheme) is designed to encourage private individuals to invest in the share capital of SMEs in recognition of the fact that such investments are risky. SMEs, as a result, often find it difficult to raise funding from investors or other sources. The scheme was originally introduced in 1984.

The incentive was amended in Finance Act 2011 in order to target the relief at job creation. A taxpayer can now claim 30% of the tax relief up front on their investment and a further 11% relief at the end of the three year holding period if the company has increased the number of its employees or has spent at least 30% of the monies raised on research and development. In addition, access to the incentive was opened up to the majority of industry sectors.

Obtaining the permission of the European Commission for these changes took over 9 months and the new incentive commenced on 25 November 2011. The scheme is scheduled to finish at the end of 2013.

5.2.2 Reducing Investment Levels

The table below shows the level of investments made under the incentive between 2007 and 2011 (figures are provisional).

Year	Funding Raised (€ million)	Tax Cost (€ million)	No. of Companies	No. of Investors
2007	42	17.5	271	1913
2008	135.7	55.7	461	3200
2009	62.3	25.6	326	1642
2010	58.6	24	340	1470
2011	36.2	15	244	791

Since the high of 2008, investment levels (and the number of investors) have dropped by approximately 75%.

The reduction in investments may be related to the economic downturn or it could be caused by other aspects of the tax system. The availability of film relief for example, which is considered to be of limited risk, may be a much more attractive option for individuals. The operation of the high income individuals restriction may also be acting as a constraint due to the €80,000 in specified reliefs that can be fully tax relieved in a single tax year (The terms of the EII permit an individual to invest up to €150,000 in relevant companies in a single tax year although the high earners' restriction overrides this).

5.2.3 Potential for the future

Given the fact that the EII only commenced on 25 November 2011, it is too early to say whether the changes introduced will make the scheme more attractive for investors. To date there have only been approximately 100 applications for the incentive and not all of these companies will go on to raise funding. However, the peak period for raising investments is traditionally November/December.

5.2.4 Potential Problems

We have received anecdotal evidence that the reduction in the holding period for shares from 5 to 3 years is not working for some companies, as they consider that they will not be in a position to pay back the investors at that stage of their development. At the time the amendment was made, the reduction in the holding period was designed to compensate the investor for the reduction in the upfront relief from 41% to 30%.

A number of companies that operate designated funds have indicated to us that the restriction is causing confusion among potential investors, especially where such investors are claiming other specified reliefs. Investors are seeking guidance from these companies on the amount that they can invest in designated funds that will be fully tax relieved. The companies concerned cannot provide the required advice to investors without seeking access to full information on the tax affairs of each investor. As a result, the companies say that some investors are simply choosing not to invest under the scheme. These companies have also indicated that they have had to turn down many applications for funding from viable businesses due to the low levels of private investments raised.

When the BES was reviewed in 2006 and a decision was taken to extend it for a further 7 years in Budget 2007, there was a hiatus of approximately 8 months in the operation of the scheme pending the receipt of European Commission approval for it. As indicated earlier, a similar lengthy delay was encountered when approval was sought from the EU Commission for the changes to facilitate the introduction of the EII. In view of the impending expiry of the scheme, preparations for its possible extension need to be progressed.

5.2.5 Options for Change

The scheme has only one more year to run before it expires at the end of the 2013 tax year. Any change to the legislation would have to be notified to the European Commission and could not be commenced until its approval had been received. Given our experience of this process last year, we could not guarantee that approval for any changes would be forthcoming in time for the conclusion of the scheme. However, if minor changes were to be introduced, the Commission might not subject the complete legislation to scrutiny again.

Notwithstanding the above, any change to the high income individuals' restriction would not require the approval of the Commission as it is a separate aspect of the tax system, which works to restrict a separately approved State aid. Therefore, removal of the EII from the list of specified reliefs might be worth considering with a view to increasing the attractiveness of the incentive.

In the context of the high earners' restriction, it is worth noting that film relief continues to be available for investments of up to €50,000 per annum. This scheme is considered to be a lot less risky than EII (due to a shorter return period and a relief rate that is practically

guaranteed) and as such, investors might be more attracted to it. Given that the high earner's restriction now applies where reliefs over €80,000 are claimed, investors are likely to invest the maximum amount in the film relief scheme before considering other investments. Perhaps changes to other tax reliefs and incentives could operate to make EII more attractive.

It should also be noted that for those taxpayers that claim other reliefs (including legacy property based reliefs in their run down period), investment in EII may not be an option at all, depending on the levels of the other specified reliefs claimed.

The high earners' restriction will be scheduled for discussion at a future meeting of the group.

5.3 Extension of the Seed Capital Scheme to non-Corporates

5.3.1 Background

The Seed Capital Scheme (SCS) provides that an individual, who makes an investment in a qualifying incorporated company, may set off the amount of that investment against his or her taxable income in any of the previous 6 years which will result in an overpayment of tax. The individual may then claim a refund of the tax overpaid.

The minimum investment under the SCS is €250. This would generate a refund of €102.50 if the individual had sufficient income earned in the refund year on which income tax had been paid at the 41% rate.

The maximum investment that can be set against taxable income in any one year of assessment is €100,000. This means that the maximum total investment that can be made under the Seed Capital Scheme is €600,000, as the individual may set up to €100,000 against the taxable income of each of the previous 6 years.

The following table shows the number of applications approved for refund under the Seed Capital Scheme in the past two years:

Year	Applications
2011	86
2012	40

As can be seen, take-up of this scheme is very low. The changes introduced in Finance Act 2012 opened up the scheme to practically all sectors of the economy and it is hoped that a further increase in the numbers will be evidenced as the year draws to a close.

5.3.2 Possible Options

SMEs make up the substantial proportion of the enterprise economy[10], with over 99% of businesses in this sector and almost 70% of people employed by them. According to the Revenue Commissioners, there were 230,000 tax returns from sole traders and 124,400 tax

[10] The enterprise economy represents the number of people employed and people engaged in each of the 5 areas Industry, Construction, Distribution, Services and Financial and Insurance Activities.

returns from incorporated companies in 2010, showing that the vast majority of SMEs are unincorporated.

Extending the SCS such that unincorportated businesses could qualify might provide a boost for the take-up level of the scheme. However, it could provide the potential for abuse. Individuals could set up companies using, for example, redundancy payments in order to claim the tax relief. The company could subsequently fold. It would be difficult to prove that legitimate efforts had not been made to make the company successful. It would also be difficult to legislate for the concept of investing in oneself.

An alternative option might be to provide an additional tax credit for the self-employed who start a new business venture.

Currently employees receive both a personal tax credit of €1,650 and a PAYE tax credit of €1,650 while self-employed individuals only receive the personal credit of €1,650. To encourage entrepreneurship an additional individual tax credit of €1,650 for individuals who start a business in 2013, 2014 or 2015 could be considered. This credit might apply for the first three years of operation.

Such a measure could prove costly to the Exchequer. If 10,000 new businesses were created in 2013 the cost of the credit could be €16.5 million, potentially rising to €49.5 million in 2015 if the same number of businesses were created each year. A large portion of this cost could relate to deadweight.

As many new businesses are loss-making in the early stages however, this could mean that the credit would be unused by many individuals. In addition, if the credit was provided on a once per lifetime basis to individuals it could prevent multiple claims from individuals that fold and re-form their businesses.

It is unclear how this tax credit would stimulate business creation, or increase levels of employment. The provision of such a tax credit might not be sufficient in its own right to encourage individuals to take up self-employment.

5.4 Relief for Loans to an Employer made by an Employee

5.4.1 Background

The availability of credit to viable small and medium sized businesses is a recurring challenge that has hampered new or expanding firms from developing new products and markets and thereby protecting or creating jobs. There remains an issue that pre-dates the recent banking crisis, whereby new companies or expanding SMEs trying to develop new products or markets struggle to secure finance. This can be due to a lack of familiarity or understanding of the new industry, the new product or the potential of new markets, or the absence of security in the traditional sense.

Notwithstanding recent initiatives such as the Microfinance Scheme and the Credit Review Office, SME owners continue to report that access to credit from lending institutions is scarce.

5.4.2 Existing Support

Although the EII (an already approved State Aid) already provides tax relief for investments in incorporated SMEs, it has been brought to our attention that some employers do not wish to dilute the share capital of their company, and where not incorporated, provide any ownership rights to employees.

5.4.3 Possible Options

An alternative option to support the provision of additional funds to businesses might be the provision of tax relief for employees who make loans to their employer. Depending on the scale of any such scheme, State Aid approval might be required from the European Commission.

One option could be a scheme limited to employers who satisfy the criteria under the Microfinance Scheme which are:

- Businesses, including sole traders, across all sectors employing not more than 10 staff
- A balance sheet and turnover of less than €2million
- A request for credit must first have been declined by the banks.

The employee could be given tax relief on a portion of his/her investment over a specified loan period.

5.4.4 Issues

There are a number of issues with this proposal, such as whether relief should be available to directors. It would be difficult to prevent this in small businesses as directors are often also employees. It would be envisaged that this is the area where the largest potential for abuse would lie. Directors might have to be specifically excluded from any scheme.

If employees charge the employer interest on the loan then that interest is currently chargeable to tax in the hands of the employee and a specific exemption might need to be considered.

Issues arising out of non repayment of loans in cases of business collapse or inability to pay would need to be addressed. It would need to be made clear that the employee must accept the full risk of losing their investment.

Given our experience of the low take-up for the now abolished "tax relief for new shares purchased by employees", we are sceptical as to how attractive this proposal would be to employees. There is also a question concerning whether it would be irresponsible for the State to encourage such investments in situations where the employer has already been refused credit.

6. VAT Options for assisting Small to Medium Businesses

As mentioned earlier in this paper, taxpayers have identified VAT as posing the greatest administrative burden in terms of their interaction with the tax system. The TSG paper on VAT, which was presented on September 18th, explored a number of options for changes to the VAT system that would assist small to medium enterprises:

- Increasing the cash receipts basis threshold
- Increasing the VAT registration thresholds
- Increasing the thresholds for reduced VAT filing

The Tax Strategy Group may wish to consider these issues.

An Roinn Airgeadais
Department of Finance

Economic Assessment of SME Sector in Ireland

Economic Research Paper for Tax Policy Division

For further details contact:
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0. Executive Summary

0.1 This paper sets out the size and structure of the small and medium-sized enterprise sector in Ireland taking into account its contribution to the economy in terms of employment, Gross Value Added and Turnover. It also outlines the main challenges facing the sector today in the form of low credit supply and weak domestic demand. The key points to note from this paper are set out below.[11]

- SMEs make up the substantial proportion of the enterprise economy, with over 99% of businesses in this sector and almost 70% of people employed by them. Despite this SMEs make up only 52% of both turnover and gross value added in the economy.

- Despite Ireland's reputation as one of the world's most globalised economies, 64 percent of private sector workers are employed by indigenous non-exporting firms, with 56 per cent working for indigenous, non-exporting SMEs. These numbers highlight the importance of domestic demand for sustaining and generating employment, and suggest that an export orientated growth policy may not have as large an impact on number of people employed as might be expected.

- Large firms pay substantially more than SME's; in the manufacturing sector it can be up to 25-30% more. In establishing the importance of the SME sector to Ireland, the above outlined issues point to the need to understand the extent to which SMEs economic weight as evidenced throught their large employment numbers and majority owenership of GVA and Turnover are as a result of large exporting companies.

- The dependence of SME's on domestic demand given their largely non-exporting structure is significant in light of high savings rates, poor consumer sentiment and retail sales index figures all pointing towards a flagging domestic economy.[12]

- Lending to non-financial, non-property related SMEs by Irish resident credit institutions declined by €217 million (0.8 per cent), over the quarter to March 31st,and €1.7 billion over the year ending Q1 2012 (6.3 per cent). This follows an annual decline of 6.2 per cent in 2011.

- Both the Retail Sales Index and the Consumer Sentiment Index are at historically low levels resting at 90 and 61 which are half their 2005 levels.

[11] Substantial data and commentary for this paper were taken from both Business in Ireland 2009 and SME's in Ireland: Stylised facts from the real economy and the credit market.

[12] Recently as of late August CSO figures show domestic demand has risen 1.5% though retail sales continue to fall.

1. Introduction

1.1 SMEs form by far the majority of the business community in Ireland. As a largely indigenous, employment-intensive sector that relies primarily on domestic demand, SMEs are particularly responsive to changes in domestic policy. In view of the high proportion of people employed by SMEs in Ireland they are especially relevant to addressing the country's unemployment concerns.

1.2 SMEs have fared particularly badly when viewed against larger enterprises i.e. those above 250 employees, as a result of the poor economic climate over the last few years. Since larger companies and multinationals have access to funding from international sources, domestic financial sector difficulties which have resulted in tighter lending policies have greater implications for SMEs.

1.3 They also are more dependent on demand in the domestic economy which is continuing to experience the historic lows in consumer sentiment, retail sales and, the corollary, high savings rates maintained by consumers.

2. Role of SMEs in the Irish Economy

Business Demography

2.1 The data presented in section 2 is based on the Business Demography statistics taken from the CSO Central Business Register. The Business Register is a register of all enterprises that are active in the State and is based on enterprises that are registered with the Revenue Commissioners.

2.2 In 2009, there were over 199,000 active enterprises in the business economy with over 1.3 million persons engaged. Table 1 below represents the number of people employed and people engaged in each of the 5 areas Industry, Construction, Distribution, Services and Financial & Insurance Activities. These represent the business economy according to the NACE Rev. 2 classifications of economic activity which leave out Agriculture, Forestry & Fishing, Public Administration & Defence, Education and Health.

	Industry	Construction	Distribution	Services	Financial & Insurance Activities	Total Enterprise Economy
Active Enterprises	**14,273**	**44,970**	**44,143**	**90,799**	**5,056**	**199,241**
Persons employed	**216,527**	**124,774**	**340,012**	**527,377**	**93,392**	**1,302,082**
Employees	**211,243**	**96,350**	**317,601**	**471,337**	**92,632**	**1,189,163**

Table 1: Total No. of Enterprises in the Enterprises by Sector
Source: Business in Ireland 2009

2.3 Using the Business Demography data, it is possible to break down the number of active enterprises and the number of persons engaged into employment size classes. The majority of enterprises in the business economy at 90.4% were micro enterprises with less than 10 persons engaged. A further 8.0% were other small enterprises with between 10 and 49 persons engaged. Medium-sized enterprises with between 50 and 250 and large enterprises with greater than 250 persons engaged made up 1.3% and .2% respectively. In total SMEs accounted for 99.7% of the enterprise economy in Ireland. Persons engaged include employees as well as proprietors and family members.

	Total Business Economy			
Class Size	**Active enterprises**	**Percentage of Active Enterprises by Class Size**	**Persons Engaged**	**Percentage of Persons Engaged by Class Size**
Micro <10	**180199**	**90.4%**	**350533**	**26.9%**
Small 10-49	**15990**	**8.0%**	**305296**	**23.4%**
Medium 50-249	**2571**	**1.3%**	**245123**	**18.8%**
Large >250	**481**	**0.2%**	**401130**	**30.8%**
Total	**199241**	**100.0%**	**1302082**	**100.0%**
SME	**198760**	**99.76%**	**900952**	**69.19%**

Table 2: Number of active enterprises and persons engaged by Size class 2009
Source: Business in Ireland 2009

Business Operations Data

2.4 The following data is taken from the main structural business surveys which cover the enterprise economy in Ireland.[13] Though the Industrial Survey which covers NACE sectors B, C, D and E is missing data on micro businesses with 2 or less people it still represents adequate coverage of the sector.

2.5 Data relates to NACE rev 2 categories B to N, less 642 (excluding activities of holding companies), and excludes NACE rev 2 categories A (agriculture, fishing & forestry) and categories O to U (which includes public admin, education, health & social work, arts, entertainment & recreation, and a number of other smaller activities).The Financial & Insurance Activities sector (NACE Sector K) was not included in this analysis due to the unavailability of persons engaged data on the relevant survey forms.

2.6 The following financial variables of turnover and gross value added are analysed in terms of the employment size classes using the business survey data. Turnover comprises the totals invoiced by the enterprise during the reference period and Gross Value Added is the gross income from operating activities after adjusting for operating subsidies and indirect taxes.

2.7 Large enterprises were dominant in terms of both turnover and gross value added. Large enterprises accounted for 48.1% of turnover and 48.9% of gross value added. In contrast to the employment data seen above, micro enterprises were not as significant in terms of turnover and gross value added. Micro enterprises accounted for just 11.4% of turnover and 14.7% of gross value added while other small enterprises accounted for 19.0% of turnover and 15.8% of gross value added. Overall, SMEs contributed 52% both to turnover and gross value added which is much lower than their percentage of persons engaged contribution of 69%.

	Total Business Economy			
Class Size	Turnover €m	Percentage of Turnover by Class Size	Gross Value Added €m	Percentage of Gross Value Added by Class Size
Micro <10	35,756	11.4%	12,406	14.7%
Small 10-49	59,570	19.0%	13,325	15.8%
Medium 50-249	67,533	21.5%	17,323	20.6%
Large >250	151,130	48.1%	41,207	48.9%
Total	313,989	100.0%	84,261	100.0%
SME	162,859	51.87%	43,054	51.10%

Table 3: Turnover and gross value added broken down by sector and size class, 2009

Source: Business in Ireland 2009

2.8 An important point to note from the above outlined statistics is that while SMEs are responsible for the majority of employment in the economy it is large firms who generate a disproportionate amount of turnover and gross value added. This perhaps reflects the concept of large companies creating demand for large numbers of indirect jobs in the economy which are supplied by SME's.

2.9 Also of interest, is a breakdown of companies, by their size, ownership nationality and export orientation. Data taken from the Census of Industrial Production (2009) and Annual Services Inquiry (2008) (Note: omitting the construction sector) is displayed in the tables 4, 5, and 6 below. This data does not include sole traders and firms with fewer

[13] Census of Industrial Production (CIP), Building & Construction Inquiry(BCI), Annual Services Inquiry(ASI)

than three employees in the manufacturing sector, and so under represents micro enterprise's contribution in the economy.

2.10 Table 4 identifies the Services and Manufacturing share of employment by national and non-national owned SMEs as well as their export status. Note that the table now breaks down by employment in the non-constuction, non financial private sector. SMEs are shown to account for 72 per cent of employment in the private sector, while they account for 82 per cent of the people employed in the indigenous economy. Of note is the fact that, despite Ireland's reputation as one of the world's most globalised economies, 64 percent of private sector workers are employed by indigenous non-exporting firms, with 56 per cent working for indigenous, non exporting SMEs. These statistics highlight the importance of domestic demand for sustaining and generating employment, and suggest that an export orientated growth policy may not have as direct impact on number of people employed as might be expected.

Class Size	Irish Non-Exporter	Irish Exporter	Foreign Non-Exporter	Foreign Exporter	Total
Micro<10	23.4%	0.6%	0.4%	0.1%	24.5%
Small 10-49	20.3%	3.1%	1.0%	0.7%	25.2%
Medium 49-250	12.7%	4.1%	2.3%	2.9%	21.9%
Large >250	7.5%	6.6%	7.4%	6.9%	28.4%
Total	63.9%	14.3%	11.1%	10.7%	100.0%
SME	56.4%	7.8%	3.7%	3.7%	71.6%

Table 4: Services and Manufacturing, Share of **Employment** by Ownership, Export Status and Size

Source: Irish SMEs: Stylised facts from the real economy and credit market

2.11 Table 5 below outlines the share of Gross Value Added by class size, export status and nationality. It's clear that in terms of this measure of output, neither SMEs nor indigenous non-exporters are as important as they are for employment. Multinational exporters, accounting for 11 per cent of employment, make up 38 per cent of GVA. Indigenous non-exporters, on the other hand, while accounting for 64 per cent of employment, appear much less important in GVA, with 33 per cent of the total. The SME total of 52 per cent of GVA is also significantly lower than their 72 per cent share in employment.

Class Size	Irish Non-Exporter	Irish Exporter	Foreign Non-Exporter	Foreign Exporter	Total
Micro <10	11.2%	0.8%	1.0%	0.3%	13.3%
Small 10-49	10.6%	2.7%	4.0%	1.0%	18.3%
Medium 50-249	6.3%	4.0%	2.7%	7.4%	20.5%
Large >250	4.7%	9.0%	5.2%	29.0%	48.0%
Total	32.9%	16.5%	12.9%	37.7%	100.0%
SME	28.1%	7.5%	7.7%	8.7%	52.1%

Table 5: Services and Manufacturing, Share of Gross Value added by Ownership, Export Status and Size

Source: Irish SMEs: Stylised facts from the real economy and credit market

2.12 Table 6 below sets out the sources of aggregate investment. Similar to GVA, SMEs are shown to account for 52 per cent of total investment in the private sector. The non-exporting sector in Ireland accounts for 59.9 per cent of aggregate investment. This

suggests that flat domestic demand is likely to be having a large impact on aggregate investment, regardless of the performance of the exporting sector.

	Irish Non-Exporter	Irish Exporter	Foreign Non-Exporter	Foreign Exporter	Total
Micro <10	**10.9%**	**0.1%**	**0.7%**	**0.0%**	**11.7%**
Small 10-49	**9.2%**	**2.4%**	**11.0%**	**0.6%**	**23.2%**
Medium 50-249	**8.4%**	**3.5%**	**2.4%**	**3.2%**	**17.4%**
Large >250	**10.7%**	**18.0%**	**6.6%**	**12.3%**	**47.6%**
Total	**39.2%**	**24.1%**	**20.6%**	**16.2%**	**100.0%**
SME	**28.5%**	**6.0%**	**14.1%**	**3.8%**	**52.3%**

Table 6: Services and Manufacturing, Share of Investment, by Ownership and Export Status and Size

Source: Irish SMEs: Stylised facts from the real economy and credit market

2.13 Table 7 displays information on average wage of firms of different class size and nationality. It shows that firms that are larger tend to pay more, with foreign firms paying more than Irish firms. This information could be viewed as a proxy for the value of generating a job in a large company versus a small or medium sized enterprise. Combined with the knowledge that large firms have much higher GVA with lower amounts of persons engaged, it seems likely that a given amount of jobs in a large firm are worth much more to the economy as a whole than the same amount in SMEs on average.

	Manufacturing		Services	
	Irish	**Foreign**	**Irish**	**Foreign**
Micro	**35**	**42**	**30**	**65**
Small	**36**	**51**	**32**	**62**
Medium	**41**	**52**	**31**	**56**
Large	**48**	**63**	**36**	**41**
SME	**37**	**48**	**31**	**61**

Table 7: Average wages in €000s in Manufacturing and Services by nationality

Source: Irish SMEs: Stylised facts from the real economy and credit market

Note relatively large wage in Micro/Small foreign firms could be a result of small sample size allowing some high-end foreign producers to push up the wage average. Also, the average wage for SME is a simple average. The relatively high number of employees in micro firms with lower wages would pull down the average even further if weighted.

3. Challenges facing the industry

Access to Credit

3.1 Research conducted by the Central bank has shed light on the difficulties SME's face in accessing credit. They have found evidence that as a consequence of economic conditions, many foreign banks are exiting the Irish lending market leaving a smaller pool of lenders supplying credit to meet demand (especially so for SMEs), with less competition between those lenders.[14]

3.2 The Central Bank's research shows that while there has been a small fall in SMEs demanding credit there has been a large rise in rejection rates independent of the productivity or growth rate of the firm.[15] They also indicate the likelihood that banks' lending decisions are likely to display credit rationing implying that viable businesses aren't receiving funds they would have in years gone by or they are receiving them at higher interest rates.[16]

3.3 Figure 1 below shows changes in credit advanced to all enterprises in the economy and SMEs. Lending to non-financial, non-property related SMEs by Irish resident credit institutions declined by €217 million (0.8 per cent), over the quarter to March 31st,and €1.7 billion over the year ending Q1 2012 (6.3 per cent). This follows an annual decline of 6.2 per cent in 2011. Figure one below shows declining overall lending to all enterprises in the economy with lending to SME's losing a greater amount of credit each in many quarters than all enterprises taken together.

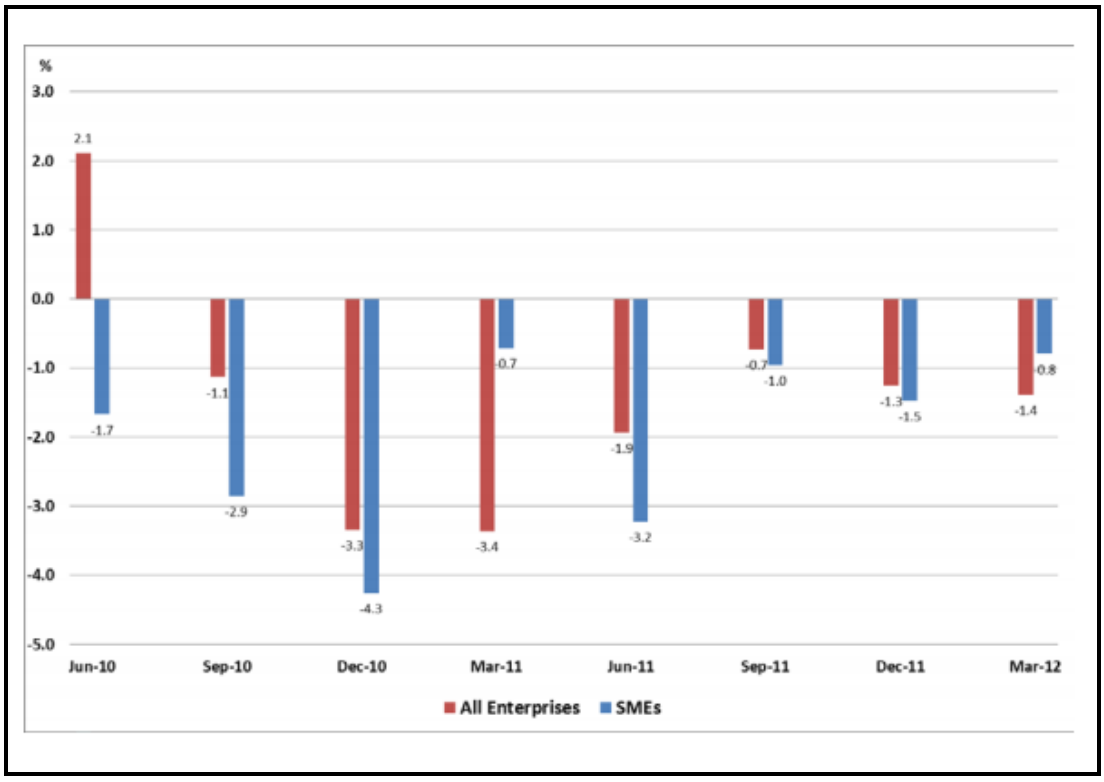

Figure 1: Quarterly Rates of Change in Credit Advanced to All Private-Sector Enterprises and SMEs (Excluding Financial Intermediation and Property-related sectors)[17]

[14] http://www.centralbank.ie/stability/Documents/SME%20Conference/Session%201/Paper%203/paper.pdf

[15] http://www.centralbank.ie/publications/Documents/11RT11.pdf

[16] http://www.financialregulator.ie/publications/Documents/Economic%20Letter%20%20Vol%202011,%20No.%203.pdf

[17] http://www.centralbank.ie/polstats/stats/cmab/Documents/2012q1_ie_trends_in_business_credit_and_deposits.pdf

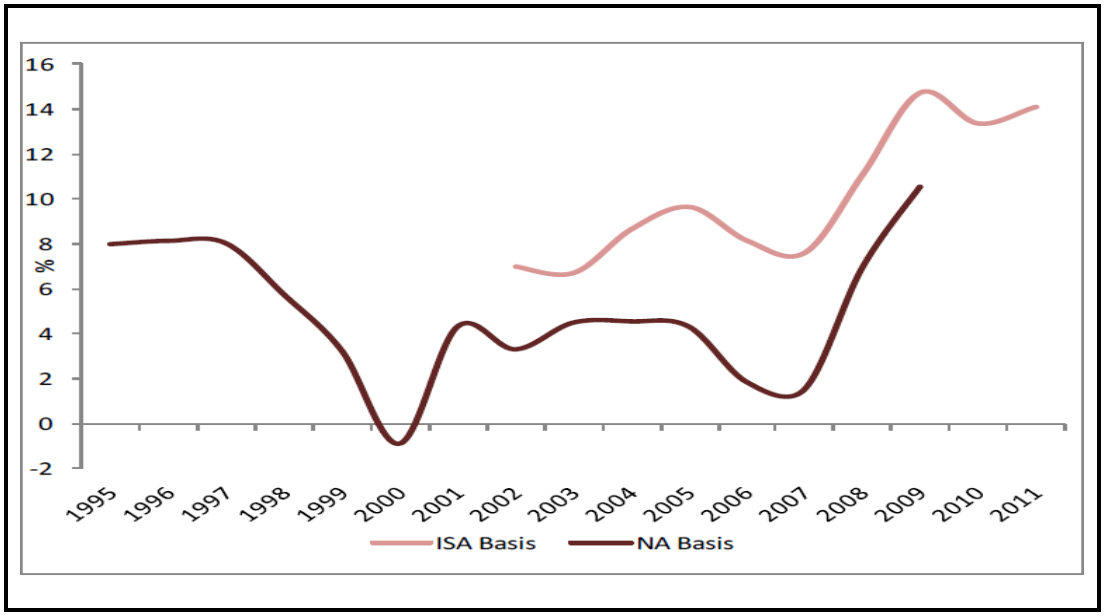

Figure 2:Savings rate in Ireland 1995-2011

Source: The savings rate during the recession-ESRI Paper[18]

3.4 Both the data from the National Accounts and the Institutional Sector Accounts displayed in Figure 2 above, tell the same story; the level of the savings rate during the period 1998-2007 was low relative to those estimated for earlier periods and were associated with significant increases in the level of real household consumption, with the National Accounts Data averaging 6.3 per cent from 1997-2007. The negative savings rate in 2000 was associated with a volume increase in consumption of 10.5 per cent between 1999 and 2000. In 2008 and 2009 the savings rate increased to 6.9 per cent and 10.5 per cent respectively from a level of 1.5 per cent in 2007 and these increases were associated with a decline in real household spending. This reservoir of savings contributes to the poor domestic climate faced by the SME sector but is worthy of hope if fundamentals of the economy increasing consumer sentiment. In this environment consumers may be encouraged to draw down savings which will support SME's going into the future.

3.5 The Retail Sales Index (RSI) and the Consumer sentiment Index (CSI) going back to 2005 are graphed in Figure 3 below. The Retail Sales Index is the official short-term indicator of changes in the level of consumer spending on retail goods. It measures the trend in the level of average weekly sales for each month, after allowances are made for calendar composition. The Consumer sentiment index records details on consumers' attitudes towards trends in the economy.

3.6 Both indexes have fallen substantially from 2005 onwards and remain low historically. More recently the CSI has fallen in May after rising for the first four months of 2012. Similarly in the RSI there has been a 1.8% fall from March to April 2012 and a 3.8% annual decline to April 2012.[19][20]

[18] http://www.esri.ie/publications/latest_publications/view/index.xml?id=3563
[19] https://www.esri.ie/irish_economy/consumer_sentiment/latest_consumer_sentiment/?
[20] http://www.cso.ie/en/media/csoie/releasespublications/documents/latestheadlinefigures/rsi_apr2012.pdf

3.7 These indexes reflect the poor performance of the domestic economy which, as demonstrated earlier in the paper, is highly relevant for SMEs in the economy.

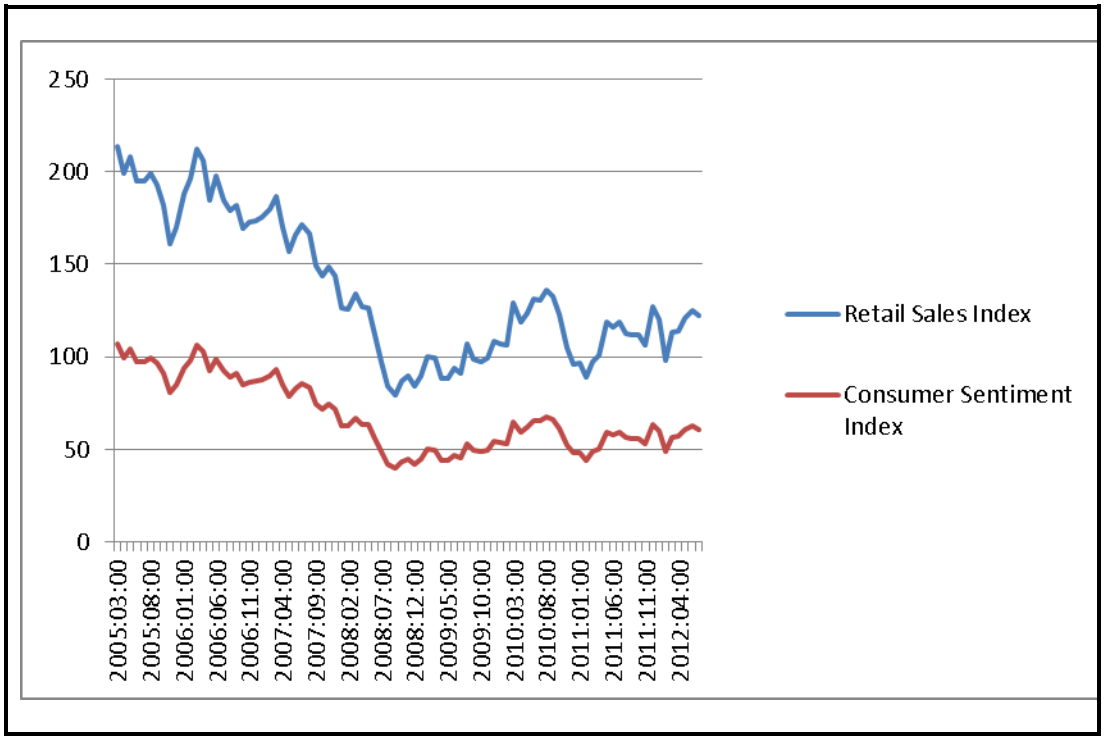

Figure 3: Retail Sales Index and Consumer Sentiment Index from 2005 to May 2012 and April 2012 respectively

Source: CSO Statbank