Presentation by Irish Tax Institute

Oireachtas Committee on Budgetary Oversight

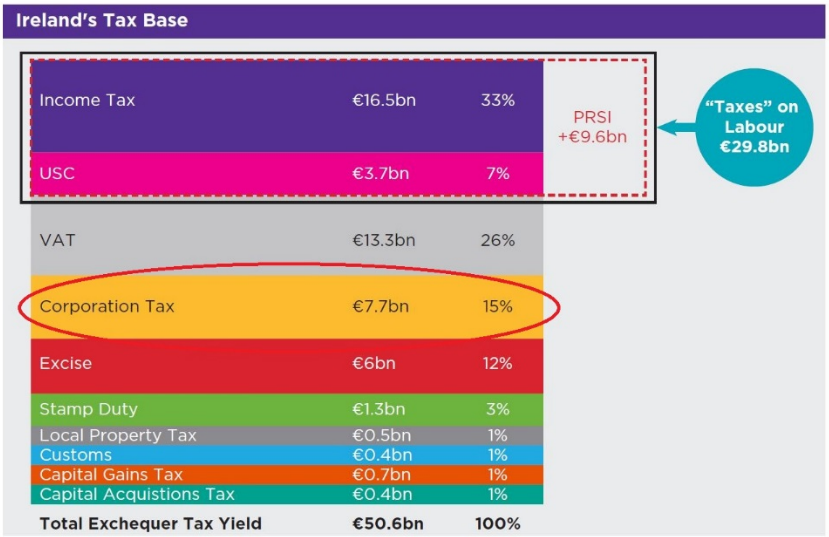
Wednesday 20 September 2017

Chairman, members, thank you for the invitation to appear before the Committee and for the opportunity to outline our views on a future tax strategy for the Irish indigenous sector aimed at strengthening and growing the country's tax base, while building resilience into our economic model.

There are important factors against which we present this proposal:

- An increasing demand for expenditure on services to meet the needs of an expanding and ageing population.
- External political and economic risks that could impact Ireland's small economy as highlighted by the IMF, the EU, the Department of Finance and the Department of the Taoiseach in its National Risk Assessment 2017 Report
- A highly concentrated tax base with very little buffering in the face of any unforeseen global or domestic disruptions to economic conditions.
- A significant reliance on foreign owned multinationals
  - IDA assisted multinationals account for 89% of total exports amongst agency-assisted companies.
  - Foreign owned multinationals account for 80% of Ireland's corporate tax base and US multinationals account for 70% of employment in IDA supported companies.
  - The foreign-dominated pharmaceutical sector, on its own, accounts for almost 40% of the value of manufacturing production in Ireland.
- An Irish economy that is approximately one third smaller when the main effects of multinational activity are removed (new GNI* economic measurement versus GDP).
  A debt ratio that is the fourth highest in the OECD (using the GNI* measurement) according to the Fiscal Authority - with only Portugal, Japan and Italy owing more as a share of their economy.

The importance of a resilient and growing tax base



To deal with this backdrop of risks and vulnerabilities we need a diversified and resilient tax base that is capable of withstanding shocks. However, our current tax base has become increasingly reliant on taxes on labour and on corporation tax paid by foreign multinationals (80% of total corporation tax).

Several international bodies have highlighted these dependencies to us. The European Commission Country Report Ireland 2017, said "The stability of tax revenues in the medium term is a concern for public finances. The increasing reliance on buoyant corporate tax receipts to finance permanent increases in current expenditure is a concern".

It stressed that "Ireland is a small and very open economy, its public finances remain vulnerable to external shocks and changes in economic outlook".

The IMF has also been instructive in terms of what Ireland must set out to do. It recommended that our policies should focus on rebuilding fiscal buffers, strengthening economic resilience and fostering sustainable, inclusive growth. It said measures to strengthen human capital and reinforce competitiveness, particularly for domestic enterprises, are key to supporting sustained growth and reducing income and regional disparities. They also emphasized the need to enhance competitiveness through greater support for SME innovation and improved infrastructure.

Opportunities to grow and diversify the indigenous tax base

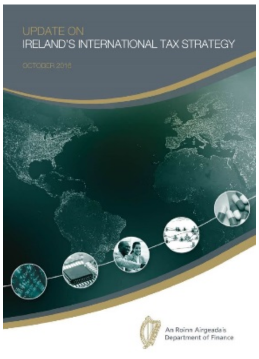
While Ireland cannot control external shocks, what it can control, it should. The Government's report on Irish trade, *Ireland Connected*, stresses that the key to sustaining jobs and incomes is Ireland's ability to succeed in international markets. Our national strategic plans have placed a firm focus on exports as the key to economic growth.

New EU free trade agreements, an expanding Eurozone economy and rapid growth in services as a share of world trade represent real opportunities for Ireland. However, we need tax policy and tax administration changes if we are to realise the plan.

While Ireland's exporting story has been a successful one, there is an acceptance that (a) it is highly dependent on exports from foreign companies and that (b) our indigenous export model is a skewed model in many respects with high concentrations of exports in certain sectors and markets.

Although there are "superstar" Irish performers that are globally focused, 20% of Irish manufacturing companies export just one product, and close to half of them export fewer than five. The Irish indigenous sector is also focused on a narrow range of export markets. 27% of Irish firms export to just one market.

New strategic plan needed for the indigenous sector



Roadmap for the indigenous sector

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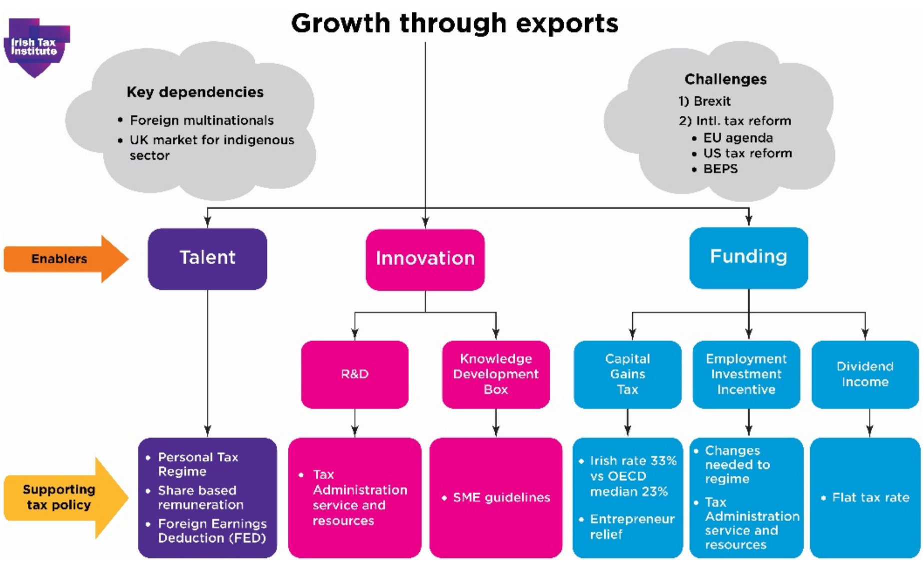
In parallel with our high-performing FDI sector, Ireland now needs an innovative, export-led Irish indigenous sector. We rightly have a comprehensive roadmap for the FDI sector, however a detailed and long-term roadmap is also urgently needed for the indigenous sector. The thorough and strategic approach that Ireland has adopted on FDI, must be applied for the benefit of Irish indigenous companies and entrepreneurs if we are to not only protect our tax base, but also grow it.

The opportunities on offer from new EU FTAs with markets such as Canada and Japan herald much hope, not to mention our access to the EU market itself. The prospects are good if we can take full advantage. However, an abundance of talent, innovation and capital investment will be central to the plan.

A New Tax Strategy

Detailed analysis from the Irish Tax Institute's new report '*A future tax strategy to grow Irish indigenous exports*' highlights a range of mismatches in tax policies that are hindering efforts to grasp global trade opportunities and meet the challenges Ireland faces. While our 12.5% corporation tax rate is valued by many Irish businesses, we have a pattern of sustained high rates across a range of other taxes that are critical for growth and we have tax reliefs that are either not available or not accessible to Irish SMEs.

The right 'tools', supported by the right policies and actions are essential.



This urgent need to change tax policy is reflected in the Irish Tax Institute/B&A survey. 84% of companies believe that tax policies relating to the future of the Irish indigenous sector now need to be addressed in October's Budget. This Budget must take a strategically focused approach to Irish business and address barriers in the tax environment.

Policies that focus on Ireland's access to highly skilled talent, expertise, innovation and R&D, as well as capital investment and finance, are critical to the plan.

Capital Tax Environment

The first challenge for releasing the necessary dynamism that the IMF has stressed as critical, is the high capital tax environment. We know that Irish SMEs are more reliant on bank finance than those in other EU Member States and that they need to diversify into other equity sources of finance. The Government has recognised the need to develop appropriate alternative funding mechanisms to support companies over the coming years. This makes the capital gains tax environment critical.

However, the high capital gains tax rate is restricting external investment in Irish businesses and creating "reluctant" business owners who may hold onto businesses beyond the point where they have the capacity to grow them to the scale required in a new global exporting environment. Unless addressed, this will hinder the structural changes needed for a new and more resilient export model, including the national ambition to "increase the number of our Irish-owned companies of scale by 30%".

Capital gains tax rates in OECD countries, 2016–2017[39]

	OECD country	CGT rate (%)	
1	France	60.5	The French tax regime allows for significant but complex tapering reductions, and a more usual rate to pay would be in the mid-20s.
2	Denmark	42	
3	Turkey	35	
4	**Ireland**	**33**	
5	Finland	30	
6	Sweden	30	
7	Portugal	28	
8	Austria	27.5	
9	Canada	27	
10	Italy	26	
11	Germany	25	
12	Israel	25	
13	Norway	25	
14	Slovak Republic	25	
15	Slovenia	25	
16	Chile	24	
17	United States	23.8	
18	Spain	23	MEDIAN OECD RATE
19	Australia	22.5	
20	Estonia	20	
21	Iceland	20	
22	Japan	20	
23	Korea	20	
24	United Kingdom	20	
25	Poland	19	
26	Greece	15	
27	Hungary	15	
28	Latvia	15	
29	Mexico	10	
30	Belgium	0	
31	Czech Republic	0	
32	Luxembourg	0	
33	Netherlands	0	
34	New Zealand	0	
35	Switzerland	0	

In fact, the 33% CGT rate is the fourth highest rate in the OECD and 10 percentage points above the median OECD CGT rate. Furthermore, Germany outstrips the rest of the EU with its excellent record of business investment and its export prowess – it has a CGT rate of 25%.

Ireland's targeted "entrepreneur relief" reduces the high CGT burden on business sales to a limited degree and is especially important given the serious competition from the UK regime, as highlighted by the UK Institute for Fiscal Studies earlier this month.

Ireland's CGT regime is uncompetitive when compared with the UK and the entrepreneur relief which should mitigate our high rates locks out the important "angel investors", who are willing to invest money, experience and industry expertise in ambitious young companies.

Business angel investment in Ireland is low compared with other countries such as the UK, Spain, France, Germany and Sweden.

The personal tax regime

Irish SMEs need the best human capital and talent to build strategic management expertise, innovation and R&D capability and to drive export-led expansion. But challenges abound here too. In addition to having high personal tax rates, Ireland does not have a workable share option regime that allows SMEs to attract and reward highly skilled and hard-found talented employees. SMEs must compete with larger companies for talent and 38% of them do not believe they can compete with these larger companies when recruiting for the best candidate. A new share option scheme that would help them attract the talent to drive and expand their businesses is vital.

R&D and innovation

In all the work and research carried out, especially post Brexit, innovation and new product development are deemed essential to export growth.

Only 1% of all small firms and 16% of medium firms consider themselves to be R&D active; a low number in the context of our national ambitions. Innovation in younger companies has flatlined since 2009. The 1% figure is a concern in the context of IMF findings which show that SMEs are the drivers of change in innovation.

Ireland has an attractive R&D tax credit regime, but administration barriers are weighing heavily on its success in terms of the low take-up amongst SMEs. Irish Tax Institute research shows that 75% of Irish companies are aware of the R&D tax credit and 20% have availed of it. However, of those that availed of it, 47% said that the process was difficult to prepare for and administer. Only 35% of companies surveyed said that they intend to use it in the next 18 months, although this would rise to 62% if there was more clarity around the criteria for qualification.

In conclusion

We appreciate that fiscal constraints limit the funds available to the Minister for Finance on Budget Day and that not all the essential policy changes can be addressed. In light of the urgency of Brexit and the need to capture markets we would like to see some immediate changes that might assist in the talent, capital and innovation area. These include:

- A less punitive Capital Tax Environment
- A workable Share Options Regime
- A reduction in the personal tax burden
- An improvement to the Foreign Earnings Deduction Regime.

On the longer term strategic front, the Institute would like to see the announcement of a new Tax Roadmap for the Irish Indigenous Sector, alongside the Roadmap for FDI so that we give Ireland the best possible growth opportunity into the future.