Irish Tax Institute

Response to public consultation on the review of the corporation tax code

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About the Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. With over 5,000 members in Ireland, along with the Chartered Institute of Taxation UK and The Tax Institute of Australia, we are part of the 28,000-strong international CTA network and a member of the Confédération Fiscale Européenne, (CFE) the European umbrella body for tax professionals.

Our members provide tax education and expertise to thousands of businesses, multinationals, and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue, state bodies and the European Commission.

After 50 years, the Institute remains deeply committed to the role it can play in education, tax administration and tax policy in Ireland and in building an efficient and innovative tax system that contributes to a successful economy and society. We are also committed to the future of the tax profession, our members and our role in serving Ireland's taxpayers and best interests in a new international world order. Our *Irish Tax Series* publications and online database *TaxFind* are respected and recognised as Ireland's most extensive tax information sources.

Introduction

Ireland’s corporation tax regime has long been the cornerstone of our industrial policy and has been a key driver of our economic growth. Since the introduction of Export Profits Tax Relief in the 1950’s, continuous strides have been made to enhance Ireland’s corporation tax offering through the introduction of measures such as;

- Manufacturing relief
- The 12.5% rate
- The R&D tax credit
- The participation exemption
- Allowances for intellectual property

Over the past five years, most of the significant changes to Ireland’s corporation tax code have been influenced by global initiatives developed by the OECD and the European Commission, initiatives that have been designed to tackle aggressive tax planning. Ireland has been fully committed to global tax reform and has been an early-adopter of key measures.

Like many other countries globally, Ireland now faces intense uncertainty. Our key competitor countries are proposing attractive tax reforms, many of which include tax rate reductions. Such moves are impacting the competitiveness of our 12.5% rate.

This is now a critical juncture for Ireland’s economic policy and so it is timely to refocus on the competitiveness of our overall tax offering.

Against this backdrop, we welcome the Government’s decision to commission a review of Ireland’s corporation tax system and the publication of this consultation.   The consultation provides an opportunity for interested parties such as the Institute, to express their views on Ireland’s implementation of global tax reforms, together with the opportunities and challenges presented to Ireland by recent global developments.

Summary of recommendations

Tax Transparency

Ireland has been an early adopter of all recent tax transparency initiatives, ensuring that it now has the highest international standards in tax transparency.

BEPS Implementation

Following the release of the final BEPS reports in October 2015, the Government has moved quickly to begin implementation of the key measures through a combination of domestic legislation and OECD and EU initiatives.

The transposition of the Base Erosion and Profits Shifting ("BEPS") and Anti-Tax Avoidance Directive ("ATAD") measures into domestic legislation will pose challenges for legislators, policymakers, Revenue and businesses. In this regard, it is important that a considered and holistic approach is taken towards implementation. Key to this will be early engagement with stakeholders.

Enhancing the competitiveness of Ireland's tax system

In light of recent global developments and moves by other countries to attract investment, Ireland now needs a tax strategy which enhances its attractiveness as a location for multinationals companies. This strategy should be built on:

- A **competitive corporation tax regime** which retains its attractiveness in a post-BEPS world;
- A **competitive personal tax system** with a focus on lower marginal rates and targeted measures to attract key talent;
- A tax system which provides **increased certainty** for businesses through prescribed legislation / guidance and a fully resourced tax administration;
- The preservation of **tax sovereignty** over important tax matters.

A complementary suite of measures based on the above would enhance Ireland's competitive offering.

Driving growth in the indigenous sector

To grow and broaden our corporation tax base so that it is more sustainable, Ireland needs a strategy to drive the growth of Irish indigenous companies.

Policies for indigenous business - both tax and non-tax - cannot be designed in isolation and it is important that all such policies can work together. The Institute is currently carrying out research in this area based on global best practice set down by leading bodies like the OECD, EU and IMF. We will put forward our recommendations in advance of Budget 2018.

Responses to consultation questions

Question 1: What additional legislative measures, if any, should Ireland take to achieve the highest international standards in tax transparency, having regard to the benefits which may accrue to developing countries from enhancing global tax transparency?

Measures already taken to achieve highest international standards

Tax transparency is one of the fundamental pillars of the global tax reform agenda and a number of international standards have been agreed by countries in recent years. Ireland has always been an early adopter of such measures:

- In 2015, Ireland introduced **Country-by-Country Reporting** for multinationals on foot of recommendations in the OECD's BEPS package, becoming one of the first countries to introduce this measure. The first country-by-country reports will be filed with the Revenue Commissioners ("Revenue") this year;
- In 2015, Ireland agreed to an extension of the EU Directive on Administrative Cooperation ("DAC"), to enable the **automatic exchange of tax rulings and Advance Pricing Agreements** between Member States with effect from January 2017. Under the DAC framework, Revenue already shares financial and non-financial information on non-residents with other EU tax authorities;
- In 2015, Ireland committed to the compulsory **spontaneous exchange of information on taxpayer rulings** in line with the recommendation of BEPS Action 5. This framework is in force since April 2016;
- In 2015, Ireland agreed to adopt the European Commission's Fourth Anti-Money Laundering ("AML") Directive which provides for greater transparency on the **beneficial ownership of companies and trusts**. This legislation is due to become fully effective in Ireland in June 2017;
- In 2014, Ireland was an early-adopter of the OECD's standard for the automatic exchange of financial account information, known as the **Common Reporting Standard** ("CRS"). The first exchanges under the CRS will take place in September 2017;
- In 2012, Ireland concluded an Intergovernmental Agreement with the US on the **Foreign Account Tax Compliance Act ("FATCA")**, becoming only the fourth country in the world to sign such an agreement. Revenue has been exchanging FATCA returns with the US authorities since 2015.

In addition to the above standards, Ireland has signed Double Tax Agreements with 72 countries which helps to facilitate the full exchange of tax information with Revenue authorities in these countries. The Government has also concluded Tax Information Exchange Agreements (TIEAs) with 25 countries.

In adopting these measures, Ireland has achieved the highest international standards in tax transparency. Ireland's efforts on this front have been acknowledged by leading international bodies. In 2013, Ireland was one of only eighteen countries given a top rating by the Global Forum on Transparency and Exchange of Tax Information.

"Overall, Ireland has an effective system for the exchange of information in tax matters. Its laws are clear and ensure that the appropriate information is available and that Irish Revenue has the powers to access it when needed. Ireland clearly values the benefits that exchange of information in the tax area can bring to the administration of their own tax law as well as the law of their exchange of information partners".

OECD, Peer Review Report of Ireland - Combined Phase 1 + Phase 2

Protecting taxpayer rights

The Institute fully supports the tax transparency agenda and Revenue's efforts in complying with the international initiatives in this area.

In order to preserve the integrity of the Irish tax system, it is important to ensure that taxpayer rights are safeguarded with regard to information being exchanged under these initiatives. The duty of confidentiality owed to taxpayers in respect of their information must remain a key tenet of Irish tax law. This means that:

- taxpayer information should always remain confidential. This can be challenging where information is exchanged with a jurisdiction that has a history of poor adherence to taxpayer confidentiality;
- information exchanged with third parties (including foreign tax authorities) should be underpinned by a legal instrument;
- information received by Revenue should only be used for its intended purpose.

We understand that controls and procedures are being put in place by Revenue in respect of the above.

Question 2: What additional legislative measures should Ireland take to further implement the actions of the OECD initiative to combat BEPS?

Ireland has moved quickly to introduce BEPS recommendations

The Irish Government has engaged with the OECD's BEPS project from the outset and has made significant contributions to the development of the new global tax framework. Following the release of the final BEPS reports in October 2015, the Government moved quickly to begin implementation of the key measures. As in most countries, a range of implementation approaches have been applied;

1. Some measures have been introduced directly into domestic legislation;
2. Some will be introduced by way of the OECD's Multilateral Instrument;
3. Some have been/will be transposed by way of EU Directives.

1. Measures introduced directly into domestic legislation

- As mentioned above, Country-by-Country Reporting legislation (*Action 13*) was introduced with effect from 2016 (Section 891H Taxes Consolidation Act ("TCA") 1997).
- The Knowledge Development Box (*Action 5*), one of the first BEPS-compliant patent box regimes in the world, was introduced in Finance Act 2015 (Sections 769G – R TCA 1997).

2. Measures to be introduced by the Multilateral Instrument

- In December 2016, agreement was reached at the OECD on the final text of the Multilateral Instrument ("MLI") (*Action 15*). The MLI will transpose the treaty-related recommendations of the BEPS actions into Ireland's bi-lateral tax treaty network.
- We understand that discussions are ongoing with other countries to agree the list and the detail of the changes being adopted into tax treaties. It is expected that Ireland will sign the MLI in June 2017.

3. Measures transposed by EU Directives

Over the past 12 months, the European Commission has put forward a number of proposals to ensure a consistent implementation of the BEPS recommendations, and other similar measures, across EU Member States;

Anti-Tax Avoidance Directive

EU Member States reached agreement on the Anti-Tax Avoidance Directive (ATAD) in 2016. The Directive contains five specific measures relating to:

- Deductibility of interest (*Action 4*)
- Controlled foreign company ("CFC") rules (*Action 3*)
- Hybrid mismatches (*Action 2*)
- General anti-abuse rule

- Exit tax

The first three of these measures are broadly derived from the BEPS recommendations. The latter two are additional measures pursued by the Commission.

Most of these measures must be introduced with effect from 1 January 2019 although Member States may opt to defer the introductions of certain provisions in cases where they already have equivalent and robust legislation in place.

Tax Dispute Resolution Mechanism

In line with the recommendations of BEPS *Action 14*, the European Commission recently released proposals to improve the double tax dispute resolution mechanism in the EU. The Government has publicly supported these proposals and it is expected that a final Directive will be agreed later this year.

Mandatory Disclosure Regime

The European Commission has recently concluded a public consultation with a view to developing proposals on an EU wide mandatory disclosure regime. This initiative is derived from the recommendations of BEPS *Action 12.*

Ireland was one of the first countries to adopt a Mandatory Disclosure regime, with legislation first introduced in 2011. Under the regime, promoters or taxpayers must provide information to Revenue on certain transactions which give rise to a "tax advantage".

> *"European Commission proposals on improving dispute resolution mechanisms and requiring the mandatory disclosure of aggressive tax schemes in line with the relevant BEPS reports are welcome. Ireland is one of a small number of countries to already have a mandatory disclosure regime in operation and encourages all countries to introduce similar rules. Ireland is in favour of improving dispute resolution mechanisms to provide certainty for taxpayers and business"*
>
> **Minister for Finance, Michael Noonan T.D., 16 February 2017**

BEPS Actions yet to be implemented

Of the remaining key BEPS actions, no definitive timeline has been given on the implementation of the transfer pricing recommendations (*Actions 8 – 10*).

Extensive transfer pricing rules were introduced into Irish legislation for the first time in 2010. This legislation is based on the OECD's transfer pricing guidelines which were in place at the time.

Changes to the OECD's transfer pricing guidelines were agreed in May 2016 and we understand that the Government is now considering the approach to implementation in Ireland;

> *"We now need to consider what changes are needed to ensure that Ireland's transfer pricing rules meet the standards set in the OECD transfer pricing guidelines".*
>
> **Department of Finance, Update on Ireland's International Tax Strategy, October 2016**

In considering the adoption of the new guidelines, thought needs to be given to transitionary arrangements and the practical implications for Irish businesses.

Approach to BEPS and ATAD implementation

Through its engagement across the various channels outlined above, the Government has ensured that the BEPS measures will be implemented in Ireland in a timely manner.

Given the breadth and complexity of these measures, the process and impact of implementation will pose challenges for legislators, policymakers, Revenue and businesses. In this regard, it is important that a considered and holistic approach is taken towards implementation. This could include consideration of the following;

- **Timeline for implementation:** The ATAD measures must be adopted into domestic legislation by 1 January 2019, however, Member States may opt to defer certain provisions. For example, the rules relating to interest deductibility may be deferred until 2024 for countries that have "equally effective" rules in this area. Ireland already has extensive rules on interest deductibility in Section 247 TCA 1997, which includes detailed anti-avoidance provisions, and it is expected that these rules would be sufficiently robust for the Government to seek a deferral.

- **Optionality:** A number of the ATAD measures contain various options that may be adopted by Member States. This optionality should be considered by policymakers to ensure that the ATAD design is a "best-fit" for Ireland's economic needs.

- **Implementation of counter measures:** As part of the process of implementing the BEPS measures, it is important to assess the balance of Ireland's tax regime as a whole. Consideration should be given to other measures which may be required in a post BEPS world. For example;
    - There may be merit in considering an extension of Ireland's participation exemption to dividend income upon the introduction of CFC rules, bringing Ireland in line with many other countries such as the Netherlands, Spain and the UK.
    - Consideration might also be given to a foreign branch exemption (discussed further in Question 3).
    - The capital gains tax ("CGT") rate could be reviewed in the context of the new exit tax rules.

- **Interaction with existing legislation:** Some of the ATAD measures to be introduced will be in areas in which there are already very complex legislative provisions in place. This is particularly relevant for the new rules relating to interest deductibility. Consideration must be given to the interaction of the new provisions with existing legislation.

Early engagement with stakeholders will be an important part of the transposition process and we believe that this should happen as soon as possible.Taxpayers will need adequate notice of how Ireland intends to implement the ATAD so that they can understand how the new rules will apply to them. It would be extremely helpful if consultations were held both on the policy decisions to be made under ATAD and on the text of both legislation and Revenue guidance.

We understand that the Department of Finance will hold a consultation on ATAD implementation later this year and we look forward to providing more detailed feedback on the above as part of this process.

Question 3: What legislative measures, if any, should Ireland take to maintain the competitiveness of the corporation tax code and deliver tax certainty for business in the context of the ongoing implementation of internationally agreed measures to combat BEPS?

Context

The competitiveness of the Irish regime should be a priority in any tax reform initiative.

Over the past five years, most of the significant changes to Ireland's corporation tax code have been influenced by global initiatives developed by the OECD and the European Commission, initiatives that have been designed to tackle aggressive tax planning. This trend will continue over the coming years as the ATAD is transposed.

Throughout its engagement on international tax reform matters, the Government has always stressed the importance of finding a balance - *"play fair but play to win"*[1]. In recent years, amidst the adoption of the OECD / EU initiatives, some positive measures have been introduced to enhance Ireland's corporation tax offering;

- The Knowledge Development Box was introduced with effect from 2016
- The base year restriction was removed for the purposes of calculating the R&D tax credit

Like many other countries globally, Ireland now faces intense uncertainty:

- The new US administration is proposing a complete overhaul of the US corporate tax regime which could involve a significant reduction in its corporation tax rate and the introduction of a border adjustment.
- Following the UK's decision to leave the European Union, the UK Government has suggested that it will look to strengthen its FDI offering through the adoption of more competitive corporate tax policies. The UK Government has already committed to reducing the corporation tax rate to 17% by 2020, while Northern Ireland will introduce a corporation tax rate of 12.5% in 2018.

> "We would have the freedom to set the competitive tax rates and embrace the policies that would attract the world's best companies and biggest investors to Britain"
>
> **UK Prime Minister, Theresa May, 17 January 2017**

- In reaction to Brexit, countries across the EU are enhancing their tax regimes to attract companies seeking to relocate from the UK. They are also carrying out reviews to ensure that their tax regimes are fit-for-purpose in a post BEPS world.

While these international developments pose challenges for Ireland, they also present opportunities for us.

[1] Minister for Finance, Michael Noonan T.D., 14 October 2014

Building on Ireland's Tax Strategy to enhance our corporation tax offering

In recent years, the Government has published important documents[2] which clearly set out Ireland's strategic direction on international tax matters. We must now build on this strategy to improve the attractiveness of Ireland's tax regime. Key to this will be the following;

1. **A competitive corporate tax regime**

Ireland's corporate tax strategy has long been built on the foundation of the three "Rs": rate, reputation and regime.

- The 12.5% rate has been the cornerstone of our corporation tax policy and has been a key factor in attracting foreign direct investment.
- The government's active involvement in global tax reform, our commitment to tax transparency, together with recent changes to our tax residency rules, have all helped preserve Ireland's reputation.

It is important that both of these elements are complemented by a competitive regime. The design of our regime is now more pertinent given recent moves by countries to reduce their corporation tax rates, thus impacting the benefit of the 12.5% rate.

A number of changes can be considered to improve the corporate tax regime;

Foreign branch exemption
The profits of a foreign branch of an Irish company are subject to tax in Ireland. While double tax relief will typically be available in respect of foreign tax paid, the calculation of the relief is complex and can be made up of both a credit and a deduction.

The head office / branch operating model is common for businesses operating in the financial services sector. A number of countries, such as Belgium, France, Germany, Luxembourg, the Netherlands, and Switzerland operate a foreign branch exemption to eliminate double tax. As Ireland competes to attract companies seeking to set up European headquarters, together with those financial services companies considering relocating from the UK post Brexit, a branch exemption would be an attractive proposition.

Given that branch profits are typically offset in full by tax credits in Ireland, the introduction of a branch exemption is unlikely to have a significant exchequer impact.

Knowledge Development Box
The KDB is compliant with the OECD's modified nexus approach, however, in some areas, the KDB is not fully aligned with the parameters permitted by the OECD. For example, the OECD's final report

[2] *Ireland's International Tax Strategy* (2013), *A Road Map for Ireland's Tax Competitiveness* (2014), *Updates on Ireland's International Tax Strategy* (2015 and 2016)

on Action 5 states that *"overall income should only include income that is derived from the IP asset. This may include royalties, capital gains and other income from the sale of the IP asset"*[3]

Ireland's KDB legislation does not extend to capital gains, meaning that any gain arising on the disposal of an IP asset is subject to capital gains tax at a rate of 33%.

To ensure that the KDB is 'best in class', it should be extended to include any gains arising on the disposal of qualifying IP.

R&D Tax Credit – Outsourcing restrictions

The R&D Tax Credit legislation contains two notable restrictions on costs incurred on the outsourcing of R&D activity.

i. Where a company outsources R&D activities to **third parties / universities**, the costs eligible for the credit are restricted to 15% / 5% of the in-house R&D expenditure or €100,000 (whichever is greater).
ii. Where a company outsources R&D activities to a **related-party**, the costs are not eligible for inclusion in the credit calculation.

While Ireland's R&D Tax Credit regime is well regarded internationally, these outsourcing rules are restrictive in comparison to similar regimes in competitor countries.

In developing the modified nexus approach for IP regimes, the OECD recognised the commercial rationale for outsourcing R&D and did not deem it necessary to restrict the inclusion of third party outsourcing costs. As such, the KDB contains no such restrictions.

The KDB is now an integral part of Ireland's innovation tax offering and it is important that the other innovation incentives, in particular the R&D Tax Credit, are aligned with it. Subject to certain safeguards being put in place, these outsourcing restrictions should be removed.

IP allowances

A number of the BEPS proposals may result in companies globally restructuring their IP activities to ensure that profits are aligned with substance.

Currently, companies in Ireland are precluded from claiming IP allowances (under Section 291A TCA 1997) on IP acquired from a group company where the transferor claims relief from CGT. The group thereby foregoes any unused IP allowances on the transfer. The treatment of IP compares unfavourably to that of plant/machinery which is transferred within a group. In such cases, the new owner of the plant/machinery steps into the shoes of the transferor and takes on the historical tax written down value for capital allowance purposes. Similar provisions should apply on the transfer of IP.

The specific provisions of Section 291A should also be reviewed to address timing differences which can arise on the recognition of the IP allowances under international accounting standards.

[3] OECD's BEPS Action 5 Report *"Countering harmful tax practices more effectively taking into account transparency and substance"*, October 2015

The taxation of capital gains
Ireland's CGT rate is currently 33%, having increased from 20% in 2008. This rate is very high for businesses and is a significant differential from the 12.5% corporation tax rate on trading activities. While our view is that the general CGT rate needs to be reduced in order to better promote business and transactional activity, at a minimum, some targeted measures could be considered in the interim.

In previous periods where Ireland had a high CGT rate, a rollover relief for certain business assets was available, although this relief was abolished as the CGT rate was reduced. Rollover relief allowed a chargeable gain to be rolled over where the disposal proceeds of the old asset were reinvested in a new asset. Rollover relief essentially provides for a deferral of CGT with the tax becoming payable on the ultimate disposal of the new asset. The re-introduction of this relief would help to foster capital investment by businesses.

Alternatively, a reduced CGT rate of 12.5% could apply on the disposal of **business assets** to ensure alignment with the corporation tax rate for trading activities.

Simplification of corporation tax code
We acknowledge that Ireland ranks highly in terms of ease of paying taxes[4]. However, consideration should be given to measures which further simplify and reduce the corporation tax compliance and administrative burden for companies.

The UK's Office of Tax Simplification is constantly looking at measures to simplify the UK tax system so it is important that the Irish Government also engages in similar initiatives, particularly in light of Brexit.

A number of possible simplifications to the Irish tax system could be considered such as:

- the tax registration process;
- the quantity and frequency of tax filings / payments; and
- the documentation requirements to claim certain reliefs.

2. A competitive personal tax regime

At levels above the average industrial wage, Ireland has some of the highest effective marginal tax rates internationally.

Personal tax rates of over 50% are highly uncompetitive both for indigenous businesses and multinational companies in Ireland. We are moving into a post-BEPS environment in which it is vital to have highly qualified staff and decision makers working in Ireland to support substance and profit allocation here. One of the main tax barriers to achieving this is our high marginal tax rates and so reducing the marginal rate below 50% for all taxpayers should be our competitive goal.

Share based remuneration provides companies with a greater degree of flexibility in their compensation programmes. We welcome the Government's commitment to introduce a share based remuneration regime for SMEs in Budget 2018. Consideration should also be given to

[4] In the PwC / World Bank *Paying Taxes 2017* Report, Ireland ranks sixth globally on ease of paying taxes.

improving the share based remuneration regime for large companies seeking to attract key talent from overseas. Such a regime should be designed so that no tax is payable upfront on the award of shares or the exercise of qualifying share options, with CGT being paid on the ultimate disposal of the shares.

A targeted initiative, SARP (Special Assignee Relief Programme), was introduced in 2012 to provide focussed relief to key individuals on assignment to Ireland. While the uptake of SARP is increasing, further enhancements could make the regime more effective. This would include extending the relief to new hires and reviewing the €75,000 base threshold. While we appreciate that there may be concerns about displacement, these could be addressed by attaching a skills condition to the relief.

On the administrative side, the tax treatment of short-term assignees to Ireland needs to be reviewed to ensure that multinational companies sending staff to Ireland for short periods are not faced with significant compliance costs. Recent Revenue guidance on the matter is causing significant uncertainty for businesses and employees.

3. Providing certainty for businesses

> *"At a time when good progress has been made in fighting tax evasion and aggressive tax avoidance through increased transparency and the G20/OECD BEPS Project, it is also important to focus on tax certainty. In this context, the importance of providing greater tax certainty to taxpayers to support trade, investment and economic growth has become a shared priority of governments and businesses."*
> **Tax Certainty, IMF/OECD Report for the G20 Finance Ministers, March 2017**

In what is a period of flux for businesses, certainty on tax matters is key. Revenue can help provide this certainty to taxpayers in a number of ways:

- Certain reliefs are currently available to Irish taxpayers on writing to Revenue. For example, taxpayers often seek confirmation that there is no withdrawal of relief under section 79 Stamp Duties Consolidation Act 1999 where a company is liquidated for bona fide commercial reasons. Legislating for such concessionary reliefs, or even expressly stating in Revenue guidance when such treatment applies, would increase certainty for taxpayers whilst also reducing the administrative burden for Revenue.
- Publication of technical guidance and redacted precedents / opinions on key matters would provide taxpayers with more clarity on Revenue interpretation. This would also reduce the number of taxpayers seeking opinions from Revenue.
- Timely updates to tax legislation ensures that it fully reflects changes in other areas of law. This is particularly relevant in the context of the company law changes made in the Companies Act 2014. It is important that these changes are introduced in Finance Act 2017.
- It is internationally acknowledged that BEPS changes, particularly in the area of transfer pricing, will cause a significant increase in cross-border tax disputes. Stakeholders globally recognise that significant investment will be required to efficiently resolve these disputes, so it is important that Ireland and other countries dedicate necessary investment to this area.

"Countries recognize that the changes introduced by the BEPS Project may lead to some uncertainty, and could, without action, increase double taxation and MAP disputes in the short term."
OECD, Explanatory Statement, 2015 Final Reports

4. Preserving tax sovereignty

As outlined in our response to *Question 2,* Ireland has engaged in the redesign of the global tax framework and has fully committed to introducing a range of tax reforms.

While it is important that we continue to engage constructively on such matters, we must remain cognisant of the impact of any proposals on Ireland's tax sovereignty. The European Commission has always stated clearly that the power to levy taxes is central to the sovereignty of EU Member States.

Some recent proposals emerging from the Commission could represent an erosion of tax sovereignty, in particular the Common Consolidated Corporate Tax Base ("CCCTB"). Countries need the flexibility to set their tax base to suit their economic policies, whether this is to stimulate growth in certain industries, alter their tax revenue mix, or fund capital investment. This is particularly important for small open economies like Ireland.

Question 4: What is your view of sustainability of corporation tax receipts over the short to medium term?

Corporation tax receipts are making an increasingly significant contribution to total Exchequer receipts, currently accounting for 15% of net tax receipts. These receipts have grown substantially in recent years, rising from €4.6bn in 2014 to €7.3bn in 2016.

The consultation document highlights the concentrated nature of the tax base, with foreign multinationals accounting for 80% of total net receipts. International bodies have also raised concerns over the reliance on such a small number of companies.

"Corporate tax revenue in Ireland can therefore be characterised as highly concentrated and prone to volatility. A detailed examination of the risks linked to the composition of the Irish tax system could help to ensure that public finances have access to a broad set of revenue sources"
European Commission, February 2017

"More broadly, still high public debt and risks to the outlook and to the revenue base, including from the concentrated corporate tax base, call for maintaining moderate growth in expenditures"
International Monetary Fund, February 2017

The make-up of our corporate tax base is under more focus in light of recent global developments:

- The implementation of tax reform in the US could have implications for US MNC's operating in Ireland, particularly as regards future investment decisions.
- As mentioned above, the UK may continue to use tax policy to counteract some of their Brexit challenges.

While the exact impact of these developments is unclear at this stage, they could pose a risk to the sustainability and growth potential of our corporation tax base. Against this backdrop, it is timely to consider what action can be taken to broaden our tax base.

Broadening our tax base by driving growth in the indigenous sector

The figures above clearly show that corporation tax receipts are heavily reliant on the contribution of the FDI sector. Foreign multinationals also make important contributions to other tax heads, most notably payroll taxes.

However, the indigenous sector also has an important role to play in the growth of the Irish economy. The latest figures available show that indigenous companies account for almost 98% of active enterprises and over 78% of persons in private sector employment. Yet, they only contribute 20% of corporation tax receipts.

A sharp and immediate focus on the indigenous sector is required to determine what strategies must be employed to drive the growth of Irish-owned companies, and consequently their contribution to the overall tax base.

Policies for indigenous business - both tax and non-tax - cannot be designed in isolation and it is important that all such policies can work together. The Institute is currently carrying out research in this area based on global best practice set down by leading bodies like the OECD, EU and IMF. We have identified five key pillars required to drive growth for Irish businesses;

- Funding
- Talent
- Innovation
- Exports
- Succession

We will put forward recommendations on these pillars in advance of Budget 2018.

The Institute has made a number of recent submissions to the Department of Finance in which we made various suggestions to improve the tax regime for indigenous business. While recognising that the scope of change required is very broad and extends far beyond these reliefs, it would be helpful if enhancements were made to the following;

- Revised Entrepreneur Relief
- Employment and Investment Incentive (EII)
- Start Up Refunds for Entrepreneurs (SURE)
- Share based remuneration schemes
- R&D Tax Credit

These recommendations are set out in more detail in the Appendix.

Increasing the competitiveness of our regime

As mentioned previously, many multinationals are considering alternative locations for some of their operations in light of Brexit, with others re-evaluating their business models and supply chains post BEPS.

Ireland has a unique opportunity to position itself as an attractive location for these companies and, in doing, building a strong platform for future corporation tax receipts.

We have outlined in our response to *Question 3* the actions needed to enhance Ireland's competitive offering.

Appendix: Measures to improve the tax environment for entrepreneurs

1. Revised Entrepreneur Relief

The Institute welcomed the introduction of Revised Entrepreneur Relief in Finance Act 2015, and further enhancements introduced in Finance Act 2016.

However, the relief only applies on lifetime gains up to €1m making it far less attractive than the equivalent regime in the UK which applies a lifetime threshold of £10m. This leads to a significant difference in the tax payable in both countries. For example, an entrepreneurial gain of €10m would be subject to CGT of €3.07m under the Irish regime, an effective rate of **30.7%.** A gain of €10m in the UK would attract CGT of €1,000,000, an effective rate of **10%.** We welcome recent commitments by the Government to increase the threshold and believe that this should be addressed as a matter of priority.

In addition, there are a number of conditions attaching to the relief which preclude some entrepreneurs from claiming it. This includes cases where;

- An entrepreneur is actively involved in more than two businesses
- An entrepreneur's holding company holds a dormant company
- An entrepreneur's trading company holds small investments

Institute Recommendation:

- As set-out in the *Programme for a Partnership Government*, we believe that the lifetime limit of chargeable gains should be increased from €1,000,000 to €10,000,000.
- The legislation should be reviewed to ensure that entrepreneurs are not inadvertently excluded from claiming the relief.

2. Employment and Investment Incentive ("EII")

The EII provides income tax relief for individuals who make equity investments in qualifying trading companies. Relief is granted in two tranches, 30% in the year of investment and a further 10% relief after three years if certain conditions are met.

There are a number of criteria that must be met by both the investor and the company for EII relief to apply:

- The company receiving the funds must carry out a qualifying activity
- The funds must be used by the company for that qualifying activity
- The investor must not control more than 15% of the company
- There are limits on how much a company can raise and how much an individual can invest

A number of positive changes were introduced to the regime in Finance Act 2015;

- The limits on the amounts that can be raised by companies have increased from €2.5m to €5m in any 12-month period and €10m to €15m in the lifetime of the company
- The minimum period for the holding of shares in an EII company has been increased from three years to four years
- The definition of qualifying trade was extended to include internationally traded financial services and the operation of certain nursing homes.

While we welcome these changes, we believe that a number of enhancements are needed to make the EII competitive with the regime in other competitor countries:

(i) Annual Investment Limit:

An investor is limited to claiming EII on investments of up to €150,000 per annum. Feedback from our members is that the threshold is restrictive for investors and as a result is acting as a barrier to investment. By way of comparison, the UK's EIS (which applies in respect of investments in medium-sized companies) has a £1m investment limit.

The EII seeks to increase employment and we believe that raising the investment limit for individuals would provide SMEs with the necessary capital to meet this policy objective.

(ii) Split in relief

Income tax relief under EII is currently granted to an investor in two stages - 30% in the year of investment and an additional 10% after three years, if certain employment targets are met by the investee company. Feedback from our members is that the deferral of full relief is also acting as a barrier to potential investors.

Recommendation:

- The annual investment limit for individuals of €150,000 should be increased.
- Full income tax relief of 40% should be provided in the year of investment.

3. **Start-Up Refunds for Entrepreneurs (SURE**)

SURE aims to incentivise individuals currently or recently in employment to start and invest in their own business by allowing income tax relief on investments in their business of up to €100,000.

The relief is limited to the amount of income tax the individual has paid (primarily) through the PAYE system over the previous six years. The individual must hold the eligible shares for a period of three years from the date of issue and must hold at least 15% of the issued share capital of the company for 12 months after the issue of shares.

Currently, there are two restrictions in place which make it difficult for individuals to avail of SURE;

i. An individual can only claim the SURE refund after the investment has been made and therefore must find the cash upfront to invest in his/her new business.

ii. To qualify for the relief, the individual needs to have paid sufficient income tax through the PAYE system in the previous four years (albeit that income in the year immediately before the investment can be from any source). A self-employed person, therefore, who has paid equivalent levels of income tax through the self-assessment system, does not qualify.

Institute Recommendation:

- A mechanism should be put in place, with appropriate safeguards, to provide up-front tax relief to the investor.
- All taxpayers, including non-PAYE individuals, should be entitled to avail of SURE.

4. Share based remuneration

Start-up companies often have limited cash to retain and attract the key talent necessary to grow the business. Share based remuneration provides smaller employers with a greater degree of flexibility in their compensation programmes and allows them compete with higher salaries offered by multinationals. Research conducted by the European Commission has also found that employee share ownership can be a key contributor to higher productivity and consequently higher competitiveness and growth[5].

In this regard, we welcomed the commitment by Minister Noonan to introduce a share-based remuneration regime for SMEs in Budget 2018.

Institute Recommendation:

For this new regime to meet its policy objective, it should be designed so that no tax is payable upfront on the award of shares or the exercise of qualifying share options. Instead capital gains tax would be paid on the ultimate disposal of the shares.

5. Easing administrative burden on R&D Tax Credit claims

Innovation plays a central role in driving growth and fostering competitiveness in economies. SMEs need to be innovative to develop and expand into new markets, which is particularly important post Brexit as SMEs seek to diversify from the UK export market.

In recent years, a number of important changes have been made to enhance Ireland's innovation tax offering, in particular the R&D Tax Credit and the Knowledge Development Box (KDB). Both incentives include helpful measures which are specifically aimed at SMEs.

Many SMEs, despite undertaking R&D activities, are not availing of these initiatives due to the administrative requirements involved and uncertainty over the eligibility of their claims.

[5] The Promotion of Employee Ownership and Participation, Inter-University Centre for European Commission's DG MARKT, October 2014.

Institute Recommendation:

- Documentation requirements for R&D Tax Credit claims below a €100,000 threshold should be streamlined.
- An “advance assurance” mechanism should be introduced to give SMEs certainty over their R&D claims. This would include an advance opinion as to whether the R&D activities satisfy the scientific / technological criteria.