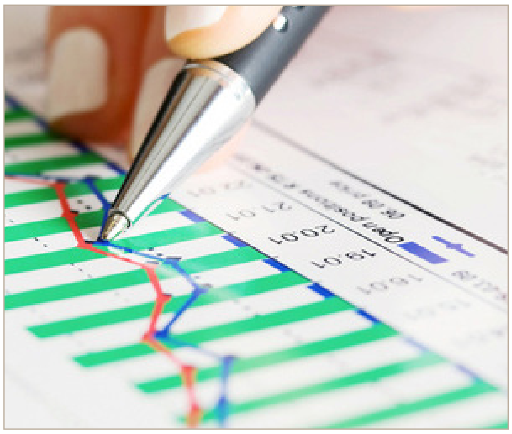
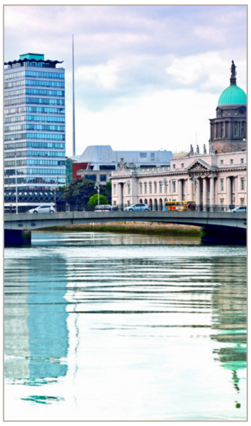
Irish Tax Institute

Leaders in Tax

Irish Tax Institute
Budget 2017 Submission

August 2016





Irish Tax Institute

Leaders in Tax

Contents

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.

SUMMARY OF RECOMMENDATIONS

Our recommendations for Budget 2017 focus on seven key areas.

1. PERSONAL TAX SYSTEM:

- The shape of our personal tax system is becoming increasingly out of balance. The bottom 50% of taxpayer units contribute less than 4% of the personal tax take while the top 12% pay 63%. We now have the most progressive system in the OECD after Israel and the most progressive system in the EU. In Ireland, someone on 2.8 times the salary of a person on the average wage pays 5.6 times the personal tax of that person.

- With cost competitiveness key, we should aim to reduce marginal personal tax rates below 50% for everyone to ensure that tax rates do not act as a barrier to continued economic recovery.

- Plans in the Programme for Government to taper out the PAYE Tax Credit and the Earned Income Credit would result in further increases in personal tax rates to over 60% on income within the taper zone (assuming that there are no reductions in tax rates). Tax rates at this level could have a serious impact on productivity and competitiveness and therefore both of these tax credits should be retained.

- Maintaining a broad personal tax base is a priority. 29% of all income earners are now out of the personal tax regime completely, meaning that the full weight of the €18.3bn contribution to the Exchequer yield from personal tax is falling on the remainder of taxpayers. As we face into a period of economic uncertainty, particularly following the UK's decision to leave the European Union, it is vital that the personal tax base is not narrowed further.

Much was asked of the personal tax system in the past 10 years and it was left with much work to do out of necessity. In the process it has become skewed, uncompetitive and complex. As our personal tax regime becomes more important in the new competitive landscape it is time to both reflect and review its size and shape in the coming years.

2. ENVIRONMENT FOR ENTREPRENEURS:

Some targeted enhancements to existing entrepreneurial reliefs would improve the tax environment for entrepreneurs, particularly in the following areas;

a) Revised Entrepreneur Relief
b) Employment and Investment Incentive (EII)
c) Start Up Refunds for Entrepreneurs (SURE)
d) Share based remuneration

Details are outlined in our submission below.

3. "BEST IN CLASS" INNOVATION OFFERING:

As a result of changes to the global tax framework, thousands of companies across the world are reviewing their operations in different countries to ensure they meet OECD and EU standards. This huge global review by multinational companies provides a unique opportunity for Ireland to expand the hub of innovation activity that is located here, with important spill-over effects for the Irish economy generally.

What is important now is that;

- All parts of the offering work in tandem, thus providing companies with a competitive and stable tax regime throughout the various stages of their IP lifecycle; and
- In doing so, the separate elements comply with the OECD BEPS and EU rules and reflect the way in which companies will be structuring their global innovation activities for the future.

The Institute makes a number of specific recommendations for change to the Knowledge Development Box regime, the Research and Development tax credit and the Intellectual Property capital allowances regime in order to achieve this "Best in Class" offering that fully complies with international rules.

4. TRAVEL AND SUBSISTENCE EXPENSES:

Simplicity and certainty are important elements of a tax regime. Taxpayers should be able to apply the travel and subsistence expense rules to modern working circumstances so that they have reasonable certainty about their compliance with the law. This is very difficult at the moment and the resulting uncertainty is leading to increased compliance costs and risk for both taxpayers and Government.

The introduction last year of measures providing clarity for non-resident non-executive directors was welcome. However, the law needs to be clarified further to address the tax regime for travel and subsistence expenses more broadly.

5. CGT PAY AND FILE DATE:

In another measure to tackle unnecessary tax compliance costs, we believe the time has come to address an anomaly in our Capital Gains Tax ("CGT") administration regime. To achieve a true pay and file regime for CGT and to streamline the complexity that currently exists, we believe it is important and timely to align the CGT payment date with the filing date on 31 October following the year of assessment. This would also align with the income tax pay and file date and would significantly simplify the regime for taxpayers and Government.

6. GLOBAL TAX REFORM

EU Member States recently agreed to adopt the European Commission's Anti–Tax Avoidance Directive ("ATAD"), with most elements of the Directive due to come into force by 1 January 2019.

The implementation of the ATAD measures will present challenges for all countries, including Ireland. As the Government now considers its approach to implementation, it is important that key stakeholders are involved in the process from an early stage.

7. REFORM OF THE FINANCE BILL PROCESS

Policymakers in Ireland have done much work over recent years to improve stakeholder engagement on tax policy issues. These good principles should now be extended to engagement also on the resulting legislation that underpins these policies – the Finance Bill. This is international best practice and ensures that the detail of the legislation correctly reflects the policy goals and that there are no unintended consequences arising.

The Institute has made a number of practical recommendations to the Oireachtas Committee on Arrangements for Budgetary Scrutiny about how the Finance Bill process could be improved. In essence, we believe that the key provisions of the Finance Bill should be published in draft for consultation as the policy consultations arise rather than waiting to publish one block of inseparable legislation in the Finance Bill post Budget, when the opportunity for scrutiny pre year-end is so tight.

THE CONTEXT FOR BUDGET 2017

Budget 2017 will come on the back of a sustained period of growth for the Irish economy. The Summer Economic Statement[1] provides a number of positive economic signals;

- The economy grew at the strongest pace of growth since 2000
- Exports grew by almost 14% in 2015, the strongest rate of growth since 2000
- Unemployment has fallen to 7.8%, from a peak of 15% in 2012
- The general Government deficit is projected to fall to 0.9% this year

Last year also saw a significant increase in the State's tax yield;

- Total net receipts amounted to €45.7 billion, the second highest yield in the history of the state
- Corporation tax receipts were €6.8 billion, up 49% from the previous year
- Income tax receipts increased to €18.3 billion, accounting for 40% of total tax yield

We recognise that Budget 2017 will take place amidst a period of economic uncertainty for Ireland following the UK's decision to leave the European Union. The Government's Brexit Contingency Framework has identified new foreign direct investment as an area of possible opportunity for Ireland and effective tax policy can have an influential role to play in achieving this, as it has done so successfully in the past. Tax policy can also help to support Irish indigenous companies which face particular uncertainty following the UK's decision.

It is estimated that €1 billion is available to provide for additional expenditure increases and tax reductions in Budget 2017, of which circa €330 million will be allocated to tax measures[2]. We recognise that the fiscal position does not allow for wide ranging tax changes in 2017. However, we believe that Budget 2017 provides an opportunity to introduce a number of targeted tax measures which would have limited Exchequer impact.

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1 Summer Economic Statement, June 2016
2 Summer Economic Statement, June 2016

PERSONAL TAX SYSTEM

Two fundamental challenges currently exist with the Irish personal tax system:

- Our high tax rates which apply at relatively low income levels by international standards; and
- The shape and make-up of our personal tax base.

HIGH MARGINAL TAX RATES

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

We welcome the decision in Budget 2016 to reduce to €70,044 the top tax rate for those earning up to €70,044. However, those earning above this amount continue to pay Ireland's high marginal tax rate of 52% (and 55% for the self-employed). In the last two Budgets, personal tax rate reductions have been capped for those earning over €70,044.

Personal tax rates of over 50% are highly uncompetitive both for Irish 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 Ireland's high marginal tax rates and so reducing the marginal rate for all taxpayers below 50% should be our competitive goal.

We welcome the Government's decision to publish the Income Tax Reform Plan. While the proposals in the Plan will result in tax savings for most taxpayers over the period from 2017 – 2019, any reduction in the marginal rate would be limited to 1.5% over the period, bringing this down to 50.5% at best.

INSTITUTE RECOMMENDATION:
A roadmap is needed towards reducing Ireland's marginal personal tax rate for all taxpayers below 50%. We recognise that the current fiscal parameters would prevent this reduction being introduced in full in Budget 2017 but we would welcome the publication of a timeframe for achieving a sub-50% rate.

RETAINING THE PAYE TAX CREDIT FOR ALL INCOME EARNERS

The Income Tax Reform Plan sets out proposals to taper out the PAYE Tax Credit and Earned Income Credit for high earners from 2018. The Plan considers tapering these credits at a rate of 5% per €1,000 from either €80,000 (with the credit fully tapering out at income of €100,000) or €100,000 (with the credit fully tapering out at income of €120,000).

The Plan recognises that *"the tapering out of a tax credit would also result in a higher marginal tax rate within the taper zone than would apply at higher income levels"*, noting that the rate within the taper zone would be over 60%.

This very high tax rate - on an income range of €20,000 - would put Ireland further out of line with key competitor jurisdictions. In addition, it is likely to impact productivity with a heavy extra tax burden being imposed for extra income earned and pay related bonuses.

INSTITUTE RECOMMENDATION:
We believe that the PAYE Tax Credit and the Earned Income Credit should be retained in full for PAYE workers and the self-employed at all income levels.

TAX BASE

Over recent years there has been a continued narrowing of Ireland's **personal tax base**. Currently, 703,800 income earners are out of the tax base in 2016, representing 29% of all income earners.

Over the past six months, the European Commission has raised concerns about the shape of Ireland's personal tax base;

"[Ireland should] reduce vulnerability to economic fluctuations and shocks, inter alia by broadening the tax base".

European Commission Country Report Ireland 2016, May 2016

"Reducing the tax base, through for example raising the threshold for the USC..... weighs on the sustainability of revenue in the medium-term"

European Commission Post-Programme Surveillance Report, January 2016

With the economic ramifications of Brexit still largely uncertain for Ireland, it is even more important that we sustain a healthy and reliable tax base.

INSTITUTE RECOMMENDATION:
No further steps should be taken to narrow the current personal tax base.

ENVIRONMENT FOR ENTREPRENEURS

Entrepreneurs are key to the continued growth of the Irish economy. The latest CSO figures available show that in 2012 SMEs accounted for 99.7% of active enterprises and 68% of persons in private sector employment.

A number of positive measures have been introduced in recent years to improve the tax environment for entrepreneurs and the Government's Action Plan for Jobs 2016 commits to the continued *"reform of the business tax environment to support entrepreneurs and existing micro and small businesses"*[3].

The UK has made a number of successful changes to its entrepreneurial tax reliefs and feedback from our members and from other bodies indicates that it is our main competitor for mobile capital investment.

"The tax environment for entrepreneurs and investors in Ireland has become more challenging, particularly when compared with the UK's tax rates. It is critical that Ireland should remain competitive as a location for both home-grown and internationally mobile entrepreneurs".[4]

The Institute made a detailed submission to the Department of Finance consultation on the *Role of the tax system in encouraging entrepreneurship* in which we made a number of recommendations to improve the tax regime for entrepreneurs. We revisit below the key recommendations in that submission and suggest a number of additional enhancements to improve the tax environment for entrepreneurs.

REVISED ENTREPRENEUR RELIEF

The Institute welcomed the introduction of Revised Entrepreneur Relief in Finance Act 2015 as a measure to reduce the CGT cost for successful entrepreneurs. However, the relief remains less attractive than the equivalent regime in the UK. There are two key differences between the Irish and UK reliefs;

Key differences	Ireland	UK
Preferential rate of CGT	20%	10%
Lifetime limit	€1,000,000	£10,000,000

3 https://www.djei.ie/en/Publications/Publication-files/Action-Plan-for-Jobs-2016.pdf
4 The National Policy Statement on Entrepreneurship 2014

The combined effect of these factors leads to a significant difference in the tax payable in both countries. For example, an entrepreneurial gain of €8m would be subject to CGT of €2.51m under the Irish regime, an effective rate of **31.4%.** A gain of €8m in the UK would attract CGT of €800,000, an effective rate of **10%.**

We welcome the commitment in the Programme for a Partnership Government to reduce the rate of CGT for new start-ups to 10% on gains of up to €10 million. We understand that this is a reference to the enhancement of the Revised Entrepreneur Relief and that it would therefore also apply to the wider SME sector (and not just to start-ups).

INSTITUTE RECOMMENDATION:

As set-out in the Programme for a Partnership Government, we believe that;

- The preferential rate of CGT should be reduced from 20% to 10%.
- The lifetime limit of chargeable gains should be increased from €1,000,000 to €10,000,000.

EMPLOYMENT AND INVESTMENT INCENTIVE

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 3 years if certain conditions are met.

There are a number of criteria that must be met by both the investor and the company, in order 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 3 years to 4 years
- The definition of qualifying trade was extended to include Internationally Traded Financial Services and the operation of certain nursing homes.

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

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.

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.

INSTITUTE 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.

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 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.

Irish Tax Institute

Leaders in Tax

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 welcome the commitment in the Programme for a Partnership Government to *"explore the mechanisms through which SMEs can reward key employees with share options in a tax-efficient manner"*.

The Institute made a very detailed submission to the Department of Finance's recent public consultation on the *Taxation of Share Based Remuneration*. Our submission sets-out the challenges faced by SMEs in accessing the current share based remuneration regime and we make a number of practical recommendations on how to increase the participation of SMEs in the regime. The key recommendations are summarised below.

INSTITUTE RECOMMENDATION:

- A targeted SME share option scheme should be introduced in Budget 2017. Under the scheme, no tax would be payable on the exercise of qualifying share options, instead CGT would only be paid on the ultimate disposal of the shares. Entrepreneur Relief should be available on disposal of the shares where the relevant conditions are met. Our current rules on share buybacks should be amended to allow share buybacks by the company qualify for CGT treatment.
- Greater flexibility is required in the current APSS and SAYE schemes by removing the requirement to offer shares to all employees on similar terms. This is important because an employer often wants to allocate shares to key performing personnel. Consideration should also be given to removing the income tax and USC charge on the allocation of shares to the APSS/SAYE trusts.
- The administration of share schemes needs to be simplified:
  a) Clearer guidance on share valuation methodologies and safe harbours to minimise uncertainty, developed from joint fora between Revenue, business and tax advisers.

CONTD OVER

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

INSTITUTE RECOMMENDATION CONTD:

- **b)** Requiring one employer return form providing information on share based remuneration. This would also be an efficient mechanism for collecting data on the use and prevalence of share based pay.
  c) Aligning the administration of share options with other share based pay by collecting tax on the exercise of an option through the payroll, rather than via the RTSO1 self-assessment procedure.
  d) Aligning the income tax return filing date for vested RSUs with the normal "pay and file" income tax return date.

"BEST IN CLASS" INNOVATION OFFERING

As a result of changes to the global tax framework, thousands of companies across the world are reviewing their operations in different countries to ensure they meet OECD and EU standards. Many companies are looking at alternative jurisdictions in which to centralise their innovation activities and as a result, countries are reviewing their overall innovation offering to attract this business. This huge global review by multinational companies provides a unique opportunity for Ireland to expand the hub of innovation activity that is located here, with important spill-over effects for the Irish economy generally. The aim is to have a Best in Class offering which, very importantly, complies with EU and OECD requirements.

In recent years, a number of important changes have been made to enhance Ireland's Innovation Tax offering; the introduction of the Knowledge Development Box ("KDB"), improvements to the R&D Tax Credit and capital allowances for Intellectual Property ("IP"). We welcome all these changes and the Government's commitment to fostering innovation in Ireland which it sees as *"critical to our new economic model"*[6].

As competition for global innovation activity intensifies post-BEPS, what is important now is that all the separate elements to our innovation offering form a fully complementary suite and that any unnecessary 'blockers' are removed. Ireland's innovation tax incentives have been introduced gradually and separately over a number of years and the various pieces of legislation were designed in a pre-BEPS era. It is now important to revisit this legislation to ensure that;

- All parts of the offering work in tandem, thus providing companies with a competitive and stable tax regime throughout the various stages of their IP lifecycle; and
- In doing so, the separate elements comply with the OECD BEPS and EU rules and reflect the way in which companies will be structuring their global innovation activities for the future.

6 Minister for Finance, Michael Noonan – Budget 2016 speech, 13 October 2015

As part of the Institute's Finance Bill 2016 submission in June 2016, we made a number of recommendations to achieve these aims, which are set out in detail in the Appendix to this submission.

INSTITUTE RECOMMENDATION:

- To compete with other 'best in class' IP regimes our KDB should be extended to include any gains arising on the disposal of qualifying IP.
- The restrictions on external outsourcing which apply currently to the R&D Tax Credit regime should be removed and an element of group outsourcing costs should also be allowed, bringing it in line with the KDB.
- Certain specific amendments are required to Sections 291A and 757 TCA 1997 as set out in the Appendix.

TAX TREATMENT OF EXPENSES ON TRAVEL AND SUBSISTENCE

The current tax treatment of travel and subsistence expenses is giving rise to significant uncertainty for both companies and individuals.

S114 TCA 1997

In September 2015, the Institute made a detailed submission to the Department of Finance *Public Consultation on the Tax Treatment of Expenses of Travel and Subsistence for Employees and Office Holders* in which we called for a redrafting of S114 TCA 1997 to ensure alignment of the tax rules relating to travel and subsistence expenses with modern day working practices.

No feedback has been published on the consultation to date. Our members have continued to express concern about the lack of certainty and consistency in this area, which is creating uncertainty for a wide cohort of taxpayers, particularly;

- Contractors
- Freelance workers
- Individuals working from home
- Employees working across multiple locations
- Virtual office workers
- Domestic and overseas secondees
- Site based workers

We are also aware that Revenue is focussing heavily on travel expenses in the construction sector and in eBrief 33/16 (issued in March 2016), Revenue noted that it is applying a strict interpretation on the payment of country money.

This is a pressing matter for our members. It is critical that S114 TCA 1997 is revisited to provide much needed certainty for all parties.

NON-EXECUTIVE DIRECTORS

On the specific issue of travel and subsistence expenses for non-executive directors ("NEDs"), the Institute welcomed the introduction of S195B TCA 1997 in Finance Act 2015 which deals with payments to non-resident NEDs. This legislative change will help to attract top executive talent to the boardrooms of Irish companies.

However, difficulties remain for Irish-resident NEDs. Since Finance Bill 2015, there has been disquiet expressed about the difference in tax treatment between resident and non-resident NEDs who are effectively performing the same functions. This leads to a situation where two NEDs (say one from Cork and one from Belfast) travelling to a board meeting in Dublin could now be treated differently for tax purposes.

NEDs in Irish companies fulfil an equally important role, whether they are Irish resident or non-resident:

- Indigenous start-ups rely on the expertise of NEDs to guide them through the early stages of their development.
- Irish companies expanding cross-border often have key board meetings overseas which Irish resident NEDs will need to attend.

In both of these cases, the reimbursement of travel expenses to these NEDs would be subject to tax. It is important that the tax position does not act as a barrier to accessing the expertise of Irish resident NEDs.

INSTITUTE RECOMMENDATION:

- S114 TCA 1997 should be re-drafted so that expenses incurred for business purposes which do not provide a personal benefit to the employee, can be reimbursed without deduction of tax.
- The provisions of S195B TCA 1997 should be extended to include payments made to Irish-resident NEDs.

CGT PAY & FILE

The current self-assessment system for the payment of capital gains tax ("CGT") and filing the associated tax return is complex. The system's main components are as follows:

- For gains arising in the period from 1 January to 30 November (the "initial period"), the CGT must be paid by 15 December in the same tax year.
- For gains arising in the period from 1 December to 31 December (the "later period"), the CGT must be paid by 31 January in the following tax year.
- A return of chargeable gains must be made on or before 31 October in the year following the year of assessment.

This process is inefficient for two main reasons;

- Firstly, a taxpayer must look at CGT related affairs three times in a 12-month period.
- Secondly, the computation of the CGT liability can be a complex process which, especially for larger commercial transactions, needs input from a number of parties. This means that taxpayers are faced with significant time-pressure to calculate CGT due, particularly for disposals arising in November and December.

One of the primary benefits of the current regime from an Exchequer perspective is that CGT payments in respect of 11 months' transactions are received in December each year. Historically, there has been a greater exchequer reliance on CGT receipts. For example, at its peak in 2006, CGT receipts of €3.1 billion accounted for 6.8% of total tax receipts.

However, we have seen a significant decline in CGT receipts since then. In 2015, CGT receipts were €692 million, making up just 1.5% of net tax receipts. Any deferral of the CGT payment date would therefore have a lesser impact on Exchequer cash-flow.

INSTITUTE RECOMMENDATION:

- The CGT payment date for all disposals should be deferred until October in the following tax year to ensure alignment with the income tax return filing date.

GLOBAL TAX REFORM

Ireland has actively engaged from the outset in the global tax reform debate and the development of proposals at the OECD and the European Commission. The Institute welcomes the steps taken by the Government to engage on these matters whilst ensuring that Ireland's competitiveness and tax sovereignty is maintained. This has been particularly evident during recent discussions on the EU Anti-Tax Avoidance Directive ("ATAD").

Most elements of the ATAD must be transposed into domestic legislation by 1 January 2019, although Member States may derogate on the implementation of the provisions concerning exit taxes (no later than 2020) and interest deductibility (no later than 2024). As the Department notes, the ATAD is being implemented in a "timeline that allows businesses to plan ahead[7]".

The implementation of the ATAD will present complexities for the Government and for companies, both in terms of the transition to the new rules and the interaction with existing legislation. Early engagement with stakeholders will be an important part of this process.

7 http://www.finance.gov.ie/news-centre/press-releases/minister-noonan-welcomes-agreement-anti-tax-avoidance-directive

REFORM OF THE BUDGETARY FRAMEWORK

We welcome the Government's commitment in the Programme for a Partnership Government to reform the budgetary framework.

"We are proposing substantive political and constitutional reform in order to create a strong and responsive political system. ***Greater openness, improved accountability and delivery, and more effective public participation are at the core of our vision****"*[8].

Good progress has taken place in Ireland in developing stakeholder engagement on tax policy issues. In recent years, the Government has published papers on various elements of Ireland's tax system on Budget day, whilst also releasing feedback statements on recent consultations. Further steps positive steps have been taken in the run up to Budget 2017, through the early release of the Tax Strategy Group papers and the publication of the Income Tax Reform Plan. We believe that these good principles should be extended to engagement on the resulting draft legislation to support these policies to minimise the possibility of unintended consequences arising in the detail of the law.

The Finance Bill cycle, a critical component of the budgetary framework, is the process through which Ireland's domestic tax legislation is designed and for this reason it is a very important matter for our members. In June, we made a comprehensive submission to the Oireachtas Committee on Arrangements for Budgetary Scrutiny in which we put forward a number of workable suggestions on how the Finance Bill process could be improved. We enclose a copy of this submission for your reference.

The Institute fully recognises the challenging environment in which the Finance Bill process takes place, most notably the time constraints imposed by the EU's Two-Pack rules, and our recommendations have been developed with these parameters in mind. We also appreciate that much of the work concerning the Budget 2017 cycle is already in progress and so our comments relate to the Budgets thereafter.

INSTITUTE RECOMMENDATION:

- There is merit in changing the current approach to the Finance Bill process so that it is formed through a sum of parts approach which have been consulted upon in advance, rather than through the development of an inseparable block of legislation.
- Draft legislation should be published in advance on an issue by issue basis (similar to the consultation process on the underlying tax policies). We fully appreciate that it would not be possible to consult on certain tax sensitive measures.

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8 Programme for a Partnership Government

Appendix - Innovation Tax Incentives

Extract from the Irish Tax Institute's Finance Bill 2016 Submission (June 2016)

KNOWLEDGE DEVELOPMENT BOX – APPLICATION TO GAINS

In setting out the initial proposals for the Knowledge Development Box ("KDB") in January 2015, the government committed to introducing a *"best in class offering"*[9] which would comply with the relevant OECD and EU requirements on income-based IP regimes.

The KDB is compliant with the OECD's modified nexus approach, an approach which has also been endorsed by the EU's Code of Conduct Group (Business Taxation). However, in some areas, the KDB is not fully aligned with the parameters permitted by the OECD. For example, the OECD's final report 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"*[10]

The 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 ("CGT") at a rate of 33%.

Ireland was one of the first countries to introduce a modified nexus based IP regime and we commend the Department for acting so quickly on this. Since then, we have seen other jurisdictions, such as the UK and Spain publish legislation on their own OECD-compliant regimes. Both of these regimes permit the inclusion of gains arising on the disposal of IP. As countries position themselves as locations for IP, it is important that Ireland's KDB is at least on a par with other jurisdictions.

INSTITUTE RECOMMENDATION:
To ensure that the KDB is 'best in class', we believe that the definition of 'overall income from the qualifying asset' in S.769G TCA 1997 should be extended to include "any gains or other sums in respect of the disposal of that qualifying asset".

9 Knowledge Development Box Consultation Paper, January 2015
10 OECD's BEPS Action 5 Report *"Countering harmful tax practices more effectively taking into account transparency and substance"*, October 2015

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. The OECD;

- Did not deem it necessary to restrict the inclusion of third party outsourcing costs as *"it is unlikely that a company will outsource the fundamental value-creating activities to an unrelated party"*.[11]
- Provided for an uplift of up to 30% in respect of costs incurred on related-party outsourcing (and acquired IP) in recognition of the fact that a company which outsources R&D to related parties *"may themselves still be responsible for much of the value creation that contributed to the IP income"*.[12]

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. In a post-BEPS world, it is important that Ireland has a competitive R&D regime which reflects how businesses structure their global R&D operations. The removal of the outsourcing restrictions is key to achieving this.

INSTITUTE RECOMMENDATION:

- Subject to certain safeguards being put in place, the outsourcing restrictions in subsections (vii) and (viii) of S.766(1) TCA 1997 should be removed.
- An uplift of up to 30% should be available in respect of costs incurred on related-party outsourcing.

11 OECD's BEPS Action 5 Report *"Countering harmful tax practices more effectively taking into account transparency and substance"*
12 OECD's BEPS Action 5 Report *"Countering harmful tax practices more effectively taking into account transparency and substance"*

RESTRUCTURING OF GROUP IP

As mentioned above, a number of the BEPS proposals may result in companies restructuring their IP activities.

For example, companies looking to avail of the KDB will need to ensure that the R&D activities and the commercialisation of the resulting IP are located in the same legal entity. We believe that a number of changes should be made to existing legislation to facilitate the restructuring of IP within groups.

(i) S.291A TCA 1997 – IP ALLOWANCES

Currently, companies are precluded from claiming IP allowances under S.291A TCA 1997 on IP acquired from a group company where the transferor claims relief from CGT under S.615 or S.617 TCA 1997. 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.

INSTITUTE RECOMMENDATION:
We believe that S.291A(9) TCA should be repealed to allow for the continuation of S.291A relief following an intra-group transfer of IP.

(ii) S.757 TCA 1997 – PATENT RIGHTS

Legislation distinguishes between the tax treatment of proceeds arising on the disposal of patents and patent rights.

- Any gain arising on the disposal of a patent is treated as a disposal of a capital asset and is subject to CGT.
- Any gain arising on the disposal of patent rights is treated as Case IV income under S.757 TCA 1997 and, as such, is subject to corporation tax of 25%.

As patent rights are not within the charge to CGT, it means that there is no group relief mechanism on the transfer of patent rights within a group.

S.757 TCA 1997 was introduced in 1967 to ensure that receipts arising on the disposal of certain patent rights could be earned tax-free. CGT legislation was introduced in 1975, thus eliminating the necessity for the standalone provisions in S.757 TCA 1997.

INSTITUTE RECOMMENDATION:
S.757 TCA 1997 should be repealed and patent rights should be treated akin to any other chargeable asset, subject to CGT.

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