Oireachtas Sub-Committee

Module on Effective Tax Rates

Opening Comments by Cora O'Brien, Policy Director, Irish Tax Institute

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Introduction

Chairman, members of the Committee, good afternoon.

Thank you for your invitation to appear before the Committee on the issue of effective corporate tax rates. We appreciate that the Committee has invested a lot of time on this issue, and that others have made contributions to this module and to the general public debate on effective tax rates.

The Irish Tax Institute has not published a specific report on effective corporate tax rates (or effective CT rates as I will refer to them). However, I hope that our experience, our knowledge and research will offer some insights and bring a greater understanding to an issue that is complex, detailed, and very often difficult.

The debate on effective tax rates is part of the wider debate on international tax issues.

There is a lot of focus on the matter in Ireland, given the high level of FDI in this country, in particular by US companies. The fact that US tax residence rules differ from the tax rules of most other countries internationally has led to many of the tax complexities (or issues) that are now at the centre of the tax debate globally.

Before talking about attempts to measure the effective CT rates of a country I would first like to focus on the principles of an effective corporate tax rate in a company - I think that will help bring some context to our discussion.

Focus on Company Effective Tax Rates

The 'effective' rate of tax is generally understood to refer to the tax arising for a company as a percentage of the profits of the company. The effective CT rate factors in the various deductions and reliefs a company is fully entitled to claim before it applies the 12.5% rate in Ireland's case (or indeed the 25% rate on investment income and the 33% rate on gains).

The majority of studies show that the effective CT rate here is generally very close to 12.5%, as there are few deductions and reliefs within our corporate tax regime.

We have built our corporate tax strategy on having an attractive low transparent 12.5% rate which is simple to understand and to administer for companies operating in Ireland and subject to tax here.

In principle, the calculation of an effective CT rate is <u>somewhat</u> akin to the calculation of an effective personal tax rate. A person could pay tax at the standard tax rate, yet his or her effective tax rate will be somewhat lower.

Under Irish tax law, a person will see their overall income tax bill reduced when he or she factors in medical expenses, rent relief, mortgage interest relief, tax credits, and many other items.

So it is the same in principle with effective corporate tax rates, albeit more complex.

Some of the negative coverage of the Irish tax system in recent times has been the suggestion that Ireland has an effective rate of tax of around 2% - implying that global companies in Ireland can 'secure' so to speak a 2% effective corporate tax rate if they are based here.

I believe the difficulty and confusion of the effective tax rate issue, comes from the mixing of legal rules on incorporation, with tax rules. Just because a global company is legally entitled to be incorporated in a country, such as Ireland, does not mean that it is taxed on all its global profits in Ireland.

It is only liable to be taxed in Ireland on the activities that are subject to Irish tax under rules recognised and accepted not just in Ireland but by other countries internationally (and the OECD).

A company may be incorporated in Ireland but the management and control of that company may be located elsewhere which means that under Irish tax laws the company is not liable to Irish tax on the foreign income. Ireland's residence rules have been in place since 1922, would not be regarded as being unusual and would be consistent with many international countries and indeed the model OECD treaties.

A global company based in Ireland, that is US in origin and US owned could have operations in 20 different countries and derive its sales and income from 70 countries worldwide. Incorporation in Ireland does not automatically mean tax residency in Ireland and does not mean entitlement to the profits from those 70 countries. Where a company is not Irish tax resident, Ireland can only legally lay claim to the tax that arises from relevant activity in Ireland.

Taking an Irish incorporated company's total global tax bill and dividing it by its total global profit in an attempt to estimate an Irish based effective corporate tax rate from it, is incorrect and distortionary.

Trying to extrapolate an overall Ireland effective corporate tax rate from these company figures is also distortionary and incorrect.

The effective corporate tax rate of a company is a mathematical computation; arrived at by virtue of the activity of a company and the application of the tax rules that are relevant to that exact activity in each jurisdiction in which the company operates.

Country Effective Tax Rates

In my comments so far I have dealt with the principle of calculating the effective corporate tax rate of a company.

However, calculating the overall effective tax rate for a country, whether it's Ireland or anywhere else, is a very complex matter. There is no agreed definition of what a country's effective tax rate means or how to calculate it. And for this reason, it is open to many interpretations. The Department of Finance Technical Paper of April 2014 has reviewed 8 different approaches using three different model types.

There is no single, internationally agreed, methodology in calculating effective rates of corporation tax for a country. As a result we have seen a variety of conflicting answers where different methodologies are applied to different data sources.

While acknowledging that there is no agreed definition of a country's effective CT rate it concludes 'that the approaches based on national aggregate statistics are the most suitable'. It cites the work on Effective Tax Rate on 'Net Operating Surplus' and 'Tax Due' as a Proportion of Taxable Income; Approach No. 3 and 5 in the report – which deliver an average effective corporate tax rate of 10.9% and 10.7% respectively.

Companies operating globally can have a combined low global effective tax rate, however you cannot attribute that rate to any one country - you cannot say that this is the effective tax rate of that country.

US BEA data that suggests a 2% effective rate for Ireland is incorrect. For example; the US BEA data provides a combined global tax rate for companies that were incorporated in Ireland, are US owned but operate in dozens of countries around the world. In reviewing this data, the Department of Finance concluded:

> "The BEA data does highlight the ability of certain US companies to achieve very low effective rates for the foreign tax paid on their non-US sourced profits arising from their operations across multiple jurisdictions (including Ireland) but cannot give an appropriate measure of the effective corporate tax rate applying on their Irish profits".

Concluding Remarks

At the outset I acknowledged that the debate on effective corporate tax rates is part of a far wider debate on international tax rules. This is what the OECD's BEPS project is all about.

The Irish Government is playing its part in this process. We issued an International Tax Strategy last October, setting out our position on international tax and emphasising the three key strands to our corporation tax strategy – Rate, Regime and Reputation. We currently have a separate Irish consultation launched by the Department of Finance on "BEPS in an Irish Context".

The Institute is also very engaged in this work. We highlighted many of the issues concerned in our Global Tax Policy Conference held last October in Dublin, we have made several submissions to the OECD and we have met with Pascal Saint Amans, Director of the OECD's Centre for Tax Policy and Administration, at OECD Headquarters in Paris last month.

I appreciate that there are many views on the international tax rules that exist at present and on corporate tax issues in general.

The OECD, through its BEPS Project, is working with member countries on its action plan to address what is accepted as outdated rules which have not kept pace with an increasing globalised and digitalised world.

The Department of Finance consultation gives Ireland and its stakeholders a forum in which we can make a real and honest assessment of all the issues relating to BEPS and the impact on Ireland and our future.

Global investment is highly competitive and will always remain so; we must be acutely aware that other countries will look to fiercely highlight their own competitive tax advantages if there are perceived weaknesses amongst others.

There are many strands to Ireland’s overall tax strategy, from regime to rate and reputation. They must all receive the focus and attention which is warranted if we are to play our part in the BEPS process, but also if we are to make the best decision for Ireland and its future.

I hope today’s presentation and discussion will help bring some light to some of the issues involved in that process and I thank you for your time here today.

ENDS