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Minister Paschal Donohoe TD
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Re: Consultation on OECD International Tax Proposals

Dear Minister

The Irish Tax Institute welcomes the opportunity to share its members' views on the proposed changes to the international tax architecture currently being discussed at the OECD/G20 Inclusive Framework on BEPS ("the Inclusive Framework").

While we are most anxious to be helpful in this regard, the lack of detail, particularly in relation to the global minimum tax rate, makes it difficult to offer technical recommendations.

Notwithstanding the Statement[1] agreed at the Inclusive Framework meeting on 1 July, the final shape of any agreed reform process is wreathed in uncertainty and contingent on the outcome of the US legislative process. The OECD Blueprints on the Pillar One[2] and Pillar Two[3] proposals have been overtaken by the US tax proposals which emerged in the spring and the 5-page Statement published following the Inclusive Framework meeting raises as many questions as it provides answers.

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[1] Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy – 1 July 2021 (oecd.org)
[2] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
[3] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

However, there are a number of broad observations we want to make on the process itself and the Government's approach to it, as well as the potential impact of the proposals on Ireland's economy and their implications for the Irish tax code and industrial policy.

Government's Approach

We agree with the Government's decision not to sign up to the draft agreement until there is more clarity on the proposals and how they are to be implemented. The potential impact of the proposed reforms is more detrimental to Ireland than to most of the countries that have signed up to the draft agreement. The 12.5% corporation tax rate has been a critical factor in the development of the modern Irish economy over the last 25 years and it should not be lightly tossed aside for a global minimum rate which has been loosely pegged at a rate of "at least 15%" for the purposes of the Global Anti-Base Erosion (GloBE)[4] rules under Pillar Two.

In fact, the Pillar Two proposal concerns effective tax rates, not statutory corporate tax rates. This makes it very difficult to truly assess the impact of the proposed agreed global minimum rate when the tax base on which it would be computed is not yet known and agreed. Nonetheless, it is important that the Government continues to engage in the process and use its voice as a member of the Inclusive Framework to seek to influence the outcome.

The Government's working assumption is that the changes proposed under Pillar One alone, will cost the Exchequer approximately €800 million to €2 billion a year in corporation tax receipts. In these circumstances, it is entirely sensible for the Government to reserve its position until more details emerge from the OECD/G20 process and, more particularly, from the US legislative process which could yet derail the entire reform project.

Importance of the 12.5% rate

The 12.5% corporation tax rate has provided certainty and stability to the many global and indigenous businesses that have set up in Ireland over the last 25 years. Ireland has built other strengths during that time, such as its educated and highly flexible workforce, and its pro-business environment. These factors, as well as being an English-speaking member of the EU makes Ireland an attractive location for those big companies that are now embedded here. But there is little doubt that the introduction of a globally agreed minimum rate of tax could raise challenges to the competitiveness of Ireland's long established and highly successful model of attracting foreign companies to this country.

In public discourse, Ireland's low corporation tax rate has, understandably, become synonymous with large, foreign-owned multinationals. But the rate equally applies to all Irish businesses, and though they are not big contributors to the State's corporation tax take,

[4] The Pillar Two Global Anti-Base Erosion (GloBE) rules refers to two interlocking rules: (i) an Income Inclusion Rule (IIR) and (ii) an Undertaxed Payment Rule (UTPR).

small indigenous companies also benefit from the competitive rate and account for close to 70% of employment in Ireland.[5] Irish SMEs should not be disadvantaged arising out of proposals that are targeted at large multinationals that operate across multiple jurisdictions.

The impact of the OECD international tax proposals and the US tax reform proposals is likely to be very significant for Irish indigenous companies, including SMEs and PLCs who operate overseas depending on the final design of such proposals. In this context, the timing and sequencing of the OECD/G20 deliberations and the US legislative process will be critical. In fact, it would be important that an EU Directive to implement any further corporate tax reform measures within the EU would not be progressed until both processes are concluded and fully understood.

OECD Pillar One Proposal

The technical architecture of the Pillar One proposal outlined in the OECD Blueprint published in October 2020 has now been completely upended by the Inclusive Framework Statement agreed in July 2021.

Threshold

The July Statement provides that multinational enterprises with global turnover above €20 billion and profitability above 10%, will be within scope of the new taxing right and profit allocation rules. However, only limited information on how this measure will operate in practice has been provided to date, making it problematic for stakeholders to comment further at this time.

The Statement contends the turnover threshold may be reduced to €10 billion after 7 years, contingent on the successful implementation of the new “Amount A” profit allocation to market countries. Such a threshold reduction would significantly increase the scope of the measure before ample time has been given to assess whether it tackles the stated policy objective of addressing the tax challenges of digitalisation. Indeed, how the existing BEPS rules agreed in 2015 have bedded into the international tax framework has not yet been adequately evaluated.

Segmentation of financial data

It is also unclear from the proposal as to how segmentation of financial data will work. The Statement provides that segmentation will occur only in exceptional circumstances where a segment meets the scope rules. But consideration needs to be given to where different

[5] OECD (2019), *SME and Entrepreneurship Policy in Ireland*, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris.

business segments of a company and group have different profitability levels and how this will be administered.

Elimination of double taxation

The Statement confirms that double taxation of profits allocated to market countries will be relieved using either the exemption or credit method. Ireland currently operates a credit system for foreign tax which is often administratively complicated and cumbersome to avail of. Careful consideration will need to be given as to how Ireland would eliminate double taxation if allocating profits to certain market countries. For example, it is unclear how credit would be obtained at an individual entity level under the Pillar One mechanism.

It will be important to ensure the Irish competent authority is adequately resourced to deal with the inevitable increase in disputes regarding double taxation. Consideration must also be given to the approach to be adopted in respect of jurisdictions which may have more limited experience in dispute resolution.

Removal of DSTs

It is welcome that the Statement confirms that the Pillar One package will provide for the removal of all Digital Service Taxes (DSTs) and other relevant similar measures on all companies. However, uncertainty remains as to whether all DSTs and similar measures will be rolled back if Pillar One is agreed and implemented.

For example, there are indications that the UK's Diverted Profits Tax may continue to apply, even though its stated purpose is to target multinationals entering into arrangements to shift profits from the UK, similar to the policy objectives contemplated under Pillar One.

The European Commission has announced it will put on hold its proposal for a digital levy as a new own resource during this period of negotiation at the OECD/G20. However, recent comments from the Commissioner for Budget and Administration, Johannes Hahn, suggest that the Commission may look to push forward these proposals after the October Inclusive Framework meetings no matter if there is agreement or not on the Two Pillar plan. This initiative, if persisted with, could seriously undermine the commitment of other countries to remove their DSTs and other similar measures, as part of the implementation of Pillar One.

It is evident that there are many unknowns and uncertainties in relation to Pillar One. Further consultation will be necessary with stakeholders as more technical detail emerges in the coming weeks and months.

OECD Pillar Two Proposal

Effective Tax Rate (ETR) test and timing differences

The Pillar Two proposal provides for an ETR test for the purpose of applying a globally agreed minimum tax rate. The Statement confirms that the ETR calculation will be on a jurisdictional basis and use a tax base determined by reference to financial accounting income. It also refers to agreed adjustments and mechanisms to address timing differences without providing any further detail on how this would be achieved. Undoubtedly, the jurisdictional approach contemplated will create a significant additional compliance burden that will be hugely time-consuming and complicated to administer.

The use of the tax charge (including deferred tax) in the financial statements to calculate the tax attributable to the period is an approach that would fit with the adoption of accounting principles in measuring the tax base. The combination of the current and deferred tax amounts for a period should capture many of the timing and permanent differences between the accounting and taxable measure of profits of a multinational group across the jurisdictions in which it operates.

When estimating the ETR on a jurisdiction-by-jurisdiction basis, the adjustments agreed to measure the tax base using accounting principles must also recognise the diverse design elements of tax regimes in different countries, to ensure that a multinational group's ETR in a relevant jurisdiction can be estimated as closely as possible. Failure to recognise such differences could result in the estimated ETR being wholly inaccurate.

We believe deferred tax accounting needs to be incorporated if accounting standards are applied to measure the tax base for the purposes of the GloBE rules under Pillar Two, to address the problem of timing differences.

Treatment of the R&D tax credit

Ireland, like many other countries, has chosen to incentivise R&D activities through the availability of a tax credit, while other jurisdictions encourage such activities through direct government funding, via grants or by offering 'super' deductions for R&D expenses.

Companies that are incentivised to carry out R&D, through tax incentives should not be penalised under the Pillar Two proposal. Equally, businesses that are encouraged to invest in green initiatives to tackle climate change through tax incentives, must not be negatively impacted under the GloBE proposal, even if such incentives result in a low ETR.

Substance based carve-out

The Statement indicates that the GloBE rules will incorporate a formulaic substance based carve-out which will operate to exclude an amount of income based on a percentage[6] of the carrying value of tangible assets and payroll.

Recognition should also be given under GloBE for the valid BEPS Action 5 approved practices, which the OECD has deemed not to be harmful preferential regimes, such as, Ireland's Knowledge Development Box. This means the substance based carve-out should also include a percentage of the carrying value of intangible assets in line with the OECD's modified nexus approach, which requires a direct link with substantial activity.

Subject to Tax Rule

The Statement suggests that Inclusive Framework countries would implement the treaty-based, Subject to Tax Rule (STTR), which provides for source taxation on certain related-party transactions subject to tax below a minimum rate, into their bilateral treaties with developing countries when requested to do so. If implemented, we would suggest Ireland follows this approach and only considers including the STTR into Irish tax treaties with developing countries upon request.

Mechanism for implementation

The Statement contends that the GloBE rules will have the status of common approach in contrast to Pillar One, which will be mandatory and implemented through a multilateral instrument. The Statement outlines that the GloBE rules will include mechanisms to facilitate over time the coordination of the rules that are implemented by individual member countries of the Inclusive Framework and suggests the possible development of a multilateral instrument for that purpose.

There needs to be certainty that the GloBE rules will be implemented consistently by Inclusive Framework members if a global consensus is reached. In our view, the best way to achieve this and avoid differing rules across jurisdictions would be through the implementation of a multilateral instrument.

US Tax Reform Proposals

In general, the US tax reform proposals, as they stand, could have a more significant impact for Ireland than the OECD international tax proposals. However, there is no certainty about which will be agreed first or indeed whether the US Congress will reach any agreement at

[6] According to the Statement this would be at least 5% but in the transition period of 5 years, at least 7%.

all. In fact, for the OECD Pillar One proposal to be implemented in the US would require amendments to US tax treaties, which would also need Congress approval.

It is important to point out that we cannot advise on how to mitigate the impact of these reforms until we know the details of the changes that may be agreed by Congress to the Global Intangible Low-Taxed Income (GILTI) rules and the likely imposition of the Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD) provision.

It looks possible that the GILTI rate will increase and will be calculated on a country-by-country basis instead of the current global blended approach and that the current substance based carve out in respect of adjustments for qualified business asset investment (QBAI) may be eliminated. However, uncertainty surrounding how foreign tax credits will be treated going forward for the purposes of GILTI could result in a much higher effective tax rate than the new GILTI rate.

In fact, the recent discussion draft[7] published by US Senate Finance Committee members refers to a country-by-country high tax exclusion system under GILTI but is unclear how this would interact with the OECD GloBE rules in Pillar Two.

The Senators also noted they are considering integrating aspects of the US Administration's SHIELD proposal into the existing Base Erosion Anti-Abuse Tax (BEAT) measure, rather than implementing the new proposal. This could result in changes to BEAT becoming effective much earlier than anticipated.

Whatever the final outcome, it is undeniable that the implications for the cost of investment to the US and from the US are likely to be substantial for Ireland. The co-existence of GILTI with the Undertaxed Payment Rule (UTPR) in the Pillar Two GloBE measures will be crucial.

If Congress does reach an agreement in the late autumn, the US reforms could be implemented before the proposed effective date for the OECD measures in 2023. In that event, we would strongly recommend that the Department adopts a flexible approach which would allow it to legislate outside the normal Finance Bill cycle so that mitigation measures to alleviate the impact of agreed changes on affected businesses could be implemented speedily.

Tax Certainty

Tax certainty is critical to business and investors. When the 12.5% corporation tax rate was introduced, a commitment was given by the then Government that the rate would be in place until 2025. That commitment has remained over the last 25 years and Government agencies

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[7] International Tax Reform Framework Discussion Draft, published by US Senate Finance Committee Chair Ron Wyden, D-Ore., Senator Sherrod Brown, D-Ohio, and Senator Mark Warner on 25 August 2021.

have used the certainty and stability of Ireland's regime to great effect in promoting Ireland and encouraging inward investment. It is crucial that whatever emerges from the global reform process, the Irish policy response should bring long-term certainty and clarity to business.

Competitiveness

Throughout this long running reform process the Minister for Finance has been steadfast in his defence of tax competition as a legitimate tool for small economies. While an agreed global minimum tax rate would significantly reduce the scope of competition in corporate tax, there are other ways in which the Government can improve the tax system and make Ireland an attractive place to do business.

For example, we need to ensure that Ireland's R&D tax credit remains best in class if we want to continue to attract additional R&D investment in this country.

The implementation of a global minimum tax rate, on top of the adoption of extensive ATAD measures, including controlled foreign company rules, to protect against foreign base erosion risks, diminishes the need for a worldwide corporate tax system. We urge the Government to proceed with the promised consultation to consider moving to a territorial corporate tax system with a participation exemption for dividends and foreign branches, without further delay.

A simple tax code that is easy to administer are key characteristics that should underpin any effective tax regime. A Commission on Taxation and Welfare has been established and now is the time to review our tax code and consider what changes are needed to enhance Ireland's competitiveness. For example, is now the time to remove Ireland's schedular tax system and different corporation tax rates? The headline rate of the Irish Capital Gains Tax (CGT), at 33%, is high by international standards. As the CGT rate is a deciding factor for potential investors, if we want to attract investment in business, should we reduce it for active business assets?

The Institute looks forward to engaging with the Commission on Taxation and Welfare on these important issues. A clear, simple, and efficient tax system would not only benefit business, it would also increase compliance.

Industrial Policy

The final question in the consultation document relating to Ireland's wider industrial policy and issues arising from the OECD international tax proposals is arguably the most pertinent of all in the consultation. The principle of a global minimum tax rate is now agreed, even if the rate and details as to the tax base remain nebulous.

Foreign direct investment will remain an important part of Ireland's economy, as a small exporting nation. We need to continue to develop an innovative, productive, indigenous SME sector. Ireland already has some excellent examples of world class domestic businesses, but the country needs more of them.

The Government should act on the reports and recommendations from diverse authorities, including the OECD, the IMF, and the European Commission to create a vibrant SME sector that will provide good quality jobs and pay taxes to fund the high-quality public services that citizens expect.

Above all else, we need a mind shift among policymakers that allows us to trust our capacity to build the kind of high-performance indigenous business sector that we have been so successful in attracting into Ireland over the last 25 years.

Conclusion

Uncertainty about the OECD/G20 process is impacting investment decisions in businesses around the world. Ireland needs a global agreement that will resolve the tax issues caused by digitalisation and globalisation and bring stability to the international tax system. The alternative is a plethora of unilateral measures which would ultimately be more detrimental to the Irish economy.

Ireland's competitive and transparent corporation tax rate is worth fighting for but ultimately, Ireland will have to adapt to whatever global settlement emerges from the OECD/G20 process. That will require quick and decisive action over the next twelve months to make whatever changes are required to the Irish corporation tax code to maintain competitiveness of the economy and protect businesses trading in and out of Ireland.

Yours sincerely

Karen Frawley
Institute President