# Irish Tax Institute

## Response to Public Consultation on BEPS in an Irish Context

July 2014

## About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

**The changing international tax environment**

The Irish Tax Institute welcomes the publication of this consultation on Base Erosion and Profit Shifting (BEPS) and the steps taken by government to date in framing an International Tax Strategy. The consultation provides an opportunity for interested parties such as the Institute, to express their views on a number of important and related issues - the opportunities and challenges presented to Ireland by the BEPS project, the unfolding EU tax agenda and other potential key changes such as US tax reform.

BEPS is a huge undertaking that involves dozens of countries and a range of tax issues which are not unique to Ireland. The OECD does not want unilateral action taking place across the globe whereby individual countries react to particular issues that affect them. This would de-stabilise the international tax framework and create unnecessary damage to economies in the OECD. Instead, it is important that the steps taken by countries as part of the BEPS project happen in a coordinated way, which prevents competitive pressure from countries which are slow to change.

> *"If only a small number of countries attempt to solve BEPS, they may in fact further jeopardize their tax base as businesses move to jurisdictions that have not yet implemented preventive measures or that choose not to do so in order to gain a competitive advantage."*[1]

The issues are complex and challenging for countries and taxpayers but this period of review and reform also provides an opportunity for Ireland to develop a Tax Strategy for Growth which is underpinned by the key principles of BEPS but which also ensures our continued competitiveness. In this submission, the Institute sets out some of the key pillars for this strategy.

However, it is difficult to make key decisions right now on the detail of the strategy that will secure our competitiveness, when so many issues remain to be resolved on the international tax agenda. This position should become much clearer over the coming months.

***The emergence of BEPS***

The global economic crisis has undoubtedly led to greater scrutiny of the international tax regime. At a time of stretched public finances, pressure on national Exchequers and rising personal taxes, public focus has turned to the tax contribution being made by some multinational companies (MNCs) over the past decade.

The OECD originally developed its framework for international taxation in the 1950s. However, since that time, there has been a total transformation in the way that companies carry on business across the globe. A growing realisation emerged that the tax rules had not

---

[1] Testimony of Pascal Saint-Amans Director, Centre for Tax Policy and Administration (OECD), before the United States Senate Committee on Finance on July 22, 2014

kept pace with this globalisation of business - it was clear that change was inevitable for taxpayers, Government Exchequers and tax administrations.

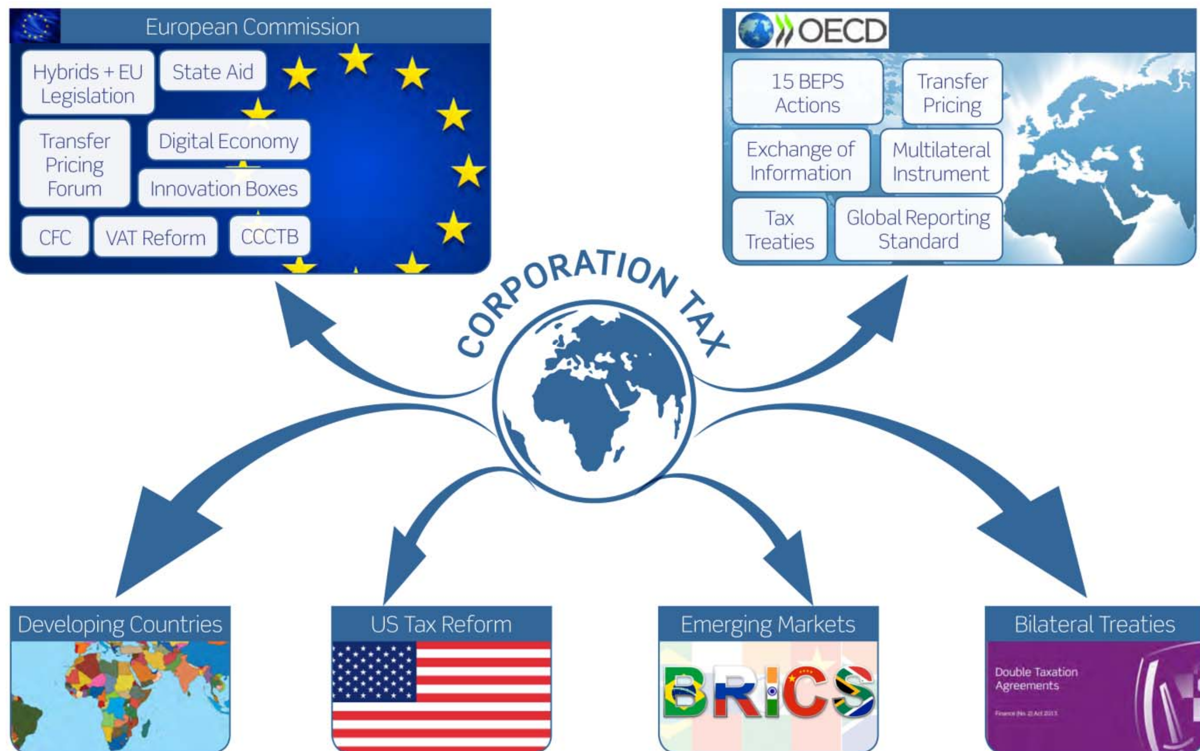
Attention from both the EU and the OECD became focused on this matter and in early 2013, the G20 group of nations called on the OECD to develop an Action Plan to address Base Erosion and Profit Shifting. A 15 point BEPS Action Plan was published by the OECD in July 2013 and this was endorsed by the G20 and other OECD member countries, including Ireland. A huge amount of work has already been undertaken since the Action Plan was published. Ireland has been very engaged at a political level, at official level through Ireland's BEPS team and through the submissions of many stakeholder groups in Ireland including the Irish Tax Institute.

The BEPS project is a coordinated approach to changes that would otherwise have taken place in an unstructured and unilateral manner. The consequences of such unilateral approaches for small open economies, such as Ireland, would be the creation of enormous uncertainty and consequently would cause serious damage.

***Other international changes***

As well as the 15 Actions currently being worked through as part of BEPS, there is also significant work and discussion on tax reform being carried out by the European Union, on an individual country level (most notably by the United States) and bi-laterally through tax treaty negotiations. The international economic environment is also undergoing radical change as the BRICS and other emerging economies continue to develop.

# The Changing Global Tax Environment




It is a time of unprecedented complexity in the area of corporate tax regimes globally.

This makes it very difficult to forecast what the future of the international tax environment is going to look like and how other countries are going to respond to the change agenda. Until we see a final package of agreed measures, it is premature for Ireland to make major decisions on changes to our domestic legislation.

**A Tax Strategy for Growth**

Ireland is now at a crucial phase of its economic recovery. Recent positive economic indicators and strong tax receipts show much progress on the economic front has been made and the Government has rightly set ambitious targets to be met. These include:

- Creating 100,000 new jobs by 2016 and full employment by 2020
- Eliminating the General Government Deficit by 2018
- Returning the economy to consistent and stable growth (2.1% in 2014, 2.7% in 2015 and 3% by 2016)

Against the complex backdrop of international tax change, we need a Tax Strategy for Growth that can help deliver these challenging targets and ensure that the economic recovery is positively impacted by our tax regime.

The fundamental aim of the OECD BEPS project is to align tax with profits and therefore substance. Ireland has been successful to date in ensuring that there is substance to the activities carried out here. Multinational companies have located substantial activities in

Ireland creating over 250,000 jobs and contributing approximately 65% of the entire corporation tax collected by the State. We have attracted significant investment from the leading global companies in a wide range of industries including pharmaceuticals, internet and social media, technology, software, medical devices and aircraft leasing. We have built a leading position in these sectors that has led to the development of a highly skilled cluster of support services and industries playing a vital role in attracting future FDI. Clustering plays an important role in investment decisions and if other countries are more successful at creating and establishing similar clusters, it will become far more difficult for Ireland to recover its status as a prime location for investment.

Across the world, competition for internationally mobile investment is intense**.** Numerous countries are interested in the same investment projects that Ireland wants to attract and tax competition is increasing. These competitors range from European countries such as the Netherlands, Luxembourg and Switzerland, to other parts of the world including Singapore and Israel.

In recent years, our nearest neighbour the UK has taken significant steps to improve the competitiveness of their tax regime. UK government officials have repeatedly outlined their determination to make their tax system as competitive as possible. The UK set out its corporation tax strategy in 2010 in its 'Corporate Tax Roadmap' with the intention of creating *"a more competitive, simpler, and more stable tax system in the future, creating the right conditions for business investment"*.

The UK's tax strategy is having a real impact in terms of their progress on FDI. EY's recent 'UK Attractiveness Survey 2014' highlights the level of success the UK has had in attracting foreign investment. The report notes that the UK secured a record number of FDI projects in 2013 and adds that:

> *"The UK is now the most attractive European location for global investors, up from eighth place to fifth in the worldwide ranking of countries that investors see as attractive for FDI over the next three years. The UK has overtaken Germany for the first time, with only China, the US, India and Brazil now ahead of it".*

It is more important than ever that Ireland does not lose its competitiveness and attractiveness as a location for investment especially in light of increasingly competitive moves by other countries.

Critical to a Tax Strategy for Growth are the following pillars:

- **A competitive income tax regime**

  Ireland has the 9th highest marginal income tax rate of 34 OECD countries and the marginal rate applies here at a much lower income level than in most other OECD countries. This high income tax burden affects both domestic and FDI businesses. As the government has recognised in its recent Statement of Priorities 2014-2016, our overall objective must be to lower this high marginal rate in order to maintain our competitiveness.

A key element of any international tax strategy is attracting the key executives who will establish and drive the operation. This will be even more critical in light of the BEPS emphasis on substance supporting the incidence of tax. The location of an FDI project can hinge on one or two key decision makers. However, our high personal tax rates are proving to be a significant obstacle to attracting these key decision makers to Ireland. A targeted initiative, SARP (Special Assignee Relief Programme), was introduced in 2012 to provide focussed relief to key individuals on assignment to Ireland. However the current SARP regime has had very limited appeal to mobile executives, due to the significant restrictions inherent in the model.

Many other jurisdictions with which Ireland competes for FDI offer more attractive personal tax reliefs targeted at mobile executives and employees; examples include the Netherlands, France, Luxembourg, Belgium, Sweden and Finland. These reliefs typically offer a higher rate of relief than SARP and have significantly less onerous conditions attaching.

The Institute made a detailed submission to the Department of Finance in May 2014 outlining the key features required in a new model relief for targeted executives:

- A skills-based regime, aimed at attracting individuals whose talents and expertise can contribute to Irish economic growth.
- An attractive and competitive flat level of relief.
- A regime that is available to new hires as well as assignees.

Introducing an improved income tax relief for skilled foreign employees locating in Ireland is an important step which Ireland can take now to improve its international tax competitiveness. A targeted and well-designed relief could remove a major barrier to attracting FDI and significantly improve our competitiveness.

Irish companies will often seek the skills of foreign individuals to serve on their Boards. This practice ensures that our companies are benefiting from the best international experience available and again, is a critical element of any strategy that requires substance and value to be added in the Irish operation. The current tax treatment of travel expenses for these directors does not support such an overall policy objective and is creating significant additional cost for these companies. Legislative change is required to address this issue.

- **A Competitive IP Regime.**

Ireland’s current IP regime is a capital allowances regime based on cost. This cost based regime is competing with numerous income and profit based “boxes” globally. Ten countries in Europe alone, (including the UK, Netherlands, France and Belgium), offer a patent or innovation box which ensures that a significantly reduced rate of corporation tax is charged on income derived from patents and other IP.

The EU is in the process of carrying out a series of investigations on various innovation box offerings. Pending the outcome of these EU reviews by the Code of Conduct Group and DG Competition, as well as the final outcome of the BEPS process, it is difficult right now to predict what a feasible and sustainable IP offering for Ireland could comprise.

As a short term measure, there are some amendments that could be made to our current regime (Section 291A of the Taxes Consolidation Act 1997), to make it more competitive.

- The current claw-back provisions in Section 288 (3C) mean that companies do not have flexibility to move IP within five years of acquisition into Ireland without giving rise to a claw-back of allowances already claimed. While this period has been reduced since the legislation was introduced, it is causing fundamental difficulty from a competitive point of view and needs to be revised. At a minimum, inconsistencies in the claw-back period based on the date the expenditure was incurred should be removed.
- Section 291A(1) contains a definition of the "specified intangible assets" that fall within the existing IP regime. There are some important intangible assets that are not currently included in this definition, such as "goodwill" and "commercial know-how, including customer lists". Consideration should be given to broadening the list of specific inclusions or alternatively recasting the definition so that it includes all intangible assets other than certain specified exceptions.
- Another issue which is proving problematic and requires examination is the "80% restriction" in any year on combined allowances and interest (for loans to acquire IP).

These changes should be considered now, while we await clarity on our longer term strategy.

Following the EU response on Innovation Boxes, a detailed review of a long term suitable IP offering for Ireland that is consistent with both EU and BEPS principles should be undertaken. It is vital that Ireland takes action on its IP regime, once the outcome of EU and BEPS actions is known, to ensure we remain competitive as a location for IP - this is a cornerstone of our FDI model.

- **A Competitive Foreign Earnings Deduction (FED)**

The FED is an important measure for indigenous business and Irish based multinationals that are focussed on exports. Small and medium sized Irish companies have to be in the export market, given the scale of our economy. Therefore a competitive FED is critical for indigenous Irish businesses in growing exports.

The current FED regime could be improved by expanding the range of countries it applies to and by reducing the number of days required to be spent working abroad.

A more flexible FED would be an important feature of an overall competitive tax offering.

- **The tax rate for non-trading transactions**

  Ireland's tax rate on income from non-trading transactions (such as interest and dividends) is 25% - a significant differential from the 12.5% corporation tax rate on trading activities. In designing a new Tax Strategy for Growth, it is important that we ensure this is a competitive offering when compared with the UK rate of 20%.

- **Fully resourced administrative supports**

  A key part of inward investment is having an effective administration system which deals with taxpayers efficiently and effectively.

  Significant changes to international tax rules over the next few years are likely to place significant additional administrative burdens on tax authorities and taxpayers. Dedicated resources will be needed for Revenue to deliver world class administrative supports and also to deal with the increased administrative burdens that will arise from BEPS. A well-resourced Competent Authority will be vital for dealing with international disputes and Mutual Agreement Procedures.

  The BEPS Action Plan is also going to bring about a greater focus on all aspects of transfer pricing and Revenue resourcing in this area will be critical to support the efficient administration of the Irish tax regime as it applies to international business.

  In addition, a dedicated mobile talent unit in Revenue would provide welcome assistance to businesses looking at bringing crucial mobile executives to Ireland. HMRC have taken this approach in the UK and created an Expatriate Team to specifically handle the tax affairs of expatriate employees in the UK.

- **Clarity and Communication**

  When clarity is available on the key issues from both the OECD and the EU, the final decisions can be made on our competitive offering. Given the uncertainty that has dominated the tax environment for the past 2-3 years, it is critical that these key aspects of our Tax Strategy for Growth are clearly and unequivocally communicated with relevant timelines, in a business tax roadmap, similar to the UK model.

**Key issues for Ireland from the BEPS project**

**2014 actions**

- **Tax Treaties**. The Main Purpose test proposed in the OECD's discussion draft on 'Granting Tax Treaty Benefits in Inappropriate Circumstances' is likely to create uncertainty for taxpayers as to whether treaty benefits are available in particular

situations. In principle, a Limitation-of-Benefits (LOB) clause would not create this level of uncertainty. However, the form of LOB proposed in the discussion draft is suitable only for large economies with significant domestic capital markets. To ensure that any LOB would not create difficulties for a small open economy such as Ireland, it is essential that it include a suitable Derivative Benefits clause.

- **Digital Economy.** The OECD appears to have taken the approach that challenges posed by the increasing digitalisation of businesses should be addressed through the amendments being made to the overall international tax framework. It is important that this approach is maintained. In particular, the extension of Permanent Establishment criteria to include entirely digital operations/presence is not an appropriate solution to concerns about how digital businesses are taxed and would lead to significant uncertainty and cost for businesses.

- **Transfer Pricing Documentation & Country by Country Reporting.** It is important that the administrative burden of any changes to transfer pricing documentation and any increased reporting requirements is fully considered. The administrative burden to taxpayers of complying with the measures must be proportionate to the benefit of the information derived for tax authorities. Adequate safe harbour limits and materiality thresholds would be important in achieving this balance. Consistent interpretation and implementation of any changes by all OECD countries involved, is also crucial to minimising the cost burden on businesses. It is also imperative that the confidentiality of any information provided by taxpayers is protected.

- **Hybrids.** The OECD Hybrids paper (Action 2) as currently drafted will lead to undue complexity and uncertainty. Ireland has introduced a number of changes over the years on interest deductibility, to ensure that it is an attractive jurisdiction for treasury services companies with requisite substance. Given the importance of the financial services industry, it is key that whatever changes Ireland may embark upon as part of BEPS, do not make it less competitive for attracting and retaining financial services investment. As with other potentially significant changes to Irish domestic law that could arise in response to BEPS, any actions on financing should only take place in the context of a multilateral, coordinated and consistent approach on the overall BEPS Action Plan across OECD states and clarity on tax reform in the US.

**2015 actions**

- **Permanent Establishment (PE).** It is important for Ireland that the long established definition of PE is not fundamentally altered. Ireland is an exporting country and Irish businesses need to visit their customers in the normal course of business. Significant uncertainty and administrative complexity could be created if a much changed or extended concept of PE is adopted.

- **Controlled Foreign Company (CFC) rules.** Ireland does not currently have CFC rules. CFC rules have to be taken into context with foreign dividend income. Ireland has a tax credit system (as opposed to an exemption system) and our view is that there is no requirement for Ireland to introduce CFC rules when we have broadly equivalent legislation.

- **Multilateral instrument.** Any BEPS solutions implemented by way of multilateral instrument must be appropriate for Ireland. Some measures included in a proposed multilateral instrument may be appropriate for some countries but not suitable for small open economies like Ireland.

- **Transfer Pricing & Intangibles.** The 2015 report on transfer pricing and intangibles will follow on from a report in 2014 and previous OECD work on this issue. This topic is a crucial part of establishing a framework that accurately aligns profits with substance. It is important that we closely monitor this important issue for Ireland.

- **Transfer Pricing and other High Risk Transactions** (Action 10), also requires careful consideration. Disputes could arise over the level of deductibility for costs such as management fees etc., leading to the need for further Competent Authority procedures.

**Residence**

The consultation document seeks views on Ireland's residence rules.

Caution needs to be adopted if any changes are being considered to the rules on residence.

If the Government needs to demonstrate a commitment to change our residence rules, these changes must be introduced in the context of the BEPS process and in the context of other countries committing to similar moves. This approach is essential to ensure that Ireland is not significantly disadvantaged competitively, by taking action without similar undertakings from competitor jurisdictions.

The communication of any such decision to change the rules based on multilateral movement through BEPS, is critical. We must be conscious of the way any change could be interpreted by investors as well as policy-makers. While policy-makers would undoubtedly be familiar with the background to any changes by countries, it is important that such changes are not misinterpreted by some in the international business community who may not have the detail behind the requirement for change. A clear communications strategy on the nature and reason for the change is therefore vital.

**Concluding remarks**

To secure our economic future and meet our economic targets, it is vital that we focus in a very positive way, on a Tax Strategy for Growth. While we appreciate that this strategy must meet the principles of BEPS, it must sustain and grow our competitiveness as an FDI location.

Any future decisions about our tax regime must be:

- Carefully considered in light of the outcome of all EU and BEPS actions over the coming 18 months.
- Fully thought through as part of an overall Tax Strategy for Growth for the Irish tax system the next 5-10 years.
- Underpinned by key pillars that comprise a competitive tax offering. These include a competitive income tax regime and a workable SARP regime, a competitive IP regime and a fully resourced tax administration system dealing with international tax issues.
- Communicated clearly within a strategic framework that provides certainty for business, and clearly demonstrates that Ireland will continue to be a competitive and effective inward investment location.

Ireland is at a very important juncture in terms of a future corporate tax strategy.

The rules for operating within the global tax environment are undergoing major reform lead by the OECD, EU and the US. But even as we await this reform, we are constantly faced with increased global competitiveness in the race for FDI.

FDI has long played an important role in the growth and expansion of Ireland's economy, not just in terms of employment and revenues from the multinational sector, but in the growth and expansion of indigenous companies serving that sector and the emergence of innovative start-ups flourishing from the influence and presence of FDI in Ireland.

Ireland's strong record on FDI has been influenced by many factors, including the certainty and competitiveness of our corporate tax regime. At a time when other countries are becoming increasingly focused on global FDI, with many having devised new tax strategies to enhance their competitiveness as a global location, it is critical that Ireland maintains a strong competitive position in the international rankings for inward investment.

We need to be prepared for clear and decisive action once the agreed BEPS package has been unveiled and for the EU have taken their decisions on key issues. Once we know what that action entails we need to ensure we have a Tax Strategy for Growth, built on certainty and competitiveness, and an unequivocal communication of the message to investors and other stakeholders.