



TITHE AN OIREACHTAIS

**An Comhchoiste um Airgeadas, Caiteachas Poiblí agus
Athchóiriú**

***Tuarascáil ar an nGaol atá ag Éirinn leis an Ollstruchtúr
Cánachais Corparáide Dhomhanda***

Nollaig 2014

HOUSES OF THE OIREACHTAS

**JOINT COMMITTEE ON FINANCE PUBLIC EXPENDITURE
AND REFORM**

***Report on Ireland's Relationship with
Global Corporate Taxation Architecture***

December 2014

31/FPER/024

Contents

Introduction	3
Summary Findings and Recommendations	5
Section 1: Ireland’s Tax Regime Compared Internationally	7
The Evolution of Ireland’s Corporation Tax Regime	7
Contribution of Corporation Tax to Tax Revenue and US MNCs to the Economy	9
The Tax Haven Question	11
Section 2: The Effective Rate of Corporation Tax in Ireland.....	13
Estimates of the Effective Rate of Corporation Tax.....	13
The Calculation of Taxable Income in Ireland.....	14
Estimating the Effective Rate of Corporation Tax in Ireland from US BEA Data	16
Section 3: Ireland’s Corporation Tax Rules and their Application	18
The Negotiation of Special Rates of Corporation Tax.....	18
The Application of Ireland’s Residency Rules	18
EU State-Aid Investigation	20
Section 4: The International Environment.....	21
The OECD’s BEPS Initiative.....	21
Transfer Pricing	21
Tax Treaties	22
Appendix 1 Meeting Dates and Links to Full Transcripts.....	23
Appendix 2 Written submissions by Witnesses.....	24
Prof. Frank Barry, Trinity College	25
Mr Gary Tobin, Department of Finance.....	34
Mr Eamonn O’Dea, Revenue Commissioners	41
Mr Brian Keegan, Chartered Accountants Ireland.....	46
Mr Sorley McCaughey, Christian Aid Ireland	48
Mr Michael Taft, Unite the Union.....	57
Mr Conor O’Brien, KPMG.....	63
Mr Liam Lynch, KPMG	69
Ms Cora O’Brien, Irish Tax Institute	73
Prof. Jim Stewart, Trinity College.....	77

INTRODUCTION

In the spring of 2013 the Joint Committee on Finance, Public Expenditure and Reform formed a sub-committee to examine the global corporate/multinational taxation architecture and Ireland's relationship with that tax architecture. Given the level of international attention which Ireland's Corporation Tax regime has attracted, the sub-Committee sought to examine the justification, if any, for criticism of:

- Ireland's Corporation Tax rate of 12.5 per cent.
- Ireland's application of its own tax rules in certain cases to facilitate an effective lower-rate especially for large multinationals.
- Ireland's facilitation of tax avoidance mechanisms by corporations such as the eponymously-named "double Irish".

The sub-Committee examined these issues under three broad areas:

- The interaction of Ireland's Corporation Tax system with the rules and regimes in operation in other countries. The sub-Committee examined the features of the Irish corporation tax system that are attractive for multinational companies (MNCs), particularly US MNCs and assessed the provisions that allow companies to engage in tax strategies such as the "double-Irish".
- An assessment of the various measures of the effective rate of corporation tax in Ireland published by different organisations and individuals. Estimates of the effective rate range from low single digits to some that are above the headline rate of 12.5%. The sub-Committee assessed the methods behind the various effective tax rates to understand why there are differences between them and sought to clarify what is measured using each approach.
- An analysis of the Base Erosion and Profit Shifting (BEPS) initiative currently being undertaken by the OECD. The sub-Committee examined some of the key points in the OECD's 'Action Plan' and sought to highlight those of significance from an Irish perspective. The sub-Committee also explored the implications of Ireland's network of bi-lateral tax treaties on the definition of permanent establishment and the automatic exchange of information.

The establishment of the sub-Committee broadly coincides with the Organisation for Economic Cooperation and Development (OECD) initiation of the Base Erosion and Profit Shifting (BEPS) project. This project seeks to equip governments with the tools to close gaps in national tax laws which are exploited by global corporations to achieve double non-taxation. The fluidity of international capital and an increasingly digital global economy facilitate such tax avoidance. As Ireland is committed to the BEPS project, the sub-committee seeks to contribute to the development of Ireland's tax regime in order to protect the country's international reputation and to ensure transparency and fairness.

There have been numerous developments in the area of the global taxation of multinational companies since the sub-Committee was created. In Budget 2014, the Minister for Finance announced changes to the residency rules for Corporation Tax in an effort to prevent companies from judging themselves to be 'stateless' if they were managed and controlled in some countries. The Minister for Finance has also indicated that there will be further changes to Ireland's residency rules and these will be discussed by the Finance Committee when the 2014 Finance Bill comes to Committee Stage.

In June of 2014 the European Commission launched a formal State-Aid investigation in relation to "the individual rulings issued by the Irish tax authorities on the calculation of the taxable profit allocated to the Irish branches of Apple Sales International and of Apple Operations Europe."

This report of the Joint Committee on Finance, Public Expenditure and Reform is based on the work of its sub-committee on Global Taxation. Its recommendations and conclusions are a contribution to the continued development of a transparent and fair Corporation Tax regime in Ireland.

In order to facilitate its work, the sub-Committee invited expert witnesses to inform its debate and discussion in relation to these issues. While there was not universal agreement on all matters, the conclusions and recommendations in this report reflect the general consensus. The invited witnesses who attended the sub-Committee were:

Mr Pascal Saint-Amans, Organisation for Economic Cooperation and Development

Prof. Frank Barry, Trinity College

Mr Gary Tobin, Department of Finance

Mr Eamonn O'Dea, Revenue Commissioners

Mr Brian Keegan, Chartered Accountants Ireland

Mr Sorley McCaughey, Christian Aid Ireland

Mr Michael Taft, Unite Trade Union

Mr Conor O'Brien, KPMG

Mr Liam Lynch, KPMG

Mr Philip Kermode, European Commission

Ms Cora O'Brien, Irish Tax Institute

Prof. Jim Stewart, Trinity College

Links to the transcripts of the seven meetings held by the sub-Committee are provided in Appendix A and the written submissions provided by the witnesses (where available) are reproduced in Appendix B.

SUMMARY FINDINGS AND RECOMMENDATIONS

1. Ireland's Corporate Tax Regime Compared Internationally

The amount of tax paid by corporations on their profits in Ireland as a percentage of GDP and as a percentage of total government receipts from tax and social contributions is at or above the average EU level.

While there is no universal agreement on the definition of a tax haven there is a general acceptance that it refers to a country that allows corporations (or individuals) to claim residence in order to avail of favourable local tax rates without insisting that significant business activity related to the corporation or individual is carried out in that country.

Countries compete with each other internationally to attract investment. Key decisions for international corporations considering investment will be nearness to market and size of the local market. Small and peripheral countries like Ireland must incentivise investment in other ways. The 12.5 per cent corporation tax rate in Ireland has been employed to attract inward investment to compensate for other advantages enjoyed by more central countries. While most agree that a low rate of corporation tax does give a competitive advantage, there is not unanimous agreement on the appropriateness of using tax competition to attract investment.

Where tax competition is used to attract investment, the Committee believes that sustainable competitive advantage can also be given by targeting improvements in areas such as education, communications and broadband infrastructure. It is important that Ireland continues to be an attractive place for investment on a number of fronts and the focus on tax policy should not be to neglect of other key areas.

2. The Effective Rate of Corporation Tax in Ireland

The effective rate of corporation tax in Ireland is disputed. The sub-Committee examined methods that provided estimates of the effective rate ranging from 2.2 per cent to 14.4 per cent.

- Ireland should ensure that all profits chargeable to Ireland's Corporate Tax are taxed at the correct rate and Ireland should take appropriate measures to reduce disparities with the effective rate.

3. Corporation Tax Rules and their Application

Ireland must do everything it can to ensure that the taxation rules are clear, transparent and applied fairly and equitably to all taxpayer groups. The perception that Ireland has engaged in 'taxation deals' with particular multinational corporations is damaging and undermines such effort. Ireland must either challenge the misperception or, if true, desist from making such deals in the future.

- There should be no special rates for any companies operating in Ireland. All companies should be liable to Corporation Tax at the statutory rates without exception.
- The residency rules for Irish Corporation Tax as provided for in the relevant legislation should be applied equally to all companies.

4. Ireland and the OECD’s Base Erosion and Profit Shifting (BEPS) Initiative

Ireland fully supports the BEPS initiative which, among many aims, intends to reduce the effectiveness of two-tier structures such as the “double-Irish” and other mechanisms where double taxation agreements between countries are not used to prevent over taxation but to avoid taxation altogether. Ireland has anticipated some of the likely outcomes of the project by introducing changes in residency rules. The Committee recommends the following:

- Ireland should continue to take a full and active role in the BEPS project and ensure that the agreement reached is to the benefit of all countries, including those not in the OECD.
- Ireland should fully support proposals in the BEPS project to introduce country-by-country reporting and the automatic exchange of information.
- The sub-Committee recommends that all transfer pricing arrangements in Ireland be completed on the basis of the arm’s length principle using best international practice as represented by the OECD standards. Preferential transfer pricing arrangements should not be put in place for any company.
- Ireland should ensure that a stringent limitation of benefits clause is not included in the OECD tax treaty as this would reduce the value of Ireland’s extensive network of tax treaties.
- Ireland should advocate for development-friendly tax treaties at national, European and international levels

SECTION 1: IRELAND'S TAX REGIME COMPARED INTERNATIONALLY

The Evolution of Ireland's Corporation Tax Regime

Ireland currently operates a Corporation Tax system with a 12.5 per cent tax rate on the trading profits of corporations and a 25 per cent rate on the profits from certain activities (such as energy extraction) and passive income.

Following independence in 1922, Ireland continued the British practice of taxing corporate profits in a manner similar to personal income. There was little change to the structure of the Corporate Profits Tax in the early history of the State with the most significant changes applied to the allowance available before a firm's profits became liable to the Corporate Profits Tax. As part of the 'protectionist' trade policy adopted at the time a special higher rate of the Corporate Profits Tax was introduced for foreign firms in the early 1930s and remained in place until 1948.

The first initiative introduced which could be considered part of Ireland's low corporate income tax strategy was the Export Profits Tax Relief (EPTR) which was introduced in 1956. Originally this allowed a 50 per cent tax reduction on profits from increased export sales, but this was quickly expanded to a 100 per cent reduction for the profits from all exports and restrictions on its use by foreign firms that survived as a legacy of the 1930s protectionist policies were abolished.

Over the next 20 years there were a number of refinements introduced that saw the Corporate Profits Tax look less like the model of personal income tax on which it was first introduced. These included amendments for depreciation, capital allowances and tax relief for royalties from patents licensed in Ireland. In 1976, these changes were consolidated with the introduction of the Corporation Tax as we know it today which combined the Corporate Profits Tax (CPT) and Capital Gains Tax (CGT) of companies.

Following Ireland's entry in the EEC in 1973 concerns were raised about the discriminatory nature of the Export Profits Tax Relief as it only applied to profits from export sales. In 1981 the EPTR was abolished¹ and replaced by a special 10 per cent Corporation Tax rate for companies engaged in activities which were broadly defined as "manufacturing and internationally traded services". At the time the standard rate of Corporation Tax was 50 per cent. In 1989 the 10 per cent rate was also made available to firms based in the International Financial Services Centre (IFSC) in Dublin, further reducing the coverage of the standard rate.

The dual-rate structure of Ireland's Corporate Tax came under further scrutiny from the EC and in the early 1990s an agreement was put in place to allow Ireland to move to a single rate over an extended period. The special 10 per cent rate for the IFSC expired in 2005 and the 10 per cent rate for manufacturing expired in 2010. In the mid-1990s the move to a single rate of Corporation Tax was initiated and the current 12.5 per cent rate was introduced in 2003. The rates of Corporation Tax are shown in the following table.

¹ A 10-year grandfathering period was available for companies availing of the Export Profits Tax relief at the time. This expired in 1990.

Table 1: Corporation Tax Rates in Ireland since 1994

Year	Standard Rate		Manufacturing Rate	IFSC Rate
	Trading Income	Passive Income		
1994	40%		10%	10%
1995	40%		10%	10%
1996	38%		10%	10%
1997	36%		10%	10%
1998	32%		10%	10%
1999	28%		10%	10%
2000	24%	25%	10%	10%
2001	20%	25%	10%	10%
2002	16%	25%	10%	10%
2003	12.5%	25%	10%	10%
2004	12.5%	25%	10%	10%
2005	12.5%	25%	10%	10%
2006	12.5%	25%	10%	
2007	12.5%	25%	10%	
2008	12.5%	25%	10%	
2009	12.5%	25%	10%	
2010	12.5%	25%		
2011	12.5%	25%		
2012	12.5%	25%		
2013	12.5%	25%		

It is to be noted that internationally it is common for different kinds of economy to have different appropriate tax rates. Typically, centrally-located and long-industrialised economies have higher corporate income tax rates. Large developed economies are attractive to many kinds of foreign direct investment that want to locate close to the markets to which they will sell. Ireland does not have that geographic advantage. Offering an attractive corporation tax rate is one avenue for peripheral countries such as Ireland compete with more centrally-located countries for investment. Competitive advantage can also be created through improvements in areas such as education, communications infrastructure and the overall business environment can also be used.

Contribution of Corporation Tax to Tax Revenue and US MNCs to the Economy

Corporation Tax is an important source of government revenue in Ireland. Compared to the EU average, revenue collected from the taxation of corporate income makes up a greater proportion of government revenue in Ireland and is equal to the EU average as a percentage of GDP. In 2012, receipts from Corporation Tax were equivalent to 2.4 per cent of GDP compared to the EU28 average of 2.5 per cent. However, in 2012, receipts from Corporation Tax counted for almost 8 per cent of total government receipts from tax and social contributions compared to an EU average of around 6 per cent.

Table 1.1: Taxes on the income or profits of corporations including holding gains

	Headline Statutory Rate	As a per cent of Gross Domestic Product			As a per cent of total government receipts from tax and social contributions		
		2008	2010	2012	2008	2010	2012
EU28		3.0	2.4	2.5	7.4	6.1	6.2
EU15		3.0	2.4	2.5	7.3	6.0	6.0
EZ18		2.9	2.2	2.4	7.1	5.5	5.8
Belgium	34.0	3.3	2.6	3.1	7.1	5.6	6.5
Bulgaria	10.0	3.2	2.0	1.9	9.9	7.3	6.9
Czech Republic	19.0	4.2	3.4	3.3	12.2	10.1	9.4
Denmark	29.8	3.3	2.8	3.0	6.8	5.8	6.1
Germany	21.0	2.7	2.2	2.7	6.7	5.6	6.7
Estonia	12.5	1.6	1.3	1.4	5.0	3.8	4.3
Ireland	12.5	2.9	2.5	2.4	9.4	8.5	7.9
Greece	20.0	2.5	2.5	1.1	7.3	7.4	3.0
Spain	30.0	2.8	1.9	2.2	8.3	5.7	6.5
France	36.1	2.7	1.9	2.3	6.0	4.3	4.9
Croatia	20.0	2.9	2.0	2.0	7.8	5.5	5.6
Italy	31.4	3.1	2.4	2.3	7.2	5.6	5.2
Cyprus	10.0	7.1	6.2	6.3	18.4	17.4	17.8
Latvia	15.0	3.2	1.0	1.6	10.8	3.6	5.7
Lithuania	15.0	2.7	1.0	1.3	8.7	3.5	4.7
Luxembourg	28.8	5.4	5.9	5.3	14.1	15.1	13.2
Hungary	20.6	2.6	1.2	1.3	6.4	3.1	3.3
Malta	35.0	6.1	5.9	6.3	17.7	17.8	18.1
Netherlands	25.0	3.4	2.3	2.1	8.5	5.8	5.3
Austria	25.0	2.6	2.0	2.4	5.9	4.6	5.4
Poland	19.0	2.7	2.0	2.1	7.9	6.3	6.5
Portugal	31.5	3.7	2.8	2.8	10.3	8.0	8.0
Romania	16.0	3.0	2.3	2.2	10.4	8.3	7.7
Slovenia	18.0	2.5	1.9	1.3	6.7	5.0	3.4
Slovakia	19.0	3.1	2.5	2.4	10.6	8.8	8.4
Finland	24.5	3.5	2.6	2.2	8.1	6.1	5.0
Sweden	26.3	2.9	3.4	2.7	6.2	7.4	6.1
United Kingdom	21.0	3.6	3.0	2.9	9.3	8.2	7.8

Source: Eurostat

The government's view is that the purpose of Ireland's Corporate Tax regime is intended to generate employment and maximise overall tax revenue. The most visible impact of the success of the regime can be seen from the contribution of US-owned companies to the Irish economy. Figures from Eurostat show that in 2011 US-controlled firms had 99,589 persons employed in Ireland.² This was nine per cent of people employed by enterprises in the business economy and around 5.5 per cent of total employment. These US-controlled enterprises had personnel expenses (mainly salaries and employer social insurance contributions) of €6,028 million which was 16 per cent of personnel expenses incurred by enterprises in the business economy in 2011. These and other measures are shown in Table 1.2 in which the strong performance of Ireland is clear.

Table 1.2: Contribution of US-controlled enterprises to the business economy in EU countries, 2011

	Percentage of People Employed	Percentage of Personnel Costs	Average Personnel Cost per Person Employed	Investment in Tangible Assets per Person Employed	Investment in Tangible Assets, % GDP
Belgium	3.6%	7.5%	€80,300	€17,110	0.5%
Bulgaria	0.9%	2.7%	€13,700	€4,976	0.2%
Czech Republic	3.0%	5.7%	€23,700	€5,198	0.4%
Denmark	2.7%	3.9%	€62,900	€10,469	0.2%
Germany	2.2%	3.7%	€55,200	€11,110	0.2%
Estonia	2.7%	3.4%	€17,900	€3,065	0.1%
Ireland	9.1%	16.0%	€60,500	€29,425	1.8%
Greece	n/a	n/a	n/a	n/a	n/a
Spain	1.4%	2.8%	€49,700	€9,573	0.1%
France	2.5%	4.8%	€77,600	€13,261	0.3%
Croatia	0.3%	0.7%	€22,300	€5,350	0.0%
Italy	1.7%	3.8%	€53,500	€12,569	0.2%
Cyprus	0.2%	0.5%	€49,900	€6,721	0.0%
Latvia	0.8%	1.6%	€14,500	€3,933	0.1%
Lithuania	0.8%	2.2%	€20,700	€4,718	0.1%
Luxembourg	5.6%	7.2%	€58,200	€12,076	0.4%
Hungary	3.5%	7.4%	€21,000	€6,675	0.6%
Malta	n/a	n/a	n/a	n/a	n/a
Netherlands	3.7%	7.1%	€63,100	€10,122	0.3%
Austria	1.8%	3.2%	€65,700	€19,467	0.3%
Poland	3.3%	5.0%	€19,500	€7,169	0.3%
Portugal	1.1%	2.8%	€36,300	€5,867	0.1%
Romania	1.9%	4.0%	€12,600	€10,741	0.6%
Slovenia	0.9%	1.7%	€36,300	€6,625	0.1%
Slovakia	1.9%	4.0%	€21,800	€4,071	0.2%
Finland	n/a	n/a	n/a	n/a	n/a
Sweden	2.9%	4.1%	€62,400	€6,587	0.1%
United Kingdom	5.9%	8.9%	€42,500	€8,829	0.5%

Source: Eurostat

² The Eurostat data used here covers enterprises in the business economy excluding those in financial and insurance activities. It does not cover public sector workers or the self-employed.

The Tax Haven Question

Ireland is a deliberately attractive location for foreign direct investment but can it be considered to be a tax haven? As part of the on-going BEPS project the OECD recently released an updated study on harmful tax regimes.³ Ireland was not included in the list of potentially harmful regimes under review.

In 1998 the OECD put forward a four-tier definition of a tax haven. It is a regime where there is:

- no tax or nominal tax,
- no transparency
- no exchange of information
- no real activity

In order to be deemed a tax haven by the OECD a country must satisfy all four criteria. In his appearance before the sub-Committee, Pascal Saint-Amans the director of the OECD's Centre for Tax Policy and Administration, indicated that no country currently meets the OECD definition of a tax haven but that there is a large number of jurisdictions that meet the criteria of no tax or no real business activity. While Ireland has a nominal 12.5 per cent rate of Corporation Tax, there are different views on the actual effective rate with calculations ranging from 14.4 per cent down to 2.2 per cent .

In relation to real business activity, there are 250,000 people employed in Ireland by multinational companies which have invested substantial amounts in tangible assets in Ireland and do carry out real business activity here.

The 12.5 per cent nominal rate is not no taxation but much attention has been paid to what is sometimes perceived as an unacceptably low level of corporate taxation. However, neither Pascal Saint-Amans of the OECD and Philip Kermode, a director in the Taxation and Customs Union Directorate General of the European Commission, expressed any concern over Ireland's rate of Corporation Tax. They considered that the rate was a matter to be decided by each national jurisdiction. The concern at international level, however, is where provisions or rulings in tax regimes are used to facilitate double non-taxation with the result that the required rate is not paid.

The 12.5 per cent rate of Corporation Tax is established government policy in Ireland. However, the rate offered may come under external pressure in the future even though it is not under official pressure at the moment as confirmed to the sub-Committee by representatives of the OECD and EU Commission. At a political level the sub-Committee recognises that some governments have expressed issues with Ireland's Corporation Tax rate.

³ The OECD report is available at http://www.oecd-ilibrary.org/taxation/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance_9789264218970-en. The 30 regimes considered by the review are listed in Table 5.1 on page 58. No regime in the review has been deemed harmful but 15 remain under consideration.

There is not unanimity among the sub-Committee on the appropriateness of using tax competition to attract investment. However, if the government sees, as stated, that the 12.5 per cent rate tax policy is a feature of Irish industrial policy, the Committee believes it should not be to the neglect of other key factors which influence companies investing in Ireland. These other factors include necessary improvements to education and the skills of the workforce, the continued improvement of Ireland's communications and broadband infrastructure as well as measures to improve overall business environment. The required resources and attention need to be given to create long-term sustainable advantage in these areas.

SECTION 2: THE EFFECTIVE RATE OF CORPORATION TAX IN IRELAND

Estimates of the Effective Rate of Corporation Tax

While the headline rate for Corporation Tax in Ireland is transparent at 12.5 per cent the effective rate is more disputed. There is broad agreement about how an effective corporate tax rate for the profits earned by a company can be measured but less so when it comes to calculating the effective tax rate for the profits earned in a country. Cora O'Brien from the Irish Tax Institute said that "calculating the overall effective tax rate for a country, whether Ireland or anywhere else, is very complex. 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." A range of estimates of the effective tax rate (ETR) were presented to the sub-Committee and these are shown in Table 2.1.

Table 2.1: Estimates of the effective rate of Corporation Tax in Ireland

Witness	Affiliation	Proposed ETR	Basis/Source
Prof. Frank Barry	Trinity College	11.1%	Devereaux methodology
Mr Gary Tobin	Department of Finance	14.4%	European Commission/ZEW
Mr Eamonn O'Dea	Revenue Commissioners	c. 12.5%	Revenue Statistical Data
Mr Conor O'Brien	KPMG	12.24%	Revenue Statistical Data
Mr Michael Taft	Unite the Union	9.1%	CSO National Accounts Data
Prof. Jim Stewart	Trinity College	2.2%/3.8%	US BEA Data

During the course of the sub-Committee's work other estimates were raised such as an 11.9 per cent figure from a World Bank/PWC report and a 6 per cent figure that represents Eurostat's implicit tax rate. Neither of these was formally presented to the sub-committee as an estimate of the effective tax rate. All of the methods commonly used to estimate the effective rate are detailed in a recent technical paper published by the Department of Finance.⁴

The figures provided to the sub-Committee by Prof. Frank Barry and Mr Gary Tobin are both based on the methodology proposed by Michael Devereaux of Oxford University. This involves the application of a country's corporation tax to a model or stylised company and estimating the effective tax rate that would apply to that company's profits. It is the use of different model companies that results in different answers.

In the study referenced by Prof. Frank Barry the model company earned all its profit from trading and the application of Ireland's 12.5 per cent rate and the limited availability of credits results in the 11.1 per cent effective tax rate. In the study referenced by Mr Gary Tobin the model company earned one-fifth of its income from passive sources and it is a combination of the 12.5 per cent on trading income and the 25 per cent rate on passive income that results in the 14.4 per cent effective rate. It is also the case that companies are liable to Corporation Tax on their capital gains which is charged at the standard Capital Gains Tax rate (currently 33 per cent).

⁴ This technical paper is available at http://www.budget.gov.ie/Budgets/2015/Documents/Technical_Paper_Effective_Rates_Corporation_Tax_Ireland.pdf

One difficulty with this approach is that the model company used may not be reflective of the mix of companies operating in any given country. The sub-Committee also analysed various different aggregate measures from the returns of Irish companies. One such source is the aggregate data provided by the Revenue Commissioners. Using this Eamonn O’Dea of the Revenue Commissioners suggested that the effective rate was around 12.5 per cent while Conor O’Brien of KPMG provided calculations that show an effective tax rate of 12.24 per cent. The basis for their calculations are provided in the following section.

The Calculation of Taxable Income in Ireland

The starting point of these analyses is the calculation of taxable income to which the 12.5 and 25 per cent rates are applied. The following table sets out the calculation of taxable income for corporation tax purposes in Ireland which in 2011 was just over €40 billion.

Table 2.2: The calculation of taxable income in Ireland, 2011

Item	€million	€million
1 Irish-Source Manufacturing Trading Profits		18,511.2
2 Other Irish-Source Trading Profits		54,225.6
3 Gross Irish-Source Trading Profits		72,736.8
4 plus Balancing Charges		1,080.5
less Allowances		
5 Capital Allowances Used	8,452.9	
6 Trading Losses Carried Forward Used	9,518.3	
		(17,971.2)
7 Net Irish-Source Trading Income		55,846.1
plus Other Income		
8 Net Rental Income	520.4	
9 Capital Gains (regrossed)	736.5	
10 Foreign-Source Income	3,002.2	
11 Other Income	1,411.2	
		5,670.3
12 Total Income		61,516.4
less Deductions and Expenses		
13 Trade Charges	14,876.4	
14 Group Relief	2,742.5	
15 Current Year Trading Losses	156.0	
16 Other Expenses	3,678.3	
		(21,453.2)
17 Taxable Income		40,062.9

Source: Revenue Commissioners, Corporation Tax Distribution Statistics

The next step is the application of the relevant rates to this taxable income to determine the gross tax due followed by the adjustments for the reliefs and credits available. In 2011, the gross amount of tax due was €5.3 billion with a net tax due of €4.2 billion as shown in Table 2.3. The largest relief

was Double-Taxation Relief which is given as a credit to Irish-resident companies that have already incurred corporate income tax in other jurisdictions on their foreign-source profits.

Table 2.3: The calculation of tax payable from taxable income, 2011

Item	€million	€million	€million
Taxable Income	40,062.9		
Amount Chargeable at 12.5%	37,940.4	x 0.125 =	4,742.6
Amount Chargeable at 25.0%	2,121.7	x 0.250 =	530.4
Amount Chargeable at other rates	0.8		0.2
Gross Tax Due			5,273.2
less Reliefs			
Double Taxation Relief		567.1	
Other Reliefs		208.7	
			(775.8)
plus Clawbacks and Surcharges			96.9
Tax Payable			4,594.3
less Credits Used			
Research and Development Credit		152.3	
Income Tax Suffered Credit		65.1	
Gross Withholding Tax on Fees		229.2	
			(446.6)
			4,147.7
plus Credits Refunded Against Other Taxes			131.4
less Payment of Excess R&D Tax Credit			(106.2)
Tax Due			4,173.4

Source: Revenue Commissioners, Corporation Tax Distribution Statistics

The 12.24 per cent effective tax rate proposed by Conor O’Brien of KPMG is based using the taxable income figure arrived at in Table 3 as the numerator and the total tax liability of companies in Ireland adjusted for double taxation relief and the research and development tax credit. The calculation is:⁵

$$\frac{€4,902.9}{€40,062.9} \times 100 = 12.24\%$$

Estimating the Effective Rate of Corporation Tax in Ireland from National Accounts Data

Michael Taft, from the Unite trade union, provided an estimate of the effective corporate tax rate in Ireland using data from the Central Statistics Office. This is based on the national accounting concept of net operating surplus which is similar to earnings before interest and tax in accounting. In 2012, the net operating surplus of companies operating in Ireland was just over €46 billion.

Data from the Exchequer Account shows that the amount of Corporation Tax collected in 2012 was €4,216 million. Using these Michael Taft provided an estimate of the effective Corporation Tax rate as:

⁵ The details behind this calculation are in the written submission provided by the witness which is reproduced in Appendix 2.

$$\frac{\text{€4.2 billion}}{\text{€46 billion}} \times 100 = 9.1\%$$

This is below the 12.5 per cent rate as companies can make a deduction for interest expense incurred when calculating their taxable income and some companies can avail of prior losses over previous years to reduce their current tax payment.

Estimating the Effective Rate of Corporation Tax in Ireland from US BEA Data

Prof. Jim Stewart of Trinity College presented an estimate of the effective tax rate using data from the US Bureau of Economic Analysis. He said that “using such data on one measure was 2.2 per cent and it was 3.8 per cent on another measure. That is for US companies incorporated in Ireland.” Prof. Stewart stated that these estimated effective tax rates include companies which are not tax resident in Ireland and that such companies did not pay tax on the reported \$143 billion of net income in any other jurisdiction than Ireland.

The calculation of the effective rate in Prof. Stewart’s analysis is shown in Table 2.4. It should be noted that in this instance the effective rate is calculated on a tax-exclusive basis whereas the other measures presented were done on a tax-inclusive basis. In Table 2.4 the amount of tax paid is deducted from the income measure used before the effective rate is calculated, i.e. the effective tax rate is calculated from net income rather than gross income. This does not have a significant impact on the calculated effective rate for Ireland in this analysis.

Table 2.4: Income Statement for US-owned, Irish-Incorporated Companies in BEA USDIA data

	2009	2010	2011
	\$million	\$million	\$million
Total Income	282,177	334,357	410,307
Total Costs	(210,264)	(235,913)	(263,273)
Net Income	69,580	95,343	143,872
Income Taxes	2,333	3,101	3,162
Effective Tax Rate	3.4%	3.3%	2.2%

Source: US Bureau of Economic Analysis, US Direct Investment Abroad Data

Prof. Stewart said the following about his calculation:

- The estimated effective rate includes companies which are not resident in Ireland.
- The companies are not paying tax on some of those profits in a jurisdiction other than Ireland.
- Some of the profits arise in jurisdictions where there is no corporation tax.

If the income in the US BEA data was deemed to be Taxable Income in Ireland, for example by changing the residence rules for companies, it would appear in Table 2.2 under item 10: Foreign-Source Income if all else remained unchanged. The OECD’s Pascal Saint-Amans stated that “Ireland should also consider that it is not the only country in the world and there is an interaction with

other countries. For example, part of the tax is due in the US rather than in Ireland for the simple reason that the intangible has been developed in the US, is owned by the US and should be taxable in the US, so there is a reason not to tax profit which is not accruing in Ireland.”

Prof. Stewart argued that “where a company is incorporated determines where it pays its tax” and concluded that “these profits are seen as actually arising in Ireland and hence, they should be taxed here, but apparently they are not being taxed. It is a problem of the Irish tax regime.”

The sub-Committee finds that there is no definitive answer to the question of the effective corporate income tax rate on profits earned in a country. All profit subject to Ireland’s Corporation Tax should be chargeable to the tax at the appropriate rates, after allowing for legitimate deductions and expenses, with no exceptions or special arrangements.

SECTION 3: IRELAND'S CORPORATION TAX RULES AND THEIR APPLICATION

The Negotiation of Special Rates of Corporation Tax

There has been significant recent attention on the rate and rules used in the application of Corporation Tax in Ireland. In May 2013 the US Senate produced a report that stated that in US multinational Apple had “negotiated a special corporate tax rate of less than two per cent” in Ireland.⁶ However, in a letter to the Irish government outlining the reasons why it was opening a formal state-aid investigation into the same case, the European Commission said that “[t]he taxable income ... was taxed at 12.5%, except for limited components taxed at 25% mainly represented by interest payments received.”

There should be no special rates for any companies operating in Ireland. All companies should be liable to Corporation Tax at the statutory rates without exemption. Ireland has a low rate of Corporation Tax that does not need to be augmented with special rates. If special rates have been offered to companies they should be withdrawn and no special rates should be made available.

The Application of Ireland's Residency Rules

If a company is resident in Ireland it will be subject to Irish Corporation Tax on its worldwide income not just their Irish-source income which is the case for non-resident companies which have a permanent establishment or branch in Ireland.

Under current rules⁷ a company, in general, is resident in Ireland if it is either incorporated in Ireland or has its place of central management and control in Ireland. However, there are some exceptions to this and for certain companies only the test of management and control is used to determine if they are resident in Ireland. The test of incorporation is not applied.

Under the “trading” exemption an Irish incorporated company is not treated as Irish resident if it is a ‘relevant’ company. A ‘relevant’ company must either carry on a trade in the State or be related to a company that carries on a trade in the State and is one that is either ultimately controlled by non-residents or owned by non-residents (based on the stock market its shares are traded on), where the non-residents are in an EU or tax treaty country. A company cannot be a ‘relevant’ company if it is centrally managed and controlled in Ireland.

An Irish-incorporated company may not be resident in Ireland if it falls under the “treaty” exemption. This can be the case if an Irish-incorporated company is deemed resident in a country with which Irish has signed a double-tax agreement. The usual tie-breaker in these cases is the test of management and control.

⁶ It should be noted that the material provided to the US Senate by Apple was not about a special rate but concerned the calculation of the amount of taxable income in Ireland. Prior to the Senate hearing Apple told the Senate committee that “Since the early 1990’s, the Government of Ireland has calculated Apple’s taxable income in such a way as to produce an effective rate in the low single digits The rate has varied from year to year, but since 2003 has been 2% or less.” It is the taxable income calculation that is under investigation by the European Commission.

⁷ As of November 2014.

"Where [...] a person other than an individual is a resident of both Parties, then it shall be deemed to be a resident only of the Party in which its place of effective management is situated."

This is the standard tie-breaker from Article 4 of the OECD's model tax treaty. In the case of a company being resident in two countries it will usually be deemed a resident in the country in which it is "effectively managed and controlled". Ireland can remove the use of the "trading" exemption but the "treaty" exemption is necessary because of the double-tax agreements that Ireland has entered into.

A change was introduced in the 2013 Finance Act to address the anomaly that an Irish-incorporated company may not be tax resident anywhere. This arises if an Irish-incorporated company subject to the trading exemption is managed and controlled in a country that does not apply the test of management and control. The US is a notable example of this as it only applies a test of incorporation.

The change meant that if such a company is managed and controlled in a country that only applies a test of incorporation and not a test of management and control, such an Irish-incorporated company will be deemed tax resident in Ireland. However, the sub-Committee notes that this only applies to companies managed and controlled in EU countries or in countries with which Ireland has signed a double-tax treaty so did not completely disallow the possibility of "stateless" Irish-incorporated companies.

The Finance Bill 2014 includes a proposal to remove the "trading" exemption to the test of incorporation. The proposed residency rules in the Bill are:

(1) Subject to subsection (2), a company which is incorporated in the State shall be regarded for the purposes of the Tax Acts and the Capital Gains Tax Acts as resident in the State.

(2) Notwithstanding subsection (1), a company which is regarded for the purposes of any arrangements, having the force of law by virtue of section 826(1), as resident in a territory other than the State and not resident in the State shall be regarded for the purposes of the Tax Acts and the Capital Gains Tax Acts as not resident in the State.

(3) Nothing in subsection (1) shall prevent a company that—

(a) is not incorporated in the State, and

(b) is centrally managed and controlled in the State,

being resident in the State for the purposes of the Tax Acts and the Capital Gains Tax Acts.

If this proposal is adopted all companies incorporated in Ireland will be considered resident in Ireland except those deemed non-resident under the necessary "treaty" exemption. The sub-Committee recognises that the proposal will make it more difficult for companies to use two-tier structures with Irish-incorporated, non-resident companies similar to the "double-Irish". It will still

be possible that Irish-incorporated companies are non-resident if they are managed and controlled in a treaty partner country that has a test of management and control and if the tie-breaker in the relevant treaty is the test of management and control as is the case with the OECD model tax treaty.

The residence rules for companies should be applied equally to all companies and there should be no special arrangements or exemptions.

EU State-Aid Investigation

On the 11th of June 2014 the European Commission launched a formal state-aid investigation into Apple's tax arrangements in Ireland. In announcing the investigation the Commission⁸ stated the following:

The Commission will examine if the [...] transfer pricing arrangements validated in the individual rulings issued by the Irish tax authorities on the calculation of the taxable profit allocated to the Irish branches of Apple Sales International and of Apple Operations Europe involve state aid to the benefit of the beneficiary companies.

The Commission has reviewed the calculations used to set the taxable basis in those rulings and, based on a preliminary analysis, has concerns that they could underestimate the taxable profit and thereby grant an advantage to the respective companies by allowing them to pay less tax. The Commission notes that the three rulings concern only arrangements about the taxable basis; they do not relate to the applicable tax rate itself.

In the case of Ireland, the authorities have been fully cooperative in providing comprehensive replies in response to Commission's requests. The Commission notes that although the transfer pricing rules have been tightened over the years, the tax administration had a significant degree of discretion in the past. The Commission has concerns that such discretion has been used in the case of Apple to grant a selective advantage to that company, reducing its tax burden below the level it should pay based on a correct application of the tax rules. The Commission notes however that the number of tax rulings issued in Ireland relating to transfer pricing arrangements is limited.

The sub-Committee notes that Ireland legislated to adopt the OECD transfer pricing standards into domestic law. These standards became part of Irish tax law in 2010. The sub-Committee recommends that all transfer pricing arrangements in Ireland be completed on the basis of the arm's length principle using best international practice. Preferential arrangements should not be put in place for any company and all companies should be treated equally.

⁸ The EC press release from June 2014 is available at http://europa.eu/rapid/press-release_IP-14-663_en.htm

SECTION 4: THE INTERNATIONAL ENVIRONMENT

The OECD's BEPS Initiative

The Organisation for Economic Cooperation and Development has launched a Base Erosion and Profits Shifting Project known as the BEPS project. The project is dual-layered with the purpose of adding more transparency and reducing tax avoidance. In his appearance before the sub-Committee in July 2013 the head of the project, Pascal Saint-Amans said "our work in this area is focused on addressing one of the key challenges which has arisen in the current international environment, namely, the fact that as a result of the gap between the way international tax rules have evolved and the way business has changed, there are now wide avenues which multinational companies that are exposed to international transactions can use in order to avoid paying tax anywhere. This is what a number of observers have referred to as double non-taxation." Mr Saint-Amans summarised the objective of the BEPS project as

"to reconcile the location of the real activity and the location of the profit. It is to make sure that countries get the right to tax and do not face base erosion through artificial settings such as massive interest deductibility, the use of hybrid mismatches from entities or products and other harmful tax practices, but also through artificial shifting of permanent establishments by not meeting the current definition, abuse transfer pricing rules or just use of the transfer pricing rules, which we would then need to change."

The view of the sub-Committee is that the BEPS initiative forms an important vehicle to introduce the necessary changes to the international tax architecture. Ireland should continue to play a full and active part in the initiative and that, on balance, the proposals in the BEPS project can be beneficial for Ireland. Ireland should fully support proposals to develop country-by-country reporting and the automatic exchange of information and the sub-Committee notes that participation in the BEPS initiative does not disallow unilateral action in these areas.

There are some concerns for Ireland in the BEPS project. One would be a potential shift in the basis for corporate income tax, particularly for the digital economy. At present taxing rights are allocated on a source basis determined by the location of risks, functions and assets that generate a company's profits. A shift to a destination basis determined by the location of customers would potentially reduce the tax base in Ireland.

Transfer Pricing

One of the issues at the heart of the BEPS project is transfer pricing – the pricing of transactions between related parties such as subsidiaries in a multinational group. Transfer pricing is used to allocate profit between the various risks, functions and assets of a company. There was universal agreement amongst those who presented to the sub-committee that the existing rules for transfer pricing arrangements between related parties are not fit for purpose and need to be overhauled. The OECD recognises that profits should be allocated on the basis of substance as measured by

employment, location of decision-makers and real activity. The incorrect and inconsistent application of the arm's-length principle can result in a permanent loss of tax revenue for government.

Ireland should participate fully in the updating of transfer pricing regulations. There would be benefits to countries and companies if the outcome was an agreed international standard to be adhered to rather than a minimum to be achieved. This would make the resolution of transfer pricing disagreements between countries more straightforward and lead to the standardisation of the documentary evidence to be provided by companies in all countries.

Ireland introduced the OECD's transfer pricing standards in 2010 and should continue to follow international best practice. The application of transfer pricing rules in Ireland should be done on a non-preferential basis with all companies treated equally and consistent application of the rules. Special deals negotiated on a basis other than the arm's length principle should be entered into with companies operating in Ireland.

Tax Treaties

Ireland's extensive network of tax treaties (71 currently) represents significant interaction between the Irish tax regime with other tax regimes in the world. These are negotiated agreements between sovereign nations entered into willingly. The aim of the treaties is in order to ensure that double taxation does not take place. While Ireland follows the OECD model for taxation agreements, the OECD itself recognises that some provisions in these international agreements have led, in certain situations, to double non-taxation, a situation where individuals and corporations rather than being overtaxed pay little or no tax at all.

In the context of the BEPS project the sub-Committee notes that a concern in the possibility of a limitation of benefits clause in the model OECD tax treaty to try and limit treaty abuse. If this was to be introduced the question of whether a company qualifies to access a tax treaty would be dependent on where the company is owned. This would have serious consequences for small countries like Ireland because many companies operating in Ireland are owned outside of Ireland. If a limitation of benefits clause was introduced the value of Ireland's extensive tax treaty network would be greatly reduced.

While Ireland currently does not have many tax treaties with developing countries, the sub-Committee recommends that Ireland seek to lead in this area and advocate for the need to establish principles and practices for development friendly tax treaties, both at national, EU and international levels.

The sub-Committee welcomes the announcement from the Department of Finance to conduct a spillover analysis "to research what impact, positive or negative, Ireland's tax system may have on the economies of developing countries." The sub-Committee looks forward to the publication of this analysis and will consider the findings in the context any further work the Joint Committee on Finance, Public Expenditure and Reform will be doing on the issue of Ireland's Corporation Tax.

APPENDIX 1 MEETING DATES AND LINKS TO FULL TRANSCRIPTS

Date	Witnesses	Link to Transcript
1 23/07/2013	Mr Pascal Saint-Amans (OECD)	http://oireachtasdebates.oireachtas.ie/Debates%20Authoring//WebAttachments.nsf/(\$vLookupByConstructedKey)/committees~20130723~F15/\$File/Daily%20Book%20Unrevised.pdf?openelement
2 17/09/2013	Prof. Frank Barry (Trinity College)	http://oireachtasdebates.oireachtas.ie/Debates%20Authoring//WebAttachments.nsf/(\$vLookupByConstructedKey)/committees~20130917~F15/\$File/Daily%20Book%20Unrevised.pdf?openelement
3 18/09/2013	Mr Gary Tobin (Department of Finance) Mr Eamonn O’Dea (Revenue Commissioners)	http://oireachtasdebates.oireachtas.ie/Debates%20Authoring//WebAttachments.nsf/(\$vLookupByConstructedKey)/committees~20130918~F15/\$File/Daily%20Book%20Unrevised.pdf?openelement
4 27/05/2014	Mr Brian Keegan (Chartered Accountants) Mr Sorley McCaughey (Christain Aid)	http://oireachtasdebates.oireachtas.ie/Debates%20Authoring//WebAttachments.nsf/(\$vLookupByConstructedKey)/committees~20140527~F15/\$File/Daily%20Book%20Unrevised.pdf?openelement
5 28/05/2014	Mr Conor O’Brien (KPMG) Mr Michael Taft (Unite the Union)	http://oireachtasdebates.oireachtas.ie/Debates%20Authoring//WebAttachments.nsf/(\$vLookupByConstructedKey)/committees~20140528~F15/\$File/Daily%20Book%20Unrevised.pdf?openelement
6 11/06/2014	Mr Liam Lynch (KPMG) Mr. Philip Kermode (European Commission)	http://oireachtasdebates.oireachtas.ie/Debates%20Authoring//WebAttachments.nsf/(\$vLookupByConstructedKey)/committees~20140611~F15/\$File/Daily%20Book%20Unrevised.pdf?openelement
7 17/06/2014	Ms Cora O’Brien (Irish Tax Institute) Prof. Jim Stewart (Trinity College)	http://oireachtasdebates.oireachtas.ie/Debates%20Authoring//WebAttachments.nsf/(\$vLookupByConstructedKey)/committees~20140617~F15/\$File/Daily%20Book%20Unrevised.pdf?openelement

APPENDIX 2 WRITTEN SUBMISSIONS BY WITNESSES

Written submissions were received from the following witnesses and they are reproduced in full in this appendix.

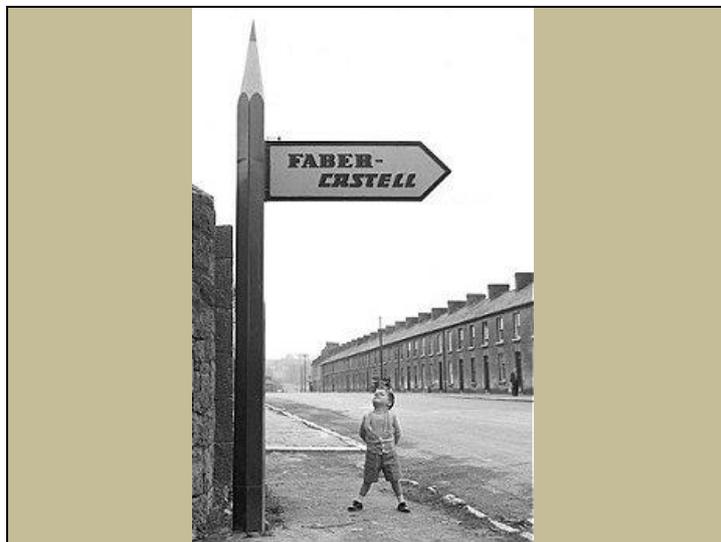
Witness	Affiliation	Page
Prof. Frank Barry	Trinity College	25
Mr Gary Tobin	Department of Finance	34
Mr Eamonn O’Dea	Revenue Commissioners	41
Mr Brian Keegan	Chartered Accountants Ireland	46
Mr Sorley McCaughey	Christian Aid Ireland	48
Mr Michael Taft	Unite the Union	57
Mr Conor O’Brien	KPMG	63
Mr Liam Lynch	KPMG	69
Ms Cora O’Brien	Irish Tax Institute	73
Prof. Jim Stewart	Trinity College	77

Written submissions were not received from Pascal Saint-Amans of the OECD and Philip Kermode of the European Commission. Their evidence to the sub-Committee is recorded in the official transcript.

Multinational Corporations, Ireland and Global Taxation

Frank Barry
School of Business
Trinity College Dublin

Joint Oireachtas sub-Committee on Global Taxation
17 September 2013



- Ireland's low corporation tax regime is "the unique and essential foundation stone of Ireland's foreign investment boom"

– Padraic White, Managing Director of the IDA
(1981-90)

Irony 1

- Marshall Aid-funded 1952 report drew the attention of the IDA to the case of Puerto Rico, whose 'favoured position' included being within the US trading market but outside the US tax system
 - Frank Barry and Micheál Ó Fathartaigh (2012) *The Industrial Development Authority, 1949-58: Establishment, Evolution, Expansion of Influence*

Irony II

EU Complains that Use of Tax Havens gives US Firms a Competitive Advantage

- "... illegal effort to subsidize US exports by making them more competitive"
 - New York Times, May 30 2000

1998 OECD definition of 'tax haven'

- Initially four criteria:
 - (i) **No or only very low taxes**
 - OECD warns that this criterion is not sufficient**
 - Optimal tax rate higher for large, core economies
 - Large economies attractive to 'market-seeking' foreign investment
 - Centrality (closeness to purchasing power) also attractive for foreign investment in particular sectors (e.g. car manufacturing)
 - Easier for long-developed economies to spin off successful firms

Effective average corporation tax rates, 2012:

Ranking	Country	EATR (%)
1	Ireland	11.1
2	Slovenia	15.7
3	Slovak Republic	15.9
4	Czech Republic	16.1
5	Greece	16.1
6	Poland	16.7
7	Turkey	16.9
8	Switzerland	17.4
9	Iceland	17.7
10	South Korea	18.0
11	Hungary	18.6
12	Netherlands	19.1
13	Chile	20.2
14	Israel	21.3
15	Austria	21.6
16	Finland	22.0
17	Denmark	22.4
18	Italy	23.0
19	Sweden	23.2
20	Luxembourg	23.8
21	Canada	24.4
22	United Kingdom	24.8
23	Portugal	25.2
24	New Zealand	25.8
25	Norway	25.9
26	Mexico	26.1
27	Australia	26.6
28	Germany	27.0
29	Belgium	28.1
30	France	29.8
31	Spain	30.0
32	United States	34.9
33	Japan	36.0

OECD criterion 2

– (ii) Lack of transparency (special deals available)

- US economist James Hines Jnr. (who included Ireland in his list of tax havens, and whose list was replicated in a White House statement of 2009) misinterpreted 'grandfathering clauses' – covering the transition from *zero rate* on manufactured exports to *10% rate* on all manufacturing in late 1970s – as Ireland offering tax holidays.
- Possibly same misinterpretation in Apple's original testimony to US Senate?

As in the James Hines case, there is a tendency for blacklists to become self-referential

- Venezuelan officials copied the Mexican blacklist word for word
 - Because Mexico had blacklisted Venezuela, Venezuela ended up blacklisting itself!

OECD criterion 3

- (iii) **Secrecy laws** preventing the effective exchange of information for tax purposes with other governments

Jurisdictions Ranked in Terms of Secrecy Score

low score implies 'good citizen'

Jurisdiction	Secrecy Score	Jurisdiction	Secrecy Score	Jurisdiction	Secrecy Score
Bermuda	85	Monaco	75	USA	58
Netherlands Antilles	83	Mauritius	74	Cyprus	58
Bahamas	83	Hong Kong	73	Germany	57
British Virgin Islands	81	Singapore	71	Netherlands	49
Liechtenstein	81	Luxembourg	68	United Kingdom	45
Jersey	78	US Virgin Islands	68	Ireland	44
Gibraltar	78	Austria	66	Denmark	40
Switzerland	78	Guernsey	65	Spain	34
Cayman Islands	77	Isle of Man	65		

Criterion 4

(for a jurisdiction to be defined as a tax haven)

- (iv): **no substantial activities**

– This criterion was vetoed by US administration of George W. Bush!

- US has been paralysed on corporation tax policy since Kennedy Administration

- Kennedy Administration proposed that overseas income of US corporations should be taxed exactly the same as income earned in the US
- Because US corporations would pay higher global taxes than competitors from lower-tax jurisdictions, Congressional Republicans argued that this would damage their international competitiveness

The 1962 compromise

- “Subpart F”
 - US taxes cannot be deferred on passive income (royalties etc.)

The 1997 Change in US Tax Procedures

- New IRS regulations (“check the box”) paved the way for creative tax-avoidance planning options
 - “... thwarted the application of Subpart F”

- “Check the box” allows certain foreign entities to be amalgamated for US tax purposes.
- For example: A US corporation sets up a holding company in Ireland and has this holding company own the corporation’s operating company in Ireland.
- With “check the box”, any monies paid to the holding company – which would have been SubPart F – are now treated as though earned by the holding company

Memo from Senator Levin, Subcommittee chairman, 20 Sept 2012

Check-the-box tax regulations issued by the Treasury Department in 1997, and the CFC Look-Through Rule enacted by Congress as a temporary measure in 2004, have reduced the effectiveness of the anti-deferral rules of Subpart F and have further facilitated the increase in offshore profit shifting, which has gained significant momentum over the last 15 years. On

- The IRS rapidly tried to row back on 'check the box' but corporate lobbying prevented this.
- Instead, it got written into law as the 'Look-Through Rule'
 - <http://www.reuters.com/article/2013/05/30/usa-tax-checkthebox-idUSL2NOE90RO20130530>

- Among the legislators who voted for 'the Look Through Rule' were Senators Levin and McCain!

Hybrid Entity

- Hybrid entity: entity with a single owner that is treated as *a separate entity under the relevant tax laws of a foreign country* and *as a branch of a foreign subsidiary that is its sole owner for US tax purposes*.
 - US Congress, X-37-10, p. 48

- The holding company and the operating company are both incorporated in Ireland so by US law they are Irish companies.
- Irish law is different. The two companies are American because that's where ownership and control resides.
- The operating company is tax resident in Ireland because it has substantive operations here. The holding company is not, because it doesn't!

- This is an example of 'cross-border tax arbitrage'
 - the purposeful use of two countries' conflicting treatment of a single entity

- 'Virtual' residency is traceable to a series of UK law court rulings culminating in the 1929 *Egyptian Delta Land and Investment Co.* case, which found that a company registered in London but without any UK activities was not subject to British taxation
- Laid down the rule for all jurisdictions whose legal framework derived from that of the UK.

Did Ireland relax its laws when US “check the box” rules came in?

- No. Finance Act 1999 tightened them.
- An Irish-incorporated company which is under the ultimate control of (EU or US) persons AND ... is related through ownership to a company with substantive activities in Ireland will continue to be able to be non-resident under the management and control test

Oireachtas Finance Sub-committee on International Taxation

18 September 2013

Opening statement by Gary Tobin, Department of Finance

Introduction

Mr Chairman I would like to thank you and the Committee for the invitation to attend here today to discuss the important topic of international tax. With your permission, I would propose making a short opening statement on the global tax architecture for multinational corporations as well as Ireland's place within it.

I am also joined here today by Mr Eamonn O'Dea, Assistant Secretary, in the Office of the Revenue Commissioners who will also be answering questions with me.

Before I begin, perhaps I should point out that we will be talking today in general terms as we are precluded from discussing the affairs of any individual taxpayer.

Policy matters are obviously a matter for the Minister for Finance, and as we are only four weeks from the Budget, there may be tax policy matters that I am not able to elaborate on at this time.

The tax arrangements of some multinational corporations have received a lot of attention in recent times— it is now a mainstream issue of interest.

Some common international tax principles and how a problem has arisen and evolved

Tax planning by multinationals has evolved to take advantage of the differences between jurisdictions' tax codes which provide opportunities for some multinational corporations to reduce their tax liabilities. Some of the international rules are also perceived as being outdated. It is recognised as a complex global problem. The opportunity for this type of arrangement has come about because of the change from traditional business models to the new models involving integrated global supply chains and the digital economy - where national borders become less relevant and the location of profit generation becomes more difficult to specify or identify.

Traditionally, a jurisdiction designed its tax laws to only take account of factors within its own borders. The tax laws of other jurisdictions, even its closest neighbours, were of little relevance. As international markets became more integrated, especially with the arrival of the EU's internal market, borders became more open and taxing rights became less clear-cut. The issue of which jurisdiction has the right to tax has become even more clouded by the emergence of the digital economy.

The task facing tax policy makers and legislators from all around the world is to put the appropriate rules in place to ensure as much consistency as possible which in turn will provide tax authorities as well as international corporations with a greater degree of certainty with regard to where and how income should be taxed.

The OECD is regarded as the pre-eminent authority on taxation policy for international business. In order to put in place a more structured international tax system it has produced two

significant publications: its Model Double Tax Convention and its Transfer Pricing Guidelines for Multinational Enterprises. Member countries (including Ireland) put in place provisions governing how they tax cross border business, taking account of the OECD's work.

The main focus of the OECD's work had been aimed at avoiding double taxation. It also sought to put rules in place on how transactions between related companies should be priced for tax purposes, so as to result in objectively fair allocation of taxing rights. At the same time it tried to minimise trade distortions and impediments to sustainable economic growth.

The interaction of domestic systems and operation of the international rules can lead to gaps that provide opportunities to significantly reduce taxation on income in a manner which is inconsistent with the policy objectives of such rules.

Rules which were put in place at a particular time for a particular purpose, can give rise to unintended results. Taxpayers (typically large multinationals) have been able to identify these situations and avail of the opportunities which arise by way of tax planning.

Against this backdrop, policymakers face an increasingly difficult balancing act in the current environment – designing tax rules which stimulate economic growth whilst also managing to increase tax revenues.

Tax policy is at the core of national sovereignty, and each country is free to devise its tax system in the way it considers most appropriate. OECD studies have indicated that international competitiveness concerns and pressures are felt in all countries. In addition, OECD research has shown that corporate taxes are the most harmful to economic growth prospects.

There are international rules around fair tax competition – which recognise that a competitive tax system is a legitimate tool for promoting business and economic growth – but there are limits as to what a country can do with its tax system before it constitutes “harmful” tax competition. The OECD issued a report in 1998 on harmful tax practices, setting out common rules around what constitutes harmful tax competition.

The report recommended that a preferential regime be assessed by reference to four key factors – i) does it offer a zero or low effective tax rate, ii) is it a ring-fenced regime (e.g. are residents excluded from benefitting from it), iii) is there a lack of transparency around the operation of the regime, and iv) is there a lack of effective exchange of information with other countries in relation to the regime.

It is not just governments who are striving to be competitive as regards taxation. It is also a competitiveness issue that affects companies. A key determinant of “shareholder value” under current corporate reporting standards is called earnings per share (known as EPS). Tax impacts this ratio (i.e. the higher a company's effective tax rate, the lower its EPS ratio). Tax also affects other financial indicators used by corporate analysts, so that it is in the interests of the companies (and specifically their shareholders, their boards, finance directors and tax directors) to strive to use all legitimate means possible to reduce their effective tax rates. The “fiduciary duty” of company directors is often also cited in this regard.

Recent events and the proposed solution

There is a growing perception that governments lose substantial corporate tax revenue because of tax planning. Various news stories have given the topic increased mainstream media attention.

The “BEPS” project was born at OECD level, backed by political stimulus. The G20 Leaders' meeting in Mexico in June 2012 explicitly referred to “the need to prevent base erosion and profit shifting”.

The project has continued to be politically endorsed at the highest level internationally ever since, and an OECD report in February of this year, and subsequent action plan in July, were both endorsed by the G20. In July the OECD's Pascal Saint Amans told this sub-committee about the OECD plans for this project for the next 2 years, so I will not dwell on it here.

The principle underpinning that work is that domestic rules for international taxation and internationally agreed standards are still grounded in an economic environment characterised by a lower degree of economic integration across borders, rather than today's environment of global taxpayers, characterised by the increasing importance of intellectual property as a value driver and by constant developments of information and communication technologies.

The aim of the BEPS Action Plan is to *“provide countries with domestic and international instruments that will better align rights to tax with economic activity”*.

The OECD has said that the optimum way to approach this is a consensus based co-ordinated international response. Competing sets of international standards and unilateral measures could lead to what they term “global tax chaos”, and likely double taxation.

In summary, international tax policy is, and always was complex and challenging, and evolution in business models has heightened this complexity. There is a consensus that the global system needs some fixing, which the OECD will look at and make recommendations on, and it is then up to countries to consider the impact of the recommendations on their own domestic system.

Ireland's interaction with this international tax architecture

I will now speak for a few moments about how Ireland fits into this global architecture on two levels.

Firstly by participating in international fora such as the OECD, and secondly by reflecting internationally agreed principles in our own domestic system where appropriate.

Irish transfer pricing rules are, for example, based on the OECD global standard.

Ireland has full exchange of tax information with partners through our double tax agreements, and more than 20 tax information exchange agreements which are based on OECD model agreements.

A General Anti-Avoidance Rule (GAAR) has been in place since 1989 – the EU Commission are now calling for all Member States to introduce such domestic legislation.

The recent OECD Global Forum Peer Review Report on Ireland's legal and regulatory framework for transparency and exchange of information found that Ireland has an effective system for the exchange of information in tax matters and is fully compliant with OECD standards.

Recently, Ireland also pushed forward the international tax reform agenda during our EU Presidency 2013, and achieved progress in countering tax fraud and aggressive tax planning.

Ireland was also one of the early movers in relation to new international initiatives on Exchange of Tax Information – being the fourth country in the world to sign a FATCA agreement with the US in December 2012.

Aggressive tax planning by companies relies to a great extent on mismatches between the domestic rules of different countries. In this regard, it is clear that these issues cannot be

addressed at national level alone - we need a co-ordinated international response. Ireland has been supportive of efforts at European and OECD level to develop this response.

The recent EU Presidency

On 30 June 2013 Ireland finished its seventh Presidency of the Council of the European Union. Ireland's Presidency coincided with tax policy issues taking centre stage in the international arena.

Against this elevated profile for taxation, Ireland's Presidency plan of focusing work on tackling tax fraud and tax evasion was very much in line with this new international focus. At a practical level our Presidency prioritised the work in the following areas: tackling tax fraud and tax evasion, achieving a mandate to negotiate with third countries on the Savings Taxation, tackling hybrid mismatches and enhancing Administrative Cooperation on tax.

In addition, in line with the commitment of Government to act as an honest broker as President of the Council of the European Union, we carried forward the work on the Financial Transaction Tax (FTT), Energy Tax Directive and the Common Consolidated Corporate Tax Base (CCCTB).

Given the international attention on the issue of tackling tax fraud and tax evasion, the informal meeting of EU Economic and Finance Ministers in April in Dublin held a special debate about the importance of this issue and the practical steps that could be taken at national, EU and international levels. Following this productive debate, Minister Noonan and the EU Commissioner for Taxation Algirdas Šemeta wrote a joint letter which identified seven actions that would deliver concrete results in the short term. The focus for the remaining three months of the Presidency was therefore to deliver those priority items. By the end of the Irish Presidency agreement had been reached on five out of the seven priority areas:

1. A Mandate was adopted to enable the Commission to negotiate with Switzerland, Andorra, Liechtenstein, Monaco and San Marino on a revision to the bilateral savings tax agreements. The existing agreements are outdated and need to be updated.
2. Agreement by ECOFIN on comprehensive Council Conclusions on tackling aggressive tax planning, tax fraud and tax evasion.
3. Agreement was reached on a VAT Anti-fraud package. This involves two Directives (Quick Reaction Mechanism and Reverse Charge Mechanism) and commitments in relation to the improvement of the VAT system. This agreement will give Member States the tools to tackle the very serious issue of VAT fraud.
4. Agreement was reached on the Fiscalis 2020 Programme. This administrative cooperation programme is an important tool for Member States Revenue authorities in the fight against tax fraud and evasion.
5. Agreement was achieved by Ministers to enhance the current level of automatic exchange of information at EU and international level. This political commitment resulted in a revised proposal from the Commission published in June for an amendment to the Administrative Cooperation Directive.

Engaging with the Developing World

At a time when resources are most needed for the poorest communities around the world, aid budgets across the developed world are under sustained pressure.

Therefore the importance of domestic tax collection to fund development should not be understated. Domestic revenue is a multiple of the amounts received in development assistance.

At OECD level, the ongoing collaboration between the Committee on Fiscal Affairs and the Development Assistance Committee has an important role to play in assisting developing countries in building more effective tax administrations in a more transparent international tax environment.

Notwithstanding our own severe budgetary challenges resulting from the international financial crisis, Ireland, through Irish Aid, is contributing to the funding of the OECD's work on tax and development.

Supporting Country by Country Reporting

To improve tax transparency and compliance in developing countries, civil society groups have for some time now been campaigning for international companies to publicly report on a country-by-country basis in their annual financial statements.

Proponents of published country-by-country reporting suggest this would discourage profit-shifting between countries.

It was originally focused on extractive industries but increasingly there have been calls for its extension to other business sectors.

Ireland supports the G8 Lough Erne Declaration on country by country reporting.

Ireland supports the ongoing work at OECD level on tax and development issues, including work on country-by-country reporting.

Ireland has given country by country reporting a significant boost by negotiating its extension to the financial services sector under our recent EU Presidency.

As a result of the EU CRD IV Directive and the Accounting Directive, the extractive industry and the financial services sector will be subject to country by country reporting.

Supporting the Automatic Exchange of Information

Another powerful tool to improve tax transparency is automatic exchange of information.

During Ireland's term as President of the Council of the EU Ireland prioritised work in the area of tax transparency. Work has been taken forward on the EU Savings Directive which provides for automatic exchange of information, and the related Negotiating Mandate to align EU savings taxation agreements with the extended scope of the proposed revised Savings Tax Directive.

The recent European Council conclusions on tax of the 22nd May called for automatic exchange of information to be extended at a global level. The European Council also called for further work to ensure that third countries, including developing countries, meet appropriate standards of good governance in tax matters.

Ireland supports the global move towards the automatic exchange of information and welcomes the European Commission's recent proposal to amend the Directive on Administrative Co-operation in the field of taxation.

European Commission Request for Information from EU Member States on Corporation Tax Matters

The Commission is currently reviewing the different tax ruling procedures in various EU member states to assess their ruling practice under EU State Aid rules.

Ireland is fully co-operating with the Commission in this exercise.

I think it is important to state clearly that no formal EU state aid inquiry has been launched by the European Commission on this issue.

It is also important to state that the European Commission is asking various member states to provide information – in other words – this is not a country specific or a company specific issue.

According to the article in the Financial Times last week a spokesperson for the Commission said that “At the moment we are simply gathering information”.

Ireland, like all Member States, from time to time receives queries from the Commission on a variety of issues, including tax, and we always cooperate fully with such requests for information.

It is not surprising given the amount of media coverage on these issues in recent months, that the Commission has asked to be provided with information.

In the majority of cases, such requests from the Commission for information do not result in formal state aid enquiries.

The essence of State Aid is about aiding a particular sector or type of investor – the Irish rules do not do that.

As has been stated before, Ireland does not do special tax rate deals with companies.

Ireland operates an open, transparent and statute based taxation system.

Throughout the recent Irish presidency of the EU Council, Ireland has been at the forefront of actions seeking to combat aggressive tax planning.

We are also fully supporting the BEPS (Base Erosion and Profit Shifting) project at OECD, and will continue to work with our international partners to ensure fair tax competition.

OECD Response

Given the OECD’s pre-eminent role in setting international tax rules, its Base Erosion and Profit Shifting (BEPS) project represents the most effective global response to the international tax issue and BEPS will be the main toolkit of the global effort to tackle these issues.

Ireland welcomes the BEPS project, and also the coordinated effort at OECD level to deal with the challenges BEPS poses.

Ireland has no particular concerns arising from the OECD’s work. Given the requirement for substance in Ireland to qualify for our competitive 12.5% rate, and the emphasis on substance in the OECD’s BEPS Action Plan, there may be opportunities to attract further FDI into Ireland, whilst adhering to our international obligations concerning fair tax competition.

We will participate fully in the various groups which are pushing forward the actions in the OECD's BEPS Action Plan, and will consider the potential impact of the output of that work on our domestic tax system.

Conclusion

Mr Chairman, that concludes my opening statement. Both I and my colleague, Mr O'Dea will do our best to answer any questions you or the Committee may have.

Mr Eamonn O’Dea, Revenue Commissioners

1. Tax Practices of Multinationals

Much of the current concern about the taxation of companies refers to low effective rates of tax being paid by high-profile multinationals. It has not been suggested that multinational companies generally do not comply with the corporate tax requirements in the individual countries in which they operate. The concern is that international tax rules or principles have not kept pace with current methods of doing business, particularly in the digital economy, and also that the interaction of the different tax regimes of the countries in which the multinationals operate can lead to reductions in the tax being paid.

2. Statutory Tax Rates

Long-established policy here has emphasized a transparent competitive tax rate applied to a broad base of corporate income. Irish corporation tax applies to the full income of companies resident here—including, for example, dividends received from foreign subsidiaries and foreign branch income, both of which are exempted from tax in many, if not most, other EU and OECD countries. In addition to the general 12.5% rate for trading income, there is also a 25% rate for non-trading income - such as investment and rental income - and a 33% rate for capital gains.

These rates are set out in legislation—in the *Taxes Consolidation Act*. Revenue has no discretion, in any respect, in relation to those rates. These are the rates that we apply to all companies, however big or small.

It is unhelpful and misleading to treat the average rate of tax, calculated by reference to the sum of the profits attributable to different countries, as being the effective rate in one of those countries. It is most definitely mistaken and wrong to refer to such average rates as being special rates negotiated by the multinationals concerned with Revenue.

3. Advance Opinions

Recent media reports refer to EU Commission enquiries in relation to tax rulings in various countries. Advance opinions are given by Revenue on the tax treatment of a proposed transaction, event or business activity based on a review of the information provided by the taxpayer and the relevant tax legislation and Revenue practice. Advance opinions are designed to provide clarity in relation to the applicable tax rules so that the company can file a correct tax return and comply fully with its tax obligations. Revenue opinions are non-binding and it is open to Revenue officers to review the position when a transaction has been completed and all the facts are known. Where Revenue considers that an opinion is likely to have a wider application or to set a precedent, it will arrange to publish a practice or guidance note on the matter.

4. Large Cases Division

Our Large Cases Division provides a strong organisational focus on multinational companies and other large cases, in line with best international practice. We monitor tax practices in the multinational sector to ensure compliance. We do this, as we do for other sectors, based on assessment of risk to the Irish Exchequer— and in many circumstances this may be a risk in relation to payroll taxes, excise or VAT rather than Corporation Tax.

5. Coordinated Response to International Issue

The tax practices of multinational corporations are the focus of work being undertaken at EU level and, in particular, by the OECD. There is broad agreement underlying the OECD/G20 Base Erosion and Profit-shifting “BEPS” Project that responses to the tax practices of trans-national, indeed global, corporations require international coordination of policy, legislation and tax administration.

Coordination is required not only because the concerns arising are often the result of the interaction of the tax regimes across countries in which multinationals operate— rather than the law or practice of any individual country on its own. International coordination is also required because the international mobility of investment by global corporations requires anti-BEPS tax measures to be adopted widely across countries if they are to be effective. Otherwise they could just lead to a withdrawal of investment from countries adopting the measures concerned.

6. Revenue Participation

Ireland supports the approach of developing coordinated responses to base erosion and profit-shifting and Revenue will participate fully in the work of the BEPS project. We also participate in the EU Council Code of Conduct Group and the OECD Forum on Harmful Tax Practices - both of which monitor harmful tax practices - and there are no issues for the Irish corporate tax regime in either of those groups. Revenue is an active participant in the OECD Forum on Tax Administration and currently chairs that committee of the Heads of OECD tax administrations.

Revenue Commissioners Note on the Effective Rate of Corporation Tax

Companies operating in Ireland are chargeable to corporation tax at the 12½ per cent rate on the profits that are generated from their trading activities here. The 10 per cent corporation tax rate for profits from manufacturing expired at the end of 2010 and the 12½ per cent rate now applies to such profits. A higher 25 per cent rate applies in respect of investment, rental and other non-trading profits, as well as certain petroleum, mining and land-dealing activities, while chargeable capital gains are taxable at the capital gains tax rate of 33 per cent.

Companies are chargeable to corporation tax on their profits after taking account of allowable deductions and reliefs provided for in the Taxes Consolidation Act 1997. Expenses that are incurred wholly and exclusively for the purposes of the trade are deductible in computing trading profits, while allowances are available for capital expenditure on plant and machinery, industrial buildings and certain intangible assets used in the trade, with such allowances treated as a deductible trading expense. Companies are charged on their net profits after account is taken of any losses they have incurred.

The Taxes Consolidation Act contains certain tax reliefs for companies that are standard features of a corporate tax system, including group relief - which allows for trading losses of a group company to be offset against profits of another group company - and double taxation relief which provides relief for foreign taxation on income earned abroad. There are also specific tax reliefs for companies that are targeted at promoting investment in key areas of economic importance, including a 25 per cent tax credit for expenditure on research and development and relief for start-up companies creating employment.

There are different ways of measuring the effective rate of corporation tax and there is no single internationally agreed comparative measure for this. An effective corporation tax rate of 11.9 per cent was estimated for Ireland in a study carried out by Price Waterhouse Coopers in 2011 for the World Bank, which includes estimates of effective tax rates for 183 countries based on the tax obligations of a standardised company operating in each country. Another study - the European Commission's *Taxation Trends in the EU 2013*⁹ - indicates an effective tax rate for Ireland that is close to the 12½ per cent corporation tax rate. In the absence of an agreed methodology for determining the effective tax rate, differences will inevitably exist in comparative studies on

9

http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_structure/2013/report.pdf (Table 91, page 262)

effective tax rates, depending on how the rate is calculated and the assumptions used in the calculation.

An estimate of total corporation tax payable as a percentage of taxable profits can be made from the latest aggregate corporation tax statistics compiled by the Revenue Commissioners, based on the tax returns of companies for the year 2010. These statistics indicate that aggregate net taxable profits, after taking account of various deductions, allowances, charges and reliefs, amounted to €41.215 billion while the total amount of corporation tax payable on these profits was €4.246 billion. This means that total corporation tax payable as a percentage of taxable profits was approximately 10.3 per cent for the year.

While this percentage is lower than the 12½ per cent rate, this can be attributed to the availability of certain reliefs – such as double taxation relief (€619 million), manufacturing relief¹⁰ (€403 million) and R&D credit relief (€142 million).

A summary of the calculations is set out in the **Annex** attached, while a more detailed breakdown is provided in Table CTS 3 and Explanatory Note in the Annual Revenue Statistical Report available on the Revenue website at www.revenue.ie.

¹⁰ This relates to the 10% rate of tax for manufacturing companies that expired on 31 December 2010.

ANNEX to Revenue Commissioners Note on Effective Tax Rates

Aggregate Taxable Profits of Companies for Accounting Periods ending 2010

	€m	€m
Gross Trade Profits		70,804
<u>Less</u> deductible amounts as follows:		
Capital Allowances	12,296	
Trading Losses Brought Forward	3,870	
Current Year Trading Losses	131	
Trade Charges	11,695	
Group Relief	2,747	
		(30,739)
Net trading Profits		40,065
Net Rental Income		547
Non-trading Profits / Capital Gains		5,849
<u>Less</u> Other Deductions:		
Management Expenses	415	
Excess Capital Allowances	15	
Non-trade charges/ other deductions	4,804	
Excepted Trade Losses	12	
	(5,246)	
Net Taxable Profits		<u>41,215</u>

Note:

After taking account of surcharges and various reliefs and credits, such as double taxation relief (€619m), manufacturing relief (€403m) and R&D credit relief (€142m), the total amount of corporation tax payable in respect of the net taxable profits of €41.215 billion for 2010 was **€4.246 billion**.

The Joint sub-Committee on Global Taxation, Leinster House

Opening statement – Brian Keegan, Chartered Accountants Ireland

Chartered Accountants Ireland is glad of the opportunity to contribute to the work of this subcommittee. Your examination of these important tax issues is already making a significant contribution to the public and political debate.

The use of the term “global taxation” by the Committee is well-informed. There is no such thing as international tax – taxes are paid by companies to the sovereign governments who hold the taxing rights. Ireland, like many other countries, charges companies to tax on the basis of their tax residence.

This concept of tax residence is fundamental to the issue under consideration today – the interaction of Ireland’s corporate income tax system with the rules and regimes in operation in other countries. Companies which are incorporated in Ireland, and are managed and controlled in Ireland, are tax resident in Ireland and subject to Irish Corporation tax irrespective of where that income arises. Sometimes overlooked is Ireland’s claim to Corporation tax on the activities of companies which are not resident in Ireland, but which are active here by virtue of a branch operation, or by having a permanent establishment in this country. Our corporation tax system is more transparent than other taxation systems which have higher headline tax rates but also provide for significant deductions to arrive at taxable income and taxable profits.

With the focus on Ireland’s 12.5% Corporation Tax Rate, the treatment of profits from companies when after-tax profits are distributed out to shareholders and other stakeholders can be overlooked in the tax debate. Ultimately, the profits of a company make their way to individuals, and much of the global tax system aims at ensuring those profits are not taxed too many times along the way.

A clearly defined interaction of the Irish tax system with the tax regimes of other countries is fundamental to international trade between companies. Ultimately tax is a business cost for companies, to be predicted and managed. It carries responsibilities but also it must be managed in the same way as utility, distribution, employees and other costs must be predictable and manageable. If our tax regime were to be too closed and protectionist, Irish companies simply would not be able to trade abroad, nor would Ireland be an attractive destination for companies seeking to locate operations in this part of the world.

The main defining instrument for the interaction of Ireland's tax regime with other tax regimes in the world is the Double Taxation Agreement. The purpose of a Double Taxation Agreement is in fact to eliminate Double Taxation; the charging to tax by two sovereign

governments of the same profits arising from the same activities of a company, or for that matter, an individual taxpayer. Double Taxation Agreements may have their flaws, but they are vigorously negotiated between sovereign states depending on the needs and aspirations of those states at a point in time. They are not static.

Critics point out that such agreements can result in double Non-Taxation. Another criticism involves so-called Treaty Shopping; the idea that certain activities are better located in one country over another, not because of any commercial considerations, but because of a more favourable treaty treatment for those activities. Nevertheless, Ireland cannot tax income or assets which are outside its sovereign charge to tax.

It is therefore no surprise that debates concerning residence rules, and the operation of Double Taxation Agreements are significant themes for the G 20 sponsored OECD Base Erosion and Profit Shifting (BEPS) initiative.

Unfortunately our country's tax regime has become something of a target in the discussion of global tax policy. This is unfair and unfounded. We are not outliers in terms of our tax rules; they are grounded in over a century of common law practice and interpretation. Our Double Taxation Agreements are based on OECD principles. In particular, Double Taxation Agreements are bilateral instruments; agreements between sovereign nations. Such Agreements have to work for both countries involved, and they can be changed where they do not work.

Harmful tax practices are simply not a feature of the Irish tax landscape. Harmful tax practices, as and when highlighted either by the OECD or by the EU, were changed by successive Irish Ministers for Finance. The Irish system has already been through the mill of good practice scrutiny. That is why concepts such as the requirement to have a substantial presence in Ireland, anti-transfer pricing rules, and exchange of information between Revenue Authorities are features of the Irish system. We must always be mindful of our obligations under the EU Treaties when contemplating any changes to our tax system.

That is not to say that there is not still room for improvement, and particularly reputational improvement. Tax legislation and best practice can and will evolve, not least because many of the rules which apply not only in this country but in other countries across the globe predate the growth in cross-border trade and the pre-eminence of intellectual property on the balance sheets of international companies.

I look forward to our discussion this afternoon. Thank you.

27 May 2014



Presentation to the Oireachtas Finance sub-Committee on Global Taxation May 27th 2014

Christian Aid is an Irish development organisation. We work globally in over 40 countries for profound change that eradicates the causes of poverty, striving to achieve equality, dignity and freedom for all, regardless of faith or nationality. We are part of a wider movement for social justice. We provide urgent, practical and effective assistance where need is great, tackling the effects of poverty as well as its root causes.

We have been working on tax and development for a number of years, and became the first leading NGO to make it a major campaign priority in 2008. Since then the importance of tax justice has been recognised by the G20, the UN, the OECD, the IMF and by many large businesses. In 2010 Christian Aid was identified as one of the 21 most influential organisations in the world of tax by International Tax Review. Christian Aid is a member of the OECD Informal Taskforce on Tax and Development and the Taskforce on Financial Integrity and Economic Development. We also are members of the European Commission's Platform for Tax Good Governance, established in 2013.

In terms of securing foreign direct investment, Ireland has been very successful since the 50s. There are now more than 1000 multinationals with operations in Ireland. Corporation tax rate has been a central plank of that, but other factors also contribute to making Ireland an attractive location to locate- including a skilled workforce, an English speaking population, membership of the EU and various other incentives such as tax credits for Research and Development carried out here.

During the course of this presentation I aim to highlight how some of these factors leave Ireland vulnerable to exploitation by some MNCs, and pose a threat therefore to Ireland's

international reputation, as well as to the development of some of the poorest countries in the world.

I will also argue that while looking at Ireland's tax regime is important in understanding how we fit in globally, without having a fuller understanding of the workings and structures of MNCs themselves, and the secrecy on which they depend, we are only ever going to have part of the picture.

Certainly a 12.5% corporation tax rate makes Ireland an attractive destination for the legal processes of moving genuine economic activity to Ireland to avail of this tax rate- and the tax breaks offered for R and D purposes. Where these activities are part of a MNCs supply chain, transfer pricing is used to assign the value, and profits, to the activities in Ireland.

However, what research by Christian Aid and others has illustrated, is that an accurate application of the OECD's arms-length principle in transfer pricing is difficult to ensure. Intra-company transactions between subsidiaries allows for highly subjective discretion in determining at what price those transactions take place, resulting in vast amounts of money being shifted between subsidiaries, around the globe- including from countries of the global south. It is particularly difficult to ensure in transactions involving intangibles such as intellectual property, management fees etc, which may not have a comparable price on the open market.

Christian Aid research shows that the least developed countries of the world lose \$160bn each year to transfer mispricing and false invoicing. Further research looking at trade mispricing also showed that between 2005-7 some \$5.8bn in mispriced capital flowed into Ireland, of which \$268m came from the least developed countries in the world.(False Profits, Christian Aid report, 2008)

Prem Sikka Professor of Accounting and Director of the Centre for Global Accountability at the University of Essex makes the point (2010) that allowing companies to offset Research and Development expenditure against taxes also makes it very attractive for companies to have an R and D presence in Ireland. However, according to Sikka it is often highly subjective as to what constitutes R and D expenditure.

Christian Aid acknowledges the strategic aims behind the R&D tax credit, namely fostering innovation and research in Ireland and driving future employment and growth. We also recognise the need for Ireland to remain competitive internationally in terms of attracting and retaining sustainable foreign direct investment.

However, in examining the architecture of Irish tax policy, consideration should also be given to the potential for our low corporation tax rate and our R&D credit to be used (or abused) in ways that may impact negatively both on our reputation, and on the ability of developing countries to raise their own revenue.

Through locating intellectual property (IP) rights in developed countries such as Ireland, multinationals have the ability to declare these IP rights as a large share of their profits on products developed and produced in other jurisdictions, including in developing countries. R&D tax credits, in reducing a company's effective tax rate, have the potential to incentivise multinationals to accumulate intellectual property rights in Ireland. (Sheila Killian; *Driving the Getaway Car*, 2011)

Thus tax expenditure such as R&D credits is more liable to manipulation for the purposes of tax avoidance. Consequently, there is an extra need for government to monitor such tax expenditure to ensure it is not an unintended vehicle for tax avoidance.

In September 2012 as reported by the Irish Times, the US Senate Homeland Security and Governmental Affairs Subcommittee on Investigations found that Microsoft used subsidiaries in Ireland and elsewhere to reduce its US tax bill for 2011 by €1.87bn. This was done in part by using the architecture of R&D tax credits and intellectual property rights in Ireland:

“Microsoft Corporation has used aggressive transfer pricing transactions to shift its intellectual property, a mobile asset, to subsidiaries in Puerto Rico, Ireland, and Singapore, which are low or no tax jurisdictions, in part to avoid or reduce its U.S. taxes on the profits generated by assets sold by its offshore entities.” Statement by Committee, 20 September 2012

In 2001 Microsoft established a subsidiary Round Island One Limited, operating from the offices of a Dublin law firm. By 2004, Round Island controlled US \$16 billion of Microsoft's assets and gross profits of nearly US\$9billion approximately 22% of the company's global profits (WSJ November 7th, 2005). Much of Round Island's income comes from royalties and licensing fees for copyrighted software code that originated in the US. Through another company, Flat Island Co, Round Island licenses rights to Microsoft software throughout Europe, the Middle East and Africa. Round Island has absorbed other Microsoft units, from Israel to India, moving much of that intellectual property to Ireland (Sikka and Wilmot 2010)

Colm Keena writing in the Irish Times on this subject, noted, *'Seen from the perspective of Africans, it must seem very rum indeed to see profits from sales in their countries being taxed in Dublin, to fund a society a million miles away from theirs in terms of development'*(IT November 2012)

But arguably the most important elements of our tax policy for enticing MNC investment to Ireland are our extensive network of tax treaties, and a benign transfer pricing regime.

In theory multinationals could base themselves out of one of the traditional tax havens of Europe – but doing so would place them outside of the global network of treaties available in Ireland, and leave them vulnerable for example, to any potential crack down on tax havens.

Ireland's membership of the European Union however, and our network of over 60 tax treaties, and in particular our tax agreement with the US has encouraged numerous MNCs to use Ireland as a base to manage their operations in the Middle East and North Africa (**TASC, Tax Injustice 2012**).

Considering then, the importance of our tax treaties, it is surely in our national interest to ensure that their integrity is not threatened by a perception that we are engaging in harmful tax competition. It is in our interest to ensure that elements of our tax regime are not contributing to such a perception.

For example, an Action Aid report from last year highlighted how Ireland's tax treaty with Zambia enabled a subsidiary of the giant food multinational ABF, Illovo Sugar, with an address

in the IFSC but with no record of employees or activities in Ireland, to avoid paying withholding tax on loan payments from Zambia into Ireland, and likewise on management and purchasing fees booked in Ireland- an accusation that ABF reject.

The impact of tax treaties on development is being increasingly debated, by both developed and developing countries. Mongolia for example has recently cancelled its double tax treaty with the Netherlands. While the Netherlands is particularly in the spotlight following research suggesting its treaty network is costing developing countries over €700m a year, it is at least beginning to acknowledge the problem and has offered to review its treaties with developing countries. While Ireland does not have many tax treaties with developing countries Ireland should seek to lead in this area, and advocate for the need to establish principles and practices for development friendly tax treaties, both at national, and EU and international levels.

In relation to our transfer pricing regime, allowing for *retroactive* challenges to *inward* transfer pricing as well as outward transfer pricing would bolster the integrity of our tax regime. To explain, changes made to our transfer pricing rules in the Finance Act of 2010, granted powers to the Revenue Authority to challenge suspected cases of transfer mispricing that aimed to minimise the amount of profit being transferred into Ireland. Of course, instances of multinationals engaging in transfer mispricing to minimise the amount of profit recorded in a low tax jurisdiction such as Ireland would be highly unlikely and the change in rules could be described as self-serving and designed to protect only Ireland's tax base.

Dr Sheila Killian, of the University of Limerick, has made the point that it would be useful, if the Revenue Authority were granted power to retrospectively challenge instances of suspected transfer mispricing *into* Ireland, rather than to just assume that what is being declared by the company in Ireland is the correct amount and not the result of transfer mispricing.

This would be especially helpful to developing countries, where weaker capacity makes it more difficult for them to identify and challenge transfer mispricing (and other harmful tax practices).

While capacity building in country is necessary, with a gap of over 650,000 tax officials in sub-Saharan Africa from the world average the capacity gap will not be bridged soon, so measures where Ireland can seek to enhance developing countries capacity should be explored, e.g. through challenging mispricing into Ireland as referred to previously, or requiring disclosure of tax avoidance schemes and sharing details with developing countries.

That being said, the degree of secrecy or opacity around the activities of corporations would challenge even the Irish Revenue Authority in detecting instances of transfer mispricing into Ireland.

The Irish Revenue Authority sees only one part of the picture of the activities of multinational corporations- those parts that are operational in Ireland. No information is available in Ireland on what subsidiaries of the same company may be doing in other jurisdictions. This makes it difficult to detect instances of illegal profit shifting. This is particularly relevant for developing countries. With limited capacity they will struggle to identify where companies may be manipulating transaction prices.

For this reason, civil society has been calling for the introduction of a new accounting standard called country by country reporting, which would require companies to report on the full range of their activities in each of the jurisdictions in which they operate- including profit made, taxes paid, sales, assets held, employees etc.- all the information required to give the full picture of what a company is doing. This is not the silver bullet for developing countries struggling to keep revenue in their countries, but it could potentially raise a red flag for countries and help them target their limited resources onto particular companies they suspect may be engaging in illegal profit shifting.

It is the complex and opaque structure of companies and their use of tax havens that makes their activities so difficult to monitor and, Christian Aid believes poses a profound threat not just to developing countries but to rich countries as well. Action Aid research from 2011 highlighted that 98 of the top 100 FTSE companies have a presence in a tax haven, while Christian Aid research from this year showed that of the 29,891 subsidiaries created by the FTSE 100, information about their turnover, assets, shareholder funds and number of employees are freely available only from one quarter of them. For almost another quarter

that kind of information is not available at all. The absence of this kind of information creates an information void which threatens investors, customers and government regulators, because it leaves them without the facts they need to make good decisions about FTSE100 companies. For instance, it may be impossible for governments to tell if they are paying the right amount of tax and for investors to tell the true worth of a company.

So while the focus of this committee on the global taxation architecture and Ireland's place in it is important, it is as important to consider company dependency on corporate secrecy and opacity to conduct their business.

This is as true for Ireland, as evidenced by the recent revelations about Apple, revelations only made public as a result of a request from the US Senate, as it is for developing countries, such as Zambia, where for example a leaked audit report from the audit firm Grant Thornton alleged the Mopani mine in Zambia- a subsidiary of the commodities giant Glencore was engaging in abusive transfer pricing, profit shifting, and manipulation of its labour costs, to shift millions of dollars out of Zambia to low tax jurisdictions. This involved the underselling of copper from Zambia to subsidiaries in Switzerland which further Christian Aid research subsequently showed, is the same copper sold on from Switzerland at considerably higher prices. Zambian civil society estimates that tax dodging by Mopani over the course of the two years for which they were audited cost almost €88 million.

It is the view of Christian Aid that examining Irish tax policy provides only part of a global picture and that the analysis needs to be wider. Indeed, examining the potentially deleterious effects of Irish tax policy on developing countries is something that the Department of Finance is already obliged to do through the Government's **One World One Future** document, approved by Cabinet in May of last year. The document sets out the policy direction for Irish Aid for the future, but critically for this committee also includes clear reference to the need to ensure greater coherence across government to ensure the policies of one Department- including our tax policy- do not undermine the development objectives of Irish Aid and the Department of Foreign Affairs. To the credit of the Department they have recently launched a tender process for a 'spillover analysis' of Irish tax policy.

In conclusion, much of the response in Ireland to criticism of Irish tax policy has been to note that the solution is necessarily global, and cannot be fixed by Ireland unilaterally.

Christian Aid certainly agrees with the assertion that taxation needs to be viewed as a global issue- the policies of one country cannot be looked at in isolation when it is clear that these policies can have negative, albeit unintentional consequences, on other countries- and in particular those countries with less capacity to engage with multinational companies and accountancy firms on an equal footing.

And while we also acknowledge that the international tax rules cannot be fixed by one state alone, we contend that there are certain things that Ireland can do to ensure that we are putting our best foot forward, responding to the reputational damage we are experiencing, embracing all opportunities that present themselves to demonstrate the highest commitment to openness and transparency- even if in cases that means going beyond what is the internationally accepted standard. As we have learned from the BEPS initiative, adherence to the standards laid down by the OECD have been insufficient in curbing the problem of base erosion and profit shifting.

What is clear, and uniformly acknowledged(OECD, Commission, World Bank, IMF etc.), is that is developing countries who suffer most as a consequence of corporate secrecy and inadequate regulation. While there is no suggestion that Ireland is deliberately setting out to deplete the resources of developing countries, what I hope has been made clear, is that there are gaps in the system that may be resulting in Ireland inadvertently undermining the tax take of poor countries. There is a clear moral responsibility on Ireland to ensure that it is doing all in its power to close these gaps, and honour its obligations to the poorest countries of the world.

What we are proposing the Irish government do:

Essentially, Ireland has a reputational problem and is already considered a conduit country. Christian Aid is of the view that it would be prudent/sensible to favourably consider all

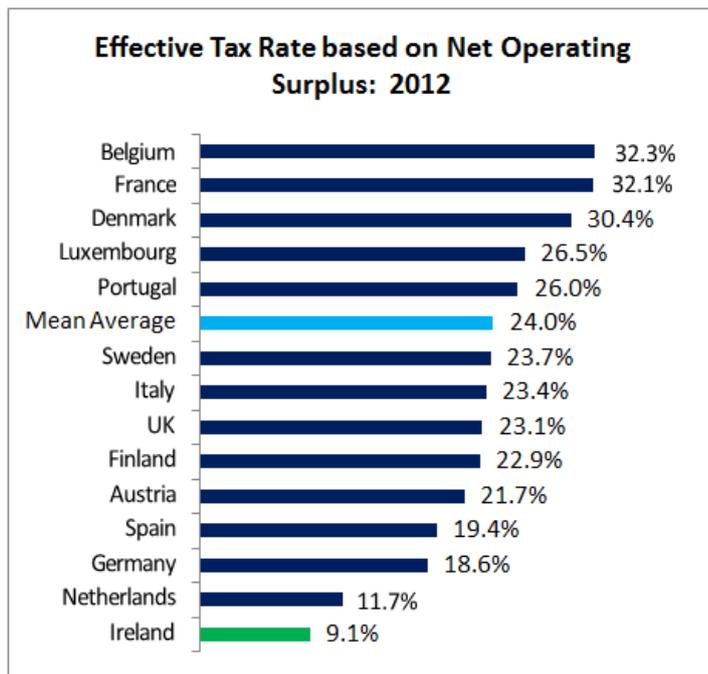
opportunities to demonstrate a commitment to transparency nationally. In some cases this may mean going beyond what is the international standard, acknowledging that in some cases the international standard is insufficient.

1. Introduce a Country By Country Reporting requirement for companies operating in Ireland(
2. Conduct a Spillover analysis- tender has been launched
3. Review all treaties from development perspective (should be done as part of spillover analysis)
4. Automatic Information Exchange- as part of the BEPS process support efforts to introduce multilateral agreement for exchange of information- which would enable developing countries participate, without necessarily being required to reciprocate in the early stages
5. Adjust transfer pricing regime to give Revenue Authority powers to challenge and adjust transaction which boost Irish profits as a consequence of transfer mispricing, as well as those which deplete them
6. Ensure any international agreement reached on global taxation is one that will work for developing countries as well



Unite Submission to the Joint Committee on Global Taxation

On behalf of Unite the Union I would like to thank the Committee for the opportunity to discuss Ireland’s effective corporate tax rate in a European and wider economic context. Our submission will use the official data collected by national statistical agencies. We do not intend to directly address the issue of Ireland’s role in the global tax avoidance network – which has considerable implications for estimating a robust and realistic effective tax rate. For our purposes, we will use the currently available macro-economic data.



The effective tax rate is a function of the headline rate combined with reliefs. There are two principle measurements of profit that can be used to estimate the effective tax rate and compare it with other Advanced European Economies.¹

The first is entrepreneurial income. The Central Statistics Office describes entrepreneurial income as ‘. . . a more comprehensive measure of corporate profitability’² Eurostat states: ‘. . . net entrepreneurial income . . . approximates the concept of pre-tax corporate profits in business accounting.’³

The Department of Finance technical paper, *Effective Rates of Corporation Tax in Ireland*,⁴ points to issues regarding net entrepreneurial income; namely that this includes income from collective investment funds which are not taxed at source. Taking this on board, we propose to use net operating surplus⁵ – a common international measure of profitability and one which is favoured by the Department of Finance technical paper.

¹ Advanced European Economies is used by the Nevin Economic Research Institute and refers to the EU-15; it excludes the poorer New Member States.

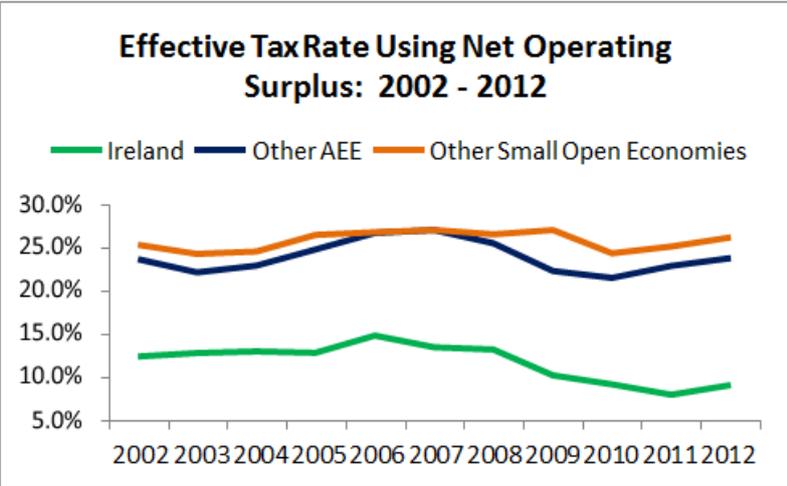
² Institutional Sector Accounts Non-Financial and Financial 2012, CSO: <http://www.cso.ie/en/media/csoie/releasespublications/documents/economy/2012/isanonfinfin2012.pdf>

³ Eurostat: http://epp.eurostat.ec.europa.eu/portal/page/portal/sector_accounts/detailed_charts/non-financial_corporations

⁴ Effective Rates of Corporation Tax in Ireland, Department of Finance: <http://www.finance.gov.ie/sites/default/files/140407%20FINAL%20Technical%20Paper%20on%20Effective%20Rates%20of%20Corporation%20Tax%20in%20Ireland.pdf>

⁵ Net operating surplus is gross operating surplus (gross value-added minus employee compensation) minus consumption of fixed capital (i.e. depreciation charges) and net indirect taxes (indirect taxes minus by producer subsidies). Value added may be stated gross (equal to the net output value, including consumption of fixed capital, i.e. depreciation charges) or net (excluding consumption of fixed capital).

There is little difference between net entrepreneurial income and net operating surplus as applied to non-financial companies. It only becomes an issue with financial companies.



Using net operating surplus for all Advanced European Economies (AEE) to estimate the effective corporate tax rate, we find, unsurprisingly, that Ireland is an outlier.⁶ The mean average effective tax rate for AEE is 24 percent; Ireland is at the bottom of the table with 9.1 percent. The Irish effective tax rate is 62 percent below the mean average of the other countries.

Another useful comparison is with other small open economies.⁷ These are countries with a similar structure to our own: small economy, small domestic market, reliant upon export earnings. The mean average for other small open economies is 26.2 percent – higher than the overall average and, so, even higher than Ireland.

Ireland’s low effective tax rate is a historical phenomenon. Since 2002 Ireland has maintained the lowest effective tax rate, even during the asset-bubble period. It is worth considering the nominal fiscal impact of Ireland’s low effective corporate tax rate. Clearly, the negative difference in tax revenue would be substantial when compared to other AEE. Of course, this exercise would have to take into account the change in behaviour; for instance, the impact on the corporate tax base and key economic sectors.

Another consideration, given the level of fiscal consolidation Ireland has endured, would be the multiplier impact of a low corporate tax regime. Studies from the Nevin Economic Research Institute⁸ and IMF research⁹ suggest that raising the corporate tax rate would have minimal negative impact on the economy and a high level of consolidation benefit. However, it is difficult to assess to what extent Ireland may be an exception to this.

Tax rates, whether headline or effective, are a result of policy. It has been stated that one of the goals of our current tax architecture is to encourage corporate investment. Therefore, it may be helpful to construct a comparison of corporate investment using elements that helped us determine the effective tax rate.

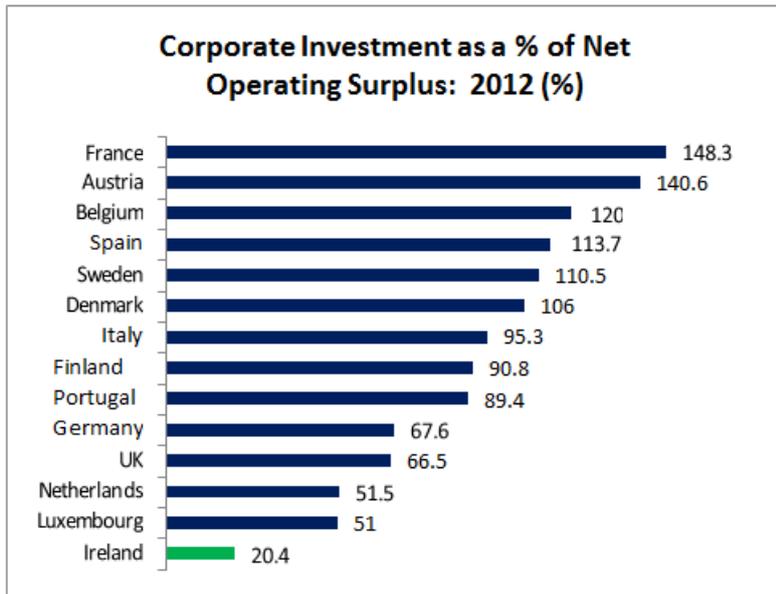
⁶ Eurostat: Non-Financial Transactions http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nasa_nf_tr&lang=en Unless where otherwise stated, estimates using AEE are based on the mean average.

⁷ Austria, Belgium, Denmark, Finland and Sweden.

⁸ The Effects of Various Fiscal Measures, Dr. Rory O’Farrell, NERI: http://www.neriinstitute.net/download/pdf/neri_wp_201310_effects_of_various_fiscal_measures_rory_ofarrell.pdf

⁹ Effects of Fiscal Stimulus in Structural Models: Coenen, G., Erceg, C. J., Freedman, C., Furceri, D., Kumhof, M., Lalonde, R <http://www.stanford.edu/~kumhof/modelcomparison2010.pdf>

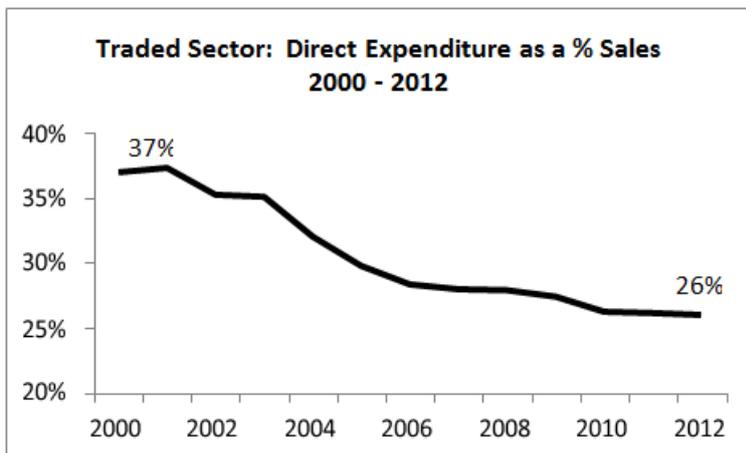
When comparing corporate investment with net operating surplus we find the following:



As seen, Irish corporate investment is extremely low in European comparison using this measurement.¹⁰ In other countries it is not unusual to see corporate investment levels exceeding profit levels. Ireland, again, is an outlier. Using other measurements we find similar results. For instance, when estimating corporate investment as a proportion of economic output (GDP), Irish corporate

investment has over the last decade been, on average, 34 percent below the EU- 28 average.

Alongside this is the attempt to encourage increased expenditure in the domestic economy. Forfás tracks this in their Annual Business Surveys.¹¹ A relevant measurement is the level of direct expenditure in the traded sector by client companies of state agencies such as IDA and Enterprise Ireland. Direct expenditure equals wages and salaries along with materials and services purchased from domestic companies (intermediate consumption).



Forfás estimates that, at the beginning of the last decade, over 37 percent of sales were returned to the economy in the form of payroll and domestic purchases. By 2012 this had fallen to a quarter. In real terms (that is, after inflation), direct expenditure fell by 17 percent. If the policy intention of a low corporate tax is to encourage

investment and higher direct expenditure in the domestic economy, it is urgent that that this be reviewed for it appears that the results have been disappointing.

Another assumption is that a policy of a low effective tax rate would encourage higher levels of employee compensation through higher levels of post-tax profits – a type of trickle-down process.

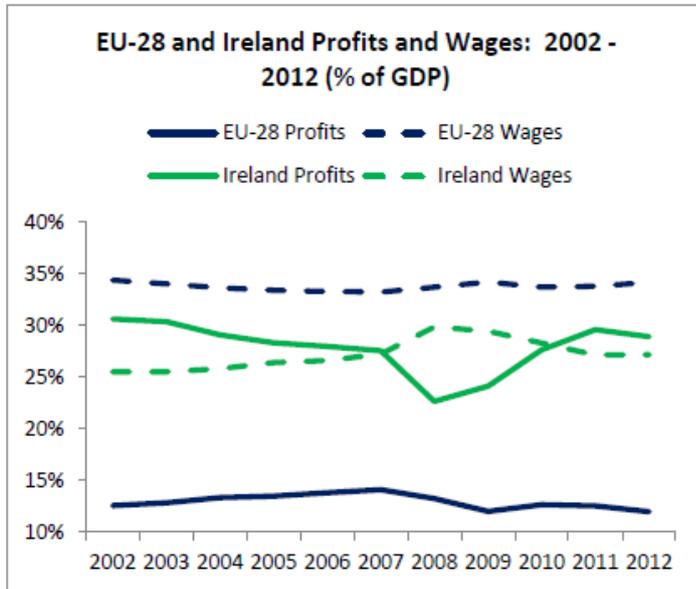
¹⁰ Eurostat: Non-Financial Transactions

http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nasa_nf_tr&lang=en

¹¹ Annual Business Survey of Economic Impact, Forfás:

<http://www.forfas.ie/publication/search.jsp?ft=/publications/2014/Title,12012,en.php>

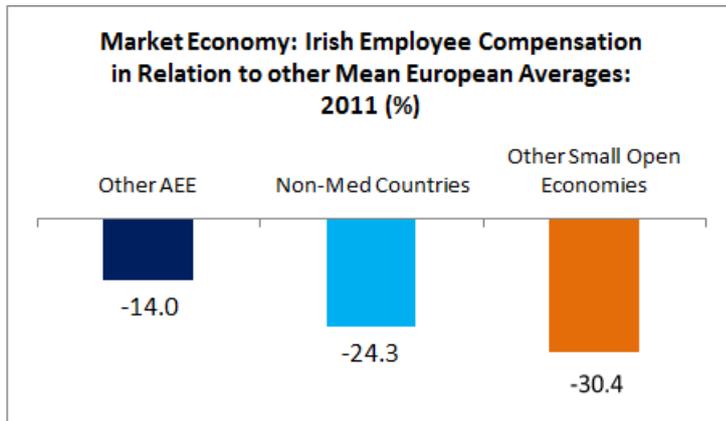
We can test this by measuring employee compensation as a proportion of profits (net operating surplus).



In EU countries, employee compensation makes up nearly three times the level of profits (net operating surplus).¹² In Ireland, however, employee compensation and profits are roughly equal.

While the data shows that, in proportion to GDP, there was a fall in profits at the beginning of the crisis, this is a function of the fact that profits are squeezed at the beginning of a recession. In Ireland, this fall has now been reversed.¹³

Ireland’s relative low-wage standing shouldn’t be too surprising. Unite has shown, using Eurostat data,¹⁴ that Irish employee compensation (or labour costs) in the market economy is well below other European averages.



Irish employee compensation is substantially below European averages; in particular, when compared with our peer group – other small open economies. It is worth pointing out that a reduced effective corporate tax rate compared to other EU-15 countries has to be compensated for by higher costs on households in the form of higher taxation or reduced

¹² Eurostat: Non-Financial Transactions

http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nasa_nf_tr&lang=en and EU Ameco database for GDP: http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm

¹³ There is a suggestion that, even using conventional macro-economic data, profit levels in Ireland are inflated due to multi-national accounting practices. The Irish Fiscal Advisory Council has attempted to address the issue of the relationship between Irish GDP and GNP by constructing a hybrid-GDP – which is less than the former but more than the latter. Using their hybrid-GDP, and assuming that the reduced GDP comes exclusively from international flows that are categorised as ‘profits’, then the Irish net operating falls from an average of 28 percent to 21 percent of adjusted GDP over the last decade. This still compares quite favourably with the EU-28 decade average of 13 percent of GDP. Irish Fiscal Advisory Council Fiscal Assessment Report September 2012: http://www.fiscalcouncil.ie/wp-content/uploads/2012/09/FAR_Sept2012.pdf

¹⁴ Ireland Needs a Wage Increase, Unite the Union:

<http://unitetheunionireland.files.wordpress.com/2014/02/ireland-needs-a-wage-increase-final-for-upload-1802141.pdf>

expenditure on public services, social protection and / or investment. Irish employees' relatively low levels of compensation only exacerbate this situation.

Defining the effective corporate tax rate should be the first step in a wider analysis of its fiscal and economic impact, allowing us to explore a number of questions. Is it achieving stated policy goals (encouraging investment)? What are the historical and projected fiscal benefits? What would the impact be of alternative systems of corporate taxation? For instance, what would be the impact of a regime with a higher nominal rate but which would reward capital-intensive and other key value-added sectors for investment – something which could boost investment and yield higher tax revenue?

Clearly, if our current structures are intended to encourage investment there is persuasive evidence that countries with much higher tax rates – small open economies that are reliant on a strong export base as ourselves – are more successful in generating higher investment. It is similar story when it comes to employee compensation. The attachment of enterprises in the trade sector to the domestic economy is weakening.

There is no doubting the positive impact of foreign direct investment in key areas of the economy; for instance, the chemical and pharmaceutical sector – a capital-intensive and global-networked sector which indigenous enterprise would have struggled to create. The challenge to the Committee is to assess the deficits while pointing to the benefits, in particular the benefits of an open economy. We do see a high-profit economy with relatively low levels of corporate investment and low levels of employee compensation. Can we improve this and what role can the corporate tax rate and the tax regime play in this reform.

However, there is still a need to provide a robust estimate of the effective tax rate. In this submission Unite has used the current macro-economic data to make an estimate. However, this data has been questioned – in particular, the work of Professor James Stewart¹⁵ who has shown the effective tax rate of US multi-nationals in Ireland to be more consistent with that of classic tax havens like Bermuda and the UK Caribbean Islands than it is to average European economies.

It is certainly the case that, even using the current macro-economic data, the accounting practices of multi-national companies make determination of key measurements impossible. For instance, inflated gross value-added in multi-national dominated sectors means that Forfás cannot adequately measure Irish productivity. To make a reliable estimate they must use the productivity of the United States labour force to measure Irish productivity. This is a highly unsatisfactory situation.

It is also the case that international opinion is highly negative – whether it is the US Senate or the House of Commons or the EU investigation into our structures; or whether it is continuous articles in prestigious financial newspapers. This is causing considerable reputational damage to the Irish economy to the point of ridicule. In a recent analysis in Forbes magazine, the question was asked: if we cannot call Ireland a tax haven, what do we call it? They suggested that we be called a 'bagel'.¹⁶

¹⁵ PWC/World Bank Report 'Paying Taxes 2014': An Assessment, IIS Paper, Professor James Stewart: <http://www.tcd.ie/iis/documents/discussion/pdfs/iisd442.pdf>

¹⁶ If Ireland Is Not A Tax Haven, What Is It?, Forbes, November 6th 2013, <http://www.forbes.com/sites/taxanalysts/2013/11/06/if-ireland-is-not-a-tax-haven-what-is-it/>

We must not make the same mistake made during the middle of the last decade, sensing that something was wrong with the asset-bubble but not discussing it, never mind addressing it before it became a crisis. Tax-driven industrial and enterprise policy, especially when the tax structure is problematic in many international commentaries, can be undermined by other economies seeking to attract foreign capital, or by international agencies addressing the role of global tax avoidance. A policy based on a flawed structure could easily unravel (the proverbial stroke of a legislative pen from another country resulting in the disappearance of our ‘tax benefits’). In short, we must ensure that we are not heading blindly into another crisis because of a refusal to face up to reality or to adapt to a changing environment.

Michael Taft

Research Officer
Unite the Union

Ireland's corporation tax rate

US Bureau of Economic Analysis on Irish effective tax rates

Summary

A recent IIS paper [1] concluded that subsidiaries of US multinationals operating in Ireland have an effective tax rate of 2.2%. This is based on calculations derived from US Bureau of Economic Analysis ("BEA") data. The BEA data is fatally flawed as a source for calculating an effective tax rate for US owned companies operating in Ireland. Critically it conflates the concepts of place of incorporation and proper locus of income for corporation tax purposes. Irish Revenue statistical reports confirm that the denominator in the effective tax rate calculation of 2.2% in the IIS Paper is overstated by several hundred percent.

The 2012 Irish Revenue statistical report indicates an effective tax rate of at least 12.24% for companies in Ireland - this is likely to be somewhat understated for reasons outlined in this paper.

The BEA produces financial data on the overseas subsidiaries of US multinationals. This includes data on corporate taxes paid on the profits of those companies and data on the total income of those companies. That data has been used to calculate what are presented as "effective tax rates" for "US subsidiaries operating in Ireland" and to claim that such subsidiaries have "the lowest effective tax rate in the EU at 2.2%" a rate which is described as "not that dissimilar to effective tax rates in countries generally regarded as tax havens such as Bermuda" [2]. This has directly led to international press coverage claiming that this demonstrates that Ireland is a tax haven e.g. "Why it's completely accurate to call Ireland a tax haven", Bloomberg 11 February 2014 by Jonathon Weil.

The purpose of this paper is to analyse the BEA data and whether it supports the contention that Ireland offers an effective 2.2% tax rate to US subsidiaries operating in Ireland thereby meriting the designation of "tax haven".

1. Locus of corporate income for tax purposes

In order to calculate an effective tax rate for companies operating internationally one needs to determine what is the proper locus of the income for tax purposes i.e. is it Irish income, Bermudan income, US income etc.? It is only income which is Irish locus, under generally accepted norms of international tax law, and which therefore is properly within the Irish territorial charge to tax that ought to be included in the denominator in calculating an effective tax rate.

In order to properly analyse where is the proper locus of corporate income for tax purposes an understanding of the international tax rules on corporate tax residence, taxable branches etc. is required.

2. Where is a company tax resident?

One of the earliest and most basic questions of taxation is where is a company tax resident and following from this which country ought to tax its income.

A company may be "incorporated" (i.e. be created by filing documents with the companies office) in, say, Ireland but be "managed and controlled" (i.e. have its management personnel taking decisions) in, say, Bermuda. Is the company tax resident in Ireland or in Bermuda?

In the UK the issue was settled as long ago as 1905 in the De Beers case [3]. The judgement in that case stated:

"In applying the conception of residence to a Company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see whether (sic) [recte where] it really keeps house and does business. An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a Company.

Otherwise, it might have its chief seat of management and its centre of trading in England, under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad.

The decision of Chief Baron Kelly and Baron Huddleston, in the *Calcutta Jute Mills v Nicholson* and the *Cesena Sulphur Company v Nicholson*, now thirty years ago, involved the principal that a Company resides, for purposes of Income Tax, where its real business is carried on. Those decisions have been acted upon ever since. I regard that as the true rule; and the real business is carried on where the central management and control actually abides.” (emphasis added)

It can be seen that the court determined that the place of central management and control rather than incorporation was the preferable criteria for determining a company’s residence and that they were heavily influenced in coming to this conclusion by the stronger protection that a management and control test gave against tax avoidance.

Ireland inherited the UK tax system on gaining independence in 1922 and, consistent with international taxation principles, maintained management and control as its principal determinant of corporate tax residence. There have been two changes since 1922 to tighten up the corporate tax residence rules. Firstly, in 1999 certain Irish incorporated companies controlled from non treaty countries or with no connection with Ireland were deemed to be Irish resident – this was an ultimately successful attempt to discourage the use of such companies by groups with no connection whatsoever with Ireland where Ireland would have no visibility on the nature of the activities undertaken by the company concerned. Secondly, last year Ireland moved to eliminate the possibility of companies being resident nowhere by deeming Irish incorporated companies to be resident in Ireland if they are not resident elsewhere.

To this day the place of management / control is the preferred international norm for determining corporate tax residence. The OECD’s model tax treaty, which forms the basis of the vast majority of the world’s tax treaties, has for decades provided that the place of effective management ought to be the deciding factor in the case of two countries claiming taxing rights over the same company.

The US tax code is an outlier in having a pure focus on place of incorporation in determining the tax residence of a company and in ignoring the place of management. This is consistent with US provisions on taxation of individuals under which the US taxes its citizens even though they reside abroad – the US is again an outlier in this respect.

The BEA data reflects the US peculiar focus on place of incorporation and as we will see this means great care needs to be taken in interpreting the BEA data.

3. Branches

Determining the tax residence of a company is not necessarily the end of the analysis of where a company ought to be taxed. A company might be resident in, say, Country A, but have a “branch” [4] in, say, Ireland. In that instance international norms of taxation law would provide that Country A would have the right to tax the world wide profits of the company and Ireland would have the right to tax the Irish branch profits. To avoid double taxation of the Irish branch profits Country A might either grant a credit for Irish tax paid against Country A tax due or, alternatively, completely exempt the Irish branch profits from Country A tax – this might be done unilaterally under Country A’s domestic tax law or under the terms of a bilateral tax treaty between Country A [5] and Ireland [6] .

4. Territorial scope of Irish corporate taxation

Irish taxation law taxes the worldwide profits of Irish resident companies and the profits of Irish branches of non Irish resident companies. It also taxes some Irish source profits of non Irish resident companies – in particular rents or capital gains deriving from Irish land and buildings. This is consistent with the territorial scope rules of most other countries in the world [7] and with the principles set out by the OECD for the taxation of international profits. It is also consistent with the principles applied in Ireland, and in most countries in the world, for the taxation of individuals.

The place of incorporation of a company is largely irrelevant in determining its taxation status under Irish law as the country of tax residence is primarily based on the place of management and control rather than the place of incorporation. The following examples [8] illustrate this:

- An Irish incorporated company which is non Irish resident (because it is not managed and controlled in Ireland), which has no Irish branch and which has no Irish source rental income etc., will generally not be subject to Irish tax – in the same way that an Irish citizen resident abroad who has no Irish source income will generally not be subject to Irish tax.
- A foreign incorporated company which is Irish resident (because it is managed and controlled here) will be subject to Irish tax on its worldwide income.
- A non Irish incorporated, non Irish resident company with an Irish branch will be subject to Irish tax on its Irish branch profits.

In none of the above cases could you get a meaningful measure of the effective tax rate in Ireland by calculating the total tax paid by such companies divided by their profits and attributing that to the country of incorporation – which is essentially the method used in the IIIS Paper.

5. BEA data collection methodology

The BEA data collection methodology means that its findings are fatally flawed in drawing conclusions about Irish effective rates of corporation tax. The BEA generally collects data on the basis of place of incorporation. In almost all circumstances an Irish incorporated company has to file BEA data as an “Irish” company even though it may not be Irish tax resident, may not have an Irish branch and may have no profits subject to Irish tax – for example even €1 of sales from Irish customers would be enough to cause the company to have to file as “Irish”.

This means that Irish incorporated companies that are not tax resident in Ireland will file as “Irish”. To include such companies in calculating Irish effective corporation tax rates is as misleading as if one was to include Irish citizens working abroad in calculating Irish effective income tax rates. It should be borne in mind that the use of Irish incorporated non Irish resident companies by US multinationals is common for US groups [9] and therefore the distortive effect on the statistics gathered for Ireland is particularly pronounced.

Furthermore non Irish incorporated companies that are tax resident in Ireland, or which have a taxable branch in Ireland, and which consequently are subject to tax in Ireland may be reported by the BEA as non Irish. It should be borne in mind that the usage of non Irish incorporated Irish resident companies is increasingly common as some aspects of foreign company law [10] (as distinct from tax law) are favoured by some international groups and therefore the distortive effect on the statistics gathered for Ireland may be particularly pronounced.

6. IIIS Paper

The IIIS Paper which calculates an effective Irish tax rate of 2.2% for US owned subsidiaries in Ireland uses as its denominator the “Irish” profits number from the BEA data. As outlined at 4. above this number is fatally flawed as it heavily based on place of incorporation rather than proper locus of income for tax purposes.

Other, less significant, flaws in the IIIS Paper include:

- In calculating effective tax rates the author has used as his denominator post tax profits rather than pre tax profits – this is contrary to his own stated methodology [11] and indeed any sensible methodology. The effect of this, for example, is that the French effective tax rate is stated as 35.9% whereas it ought, even on the author’s own methodology, to be 26.5% [12].
- The German effective tax rate given of 20% does not compute on any basis – using pre tax profits as the denominator (the more sensible method) gives 21.7% while using post tax profits as the denominator (as the author has done in all other cases) gives 27.7%. [13]
- The denominator included in the calculation of the supposed effective 2.2% tax rate includes “income from equity investments”. The Paper acknowledges that this may include income on which tax “may already have been paid”. In fact, in the vast majority of cases income from equity investments is highly likely to have suffered either Irish or foreign tax already as Ireland is not generally used as a holding company location for low taxed subsidiaries [14]. Whilst the paper provides a calculation of an effective tax rate adjusted for this of 3.8% (which is itself grossly

understated for the reasons outlined in this paper) it only mentions the 2.2% rate in its summary and conclusion thereby giving the false impression that the lower number is more accurate. It is not surprising therefore that it is the 2.2% rate that has received the greatest amount of press coverage.

7. Irish Revenue Statistical Report

The Irish Revenue produces statistical reports which do not have the flaws contained in the BEA data. This allows us to calculate a far more accurate effective tax rate for Irish companies. Their 2012 statistical report gives data for 2011 – the same period for which the IIS paper claims an effective 2.2% rate for Irish subsidiaries of US multinationals.

The Irish Revenue statistical report includes all income properly within the territorial charge to Irish corporation tax. This includes:

- (i) worldwide income of all Irish resident companies (irrespective of whether they are incorporated in Ireland or abroad).
- (ii) income of Irish branches of non Irish resident companies (irrespective of whether they are incorporated in Ireland or abroad).
- (iii) certain Irish source income of non Irish resident companies which do not have branches here (irrespective of whether they are incorporated in Ireland or abroad).

Unlike the BEA data it does not include income of Irish incorporated non resident companies falling outside categories (ii) and (iii) above.

These factors help explain why the BEA data reports US multinational's total "Irish" corporate income as \$147bn [15] in 2011 whereas the Irish Revenue reports income of all (i.e. including non US owned) "Irish" corporate income as €40bn [16]. When we consider the size of the numerical difference and the fact that a significant proportion of the €40bn number relates to non US owned companies we can see that the IIS paper has overstated the denominator required to calculate Irish effective tax rates by several hundred per cent.

Based on the Irish Revenue data we calculate an effective Irish tax rate for 2011 of 12.24% which for the reasons stated below we believe to be somewhat understated.

The numerator in our calculation is €4,902.9m. Key points are:

- This is the total corporation tax liability for 2011 for all Irish companies [17] as adjusted for items mentioned below.
- The number is before double taxation relief of €567.1m. In our view, it is not appropriate to reduce the effective tax rate for double taxation relief. Double taxation relief represents relief for taxes borne elsewhere i.e. this tax has actually been paid albeit to perhaps another country. The Irish double taxation relief system does not always give full relief for double tax suffered and the data on excess foreign tax credits is not available – if known this would increase the effective tax rate.
- The number is after credit for Research and Development tax credits of €258.5m – this reduces the effective tax rate.

The denominator is Revenue's total corporate taxable income number of €40,062.9m. This is the net number after deduction of capital allowances, trade charges, losses forward etc. These are normal deductible expenses in arriving at profits and are therefore properly deductible in calculating the denominator for an effective tax rate calculation [18].

Some timing differences for tax deductions can arise as items such as capital allowances may be deducted in a different period for tax purposes than for accounts purposes but these differences reverse over time and should generally be smoothed out over the entire population of Irish companies.

The calculation should be adjusted for permanent differences. There are a number of permanent differences which the Revenue report does not provide data on – these would increase the effective tax rate if known e.g.:

- (i) Depreciation on a number of significant expenditures is not deductible for tax purposes e.g. depreciation on office buildings or retail premises.

- (ii) Certain entertainment, motor expense and non trade related expenses are non deductible.
- (iii) Unutilised losses are not included in the data and therefore the aggregate profit for the corporate sector is overstated. The amount of unutilised losses could be significant.

The €40bn number seems to be after expenses outlined at (i) and (ii) have been “added back” and before unutilised losses have been deducted - therefore our denominator is somewhat overstated. This together with the lack of data on excess foreign tax credits means that our effective tax rate of 12.24% is likely understated.

A significant permanent difference for which data is provided in the Revenue report is the Research and Development tax credit. This reduces companies’ effective tax rate and is adjusted for in the numerator as outlined above. Research and Development credits are a common feature of international tax systems and Ireland is not unusual in granting them.

The effective tax rate of 12.24% can be broadly rationalised as the trading rate of 12.5% plus an additional €265m on profits taxable at the higher 25% rate for non trading profits^[19] broadly cancelled out by the €258.5m cost of the Research and Development tax credit in 2011.

8. Conclusion

The BEA data is fatally flawed in calculating an effective tax rate for US owned companies operating in Ireland. Critically it conflates the concepts of place of incorporation and proper locus of income for tax purposes. Irish Revenue statistical reports confirm that the denominator in the effective tax rate calculation of 2.2% in the IIS Paper is overstated by several hundred per cent.

The 2012 Irish Revenue statistical report indicates an effective tax rate of at least 12.24% - this is likely to be somewhat understated for reasons outlined at 7. above.

[1] [1] IIS Discussion Paper No.442/ February 2014 by Jim Stewart, Associate Professor, Trinity College Dublin (“IIS Paper”) [\[Go Back\]](#)

[2] IIS Paper at p.1. [\[Go Back\]](#)

[3] De Beers Consolidated Mines, Limited v Howe (Surveyor of Taxes) 5 TC 198. [\[Go Back\]](#)

[4] Broadly a branch is defined by international law as a local office or locally based decision making staff. [\[Go Back\]](#)

[5] See OECD Model Tax Treaty Article 7 “Business Profits” and Article 23 “Elimination of Double Taxation”. [\[Go Back\]](#)

[6] Ireland operates a tax credit rather than an exemption system for foreign branches of Irish companies. [\[Go Back\]](#)

[7] It is a broader scope than some other countries such as Singapore, Hong Kong, the Netherlands, Luxembourg and the UK which operate a variety of exemptions for foreign income. [\[Go Back\]](#)

[8] These examples are subject to exceptions arising from the 1999 and 2013 rules referred to above. [\[Go Back\]](#)

[9] This common usage is not for Irish tax reasons. [\[Go Back\]](#)

[10] For example foreign law on repayment of capital and on examinership. [\[Go Back\]](#)

[11] See page 5 of IIS Paper. [\[Go Back\]](#)

[12] The effect is to overstate all effective tax rates in the Paper but the overstatement is greatest for the highest rates. [\[Go Back\]](#)

[13] [The source data is available here](#) (PDF, 1MB). [\[Go Back\]](#)

[14] Because Ireland’s taxation treatment of such subsidiaries is uncompetitive compared to other jurisdictions such as the UK and the Netherlands. [\[Go Back\]](#)

[15] \$144bn after tax. [\[Go Back\]](#)

[16] The Irish Revenue number for 2011 is €74bn before capital allowances, losses carried forward, trade charges and other adjustments - these are normal tax deductible expenses, which would be treated as tax deductible in most jurisdictions in the world, and therefore it is the €40bn number which is the accurate measure of properly taxable profits. [\[Go Back\]](#)

[17] Source – Irish Revenue Statistical Report 2012. [\[Go Back\]](#)

[18] Some commentators regard capital allowances as not being a proper deduction in calculating the denominator for an effective tax rate i.e. they regard capital allowances as some sort of special tax break. This misses the point that in the vast majority of cases capital allowances are simply a deduction for depreciation borne on an asset (usually equipment) - which is a genuine cost and which ought therefore to be deductible in arriving at taxable profit. Where the ultimate depreciation suffered is less than that granted through the capital allowances regime the difference is generally recaptured as a “balancing charge” when the asset is sold. Almost every country in the world grants a tax deduction for equipment depreciation costs. [\[Go Back\]](#)

[19] The Irish Revenue Statistical Report states that there were €2,121.7m of profits subject to the 25% rate in 2011. [\[Go Back\]](#)

Mr Liam Lynch, KPMG

Good afternoon, and thank you for inviting me to appear here today. I have been a tax partner in KPMG for 10 years, and have over 20 years' experience in international tax matters. As Head of Insurance I have a particular expertise in that area, although my experience has been, and continues to be, across a wide range of companies operating in Ireland and internationally. Recently I have also been elected Vice President of Chartered Accountants Ireland, where I chaired the tax committee for a number of years.

I believe that the work of this Committee in ensuring that the Oireachtas has a good understanding of the current debate on the global taxation framework, where it is going and the likely impact on Ireland, is extremely important. I look forward to your deliberations.

To start I will say a few words on the global tax framework and how it is developing at present. I will then say a few words on areas of concern for Ireland that I believe are worthy of consideration.

The current global tax framework grew up piecemeal, responding to events as they happened, and with few guiding principles. National policies responded to national imperatives.

Some countries focused on encouraging the outward expansion of their domestic businesses. These were mainly the larger economies, and in particular the US. Some focused on facilitating international trade, partly by being conduit jurisdictions. Many of these, largely but not entirely offshore islands, had close connections with, and were favoured by, the larger countries, being within their sphere of influence or indeed being semi-dependant on them.

Finally, some focused on the simple imperative of attracting international business investments and thereby providing jobs locally. Despite commentary to the contrary, Ireland falls squarely into the last category, with substantial operations employing thousands of people, and providing livelihoods for thousands more.

It is clear to me that the current global tax framework is disjointed and needs reform. That leaves the question of whether this reform should be evolutionary or revolutionary.

From a business perspective, in my view that change needs to be evolutionary, along the lines of many of the BEPS proposals, including dealing with perceived hybrid and treaty abuses, and considering the appropriateness of current transfer pricing standards.

A degree of certainty must be retained for business. We know from experience that constant changes to the framework, or rules that are hard to interpret or subject to post event reappraisal, simply add to an environment which degrades entrepreneurship, discourages business and ultimately reduces, rather than increases, tax revenues.

Uncertainty in tax law, in my experience results in businesses not making commercial decisions to move forward, and therefore undermines growth.

Chairman, your committee has already examined the framework in place at present. This is largely driven by bi-lateral tax treaties and the OECD at a global level, and, for those of us in Ireland, most importantly by the EU. The G20 have recently become the driving force with the BEPS initiative, the technical work on which is delegated to the OECD.

The BEPS initiative has much to recommend it. It is a genuine attempt to put order on how the tax systems of countries interact with each other. It aims to put a framework around international decision making in this area, and deal with mismatches between the tax laws of independent jurisdictions.

If BEPS is to succeed it is important it does not become a vehicle for protectionism and national self-interest of just a few larger countries. Within the EU, any new rules will have to be implemented with due regard to the four freedoms of movement of capital and people, of services and establishment, and Member States will have to comply with the state aid rules. However there is a danger in relying solely on EU law that a fortress Europe is created with internal trade encouraged and external trade strangled.

Fair tax completion is universally accepted, and has been endorsed by the EU Commission. In Ireland's case it is encapsulated in the 12.5% corporation tax rate. This helps to offset the pull of the centre against the periphery for jobs and economic development. It is a model for peripheral development of which we should be proud.

Some of the BEPS proposals unfortunately mitigate against peripheral development and international trade.

The economies of most countries are by now interconnected and rely on foreign as well as domestic capital. Foreign ownership operates side by side with entirely domestically owned enterprises, and is a mark of economic freedom.

There is, in my view, a need to review tax treaties and their effectiveness in today's global trade environment. However the concept of limiting their application to enterprises owned and controlled within the respective signatory states means that companies in smaller countries like Ireland could be frozen out of treaty access resulting in additional costs compared to competitors in other countries. Even some larger countries might face the same fate.

The type of treaty limitation proposals currently being discussed favour to the point of exclusivity domestic over foreign ownership and capital. In my view, the supply of foreign capital for businesses in Ireland would be hit severely. It is hard to see how such an attack on international trade and economic connectivity is justified.

Similarly the BEPS proposals that would make company residency a matter for mutual agreement between tax authorities is a recipe for disaster. It would make the proper conduct of international expansion by groups extremely difficult and uncertain; mutual agreement is, from my experience, a lengthy process with uncertain outcomes that are subject to the vagaries of outside events.

Transparency is required in many facets of tax reporting and administration, and the country by country reporting module is a helpful step for tax authorities. However, the provisions in place for information protection in Ireland are very sophisticated. It is not unreasonable to insist that mandatory sharing of data with every country in the world must be with reference to and accompanied by the high standards of confidentiality and data integrity already prevailing in our country. The extent of data sharing must also be commensurate with the ability of taxing authorities and business to manage that data.

Standardisation of transfer pricing documentation is to be welcomed. But it should be on the basis that businesses are subjected to the same requirements around the world. If it becomes merely a minimum requirement to be added to at will by individual countries, my experience tells me that it will become yet another burden for business without delivering the expected gains for taxing authorities.

The work on hybrid mismatches, that is the treatment of the same company or transaction in different ways for tax purposes by different jurisdictions, is overdue. However, it is hard to see how the current BEPS proposal of imposing the same rules on connected and unconnected parties is practicable or technically sound. This is particularly relevant for the funds industry that provides, directly and indirectly, tens of thousands of jobs in Ireland. Again, tax rules that mitigate against commercial transactions and act as a barrier to trade will tend to be revenue negative for taxing authorities.

BEPS is a worthy project to modernise the global tax framework. As home to a large number of substantive businesses employing directly and indirectly hundreds of thousands of people, and with a tax system that places a premium on real substance, Ireland has much to gain from such modernisation.

To work best, the outcomes of the BEPS project must be evolutionary and represent a consensus between all countries. It is important that it is not hijacked by national or sectional interests, and that the final proposals are practical and capable of implementation in the short-term.

Thank you.

Oireachtas Sub-Committee

Module on Effective Tax Rates

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

Tuesday 17 June 2014

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 somewhat 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

Prof. Jim Stewart, Trinity College

**Joint Committee on Finance, Public Expenditure and Reform
Meeting 17th June 2014 at 2 p.m.**

Effective Tax Rates

Presentation by Jim Stewart

Associate Professor in Finance, School of Business, Trinity College, Dublin

Thank you for inviting me today to assist you in the area of measuring effective corporate tax rates.

I have been engaged in researching the area of effective tax rates over a considerable time period.

My initial research was conducted for a Ph.D thesis submitted to the London School of Economics in 1985 and subsequently published as a book.

Measuring Effective Tax Rates

I would like to briefly describe my research approach because it illustrates a number of issues that arise in measuring effective tax rates.

First the concept itself is relatively simple. The tax rate paid on corporate profits for an individual firm can be defined as tax paid divided by pre-tax profits (T/P). When we try to measure this empirically, ambiguities immediately arise.

Let me give you an illustration from an Irish Public company; Table (1) below shows pre-tax profits and other data for the most recent three year period and also shows three possible measures of effective tax rates

Measure 1 shows the effective tax rate defined as the tax charge in the Profit and Loss account divided by pretax profits. This measure is described in company accounts as “the effective tax rate”.

Measure 2 shows the tax actually paid divided by pretax profits. The aggregate of tax actually paid is the number shown in Revenue statistics for corporate tax receipts in any given year.

Measure 3 is similar to measure 2, but includes provision for accounting depreciation in the tax base (the denominator). The reason for this is that accounting depreciation in contrast to other measures of depreciation such as accelerated depreciation is not a tax deductible expense.

Table (1)
An example of measuring Effective Tax Rates
€ Million

	2011	2012	2013
1. Pre-Tax Profits	420.9	633.0	650.9
2. Tax charge in the P and L.	46.3	72.6	81.6
3. Tax Paid (from Cash flow statement)	5.9	13.6	25.8
4. Depreciation (from cash flow statement)	277.7	302.2	329.6
Effective tax rate measure 1 (1/2)	11.0%	11.5%	12.5%
Effective tax rate measure 2 (3/2)	1.4%	2.1%	4.0%
Effective tax rate measure 3 (3/(1+4))	0.84%	1.45%	2.7%

Measure (3) is often used in academic studies to estimate effective tax rates and measure (2) appears to be the measure of individual tax rates used in studies by the US Permanent Sub Committee on Investigations (PSI).

Table (1) illustrates considerable differences between reported effective tax rates and the other two measures.

Broad based measures of effective tax rates may be estimated by first of all calculating individual tax rates for each firm. Measures of effective tax rates for the economy as a whole can then be calculated by summing the data for individual companies across the entire economy. This could be done by treating each firm as a separate observation and equally weighted, and calculating means and other distribution statistics. In addition averages could be calculated by aggregating data across all firms. In this latter case average effective tax rates will be dominated by firms with the largest profits and tax rates. US Bureau of Economic Analysis data uses this latter approach.

In an earlier study which I referred to, I estimated effective tax rates over the twenty one year period 1964-1984 for all Irish non-financial PLC's treating each firm as an individual observation and at aggregate level for each year and for sub-periods (Stewart, 1987).

However anomalies can arise:-

1. A firm rather than paying corporation tax may receive corporation tax, because for example of overpayments in previous years. Hence the numerator T will be negative resulting in a negative effective tax rate (-T/P);
2. A firm could both receive tax payments in the current year and report losses in the current year. In this case both numerator and denominator are negative (-T/-P) resulting in a positive effective tax rate;
3. A firm could pay tax even though losses were reported. This could arise because corporate tax payments are paid in arrears. Hence the measure of effective tax rates is negative (T/-P). This is less likely to occur than in previous years, because lags in corporate tax payments have been reduced;

4. A firm could report positive tax payments but report low profits, resulting in a very high measured effective tax rates (as $P \rightarrow 0$, $T/P \rightarrow \infty$).

In large data sets all these problems arise. One solution is to estimate effective tax rates over a running three year period. However anomalies will still remain. A more usual approach is to estimate effective tax rates for only those firms reporting positive profits.

It is likely that these issues are endemic to Irish data. Table (2) shows that for 2011 1% of firms (433 firms) account for 81.1% of corporate tax payments. While 76.8% of all firms account for 3.56% of corporate tax payments and 38.8% of firms report zero or negative net trading income. It is likely that there is some persistence in those firms reporting losses. In the sense that firms that report losses in one year are likely to report losses in succeeding years. Finally reported losses by banks will have had a major impact on corporate profitability in Ireland.

Table (2)

The Distribution of Corporation Tax Payments by Irish Companies in 2008-2011

	2008	2008	2009	2009	2010	2010	2011	2011
Net Trading Income € ¹	% of total tax	% of cases	% of total tax	% of cases	% of total tax	% of cases	% of total tax	% of cases
≤ 0	7.4	32.9	6.3	38.4	5.8	38.7	3.35	38.8
1 - 25,000	0.6	29.4	0.6	28.7	0.6	29.0	0.21	28.0
≥ €10 million	69.8	0.8	73.6	0.9	76.7	1	81.1	1

(1) The Table excludes data on net trading income in the range €25,000 to €10 million. This data defines net trading income as trading profits from a company's accounts, plus expenses not allowable for tax, minus tax depreciation. To the extent that accounting depreciation is higher than tax depreciation, this figure will overstate pretax profits, and conversely. Because this data uses this definition of 'trading profits' it could result in biased estimates of effective tax rates. In addition this data excludes those firms that are not domiciled in Ireland for corporation tax purposes (Stewart, 2013, p. 4).

Source: Revenue Commissioners, Corporation Tax Distribution Statistics, Table CTS1

Aggregated Data

National accounts in Ireland are currently based on what is described as the income and expenditure approach and in future an output approach will be incorporated "into the GDP compilation process" (CSO, 2014).

Aggregated data such as profit estimates from the National Accounts, ignores issues relating to the inclusion of firms making losses. The effect of including such firms is to reduce the denominator (tax payments remain the same) resulting in an over estimate of effective tax rates.

Because the distribution of tax payments is highly skewed, for example for 2011 1% of cases (433) firms account for the bulk of corporate tax payments, aggregate data cannot be interpreted as indicating effective tax rates for the median, or typical firm.

For this reason, empirical studies of measures of effective tax rates in the finance, accounting and taxation literature use data from accounting records (either publicly available or from surveys of firms which report their own accounting records as in the US Bureau of Economic Analysis data) rather than aggregate data contained in the National Accounts. This data shows effective tax rates for U.S. firms in Ireland of 2.2% for 2011, and if investment income were excluded the tax rate rises to 3.8% (Stewart, 2014 b).

In addition, in Ireland, particular issues arise from likely underestimation of profits arising in the IFSC. In December 2011, IFSC based companies held €2175 billion in foreign assets (13 times GDP). An assumed net rate of return of 1% would mean pretax profits of €21 billion.

The exclusion of those firms that are incorporated in Ireland but regarded as resident for corporate tax purposes in another jurisdiction poses another difficulty in estimating effective tax rates using aggregate data.

Where is a company located?

I have argued elsewhere (Stewart, 2014a) that it is reasonable to regard companies that are incorporated in Ireland, but treated as being resident for corporate tax purposes in another jurisdiction as being part of the Irish tax base for the following reasons:-

1. If incorporated in Ireland the auditor is located in Ireland;
2. If registered in Ireland the books of account must be maintained in Ireland;
3. Several of these companies have employees in Ireland and hence are liable to pay employers PRSI;
4. Several of these companies are liable for VAT and hence satisfy the requirements of residence for VAT purposes.
5. The European Court of justice has ruled that place of incorporation is where “central management and control” resides.
6. Eurostat regards the location of “brass plates” firms with no fixed assets or employees as being located where they are incorporated. A rule which is likely to be followed by the Revenue Commissioners.

In conclusion estimating effective tax rates is best done using data extracted from company accounts. Estimating effective tax rates from national accounts is likely to produce an underestimate of effective tax rates because of the inclusion of firms making losses. In addition estimated aggregate profits for Ireland omit the profits of firms incorporated in Ireland but located for tax purposes in another jurisdiction.

References

CSO (2014), National Accounts Output and Value Added by Activity CSO statistical release, 24 April 2014.

Stewart, J. (2014a), Corporate Tax Residence: Is Ireland Exceptional, IIS Discussion Paper no. 449, available at <http://www.tcd.ie/iis/documents/discussion/pdfs/iisd449.pdf>.

Stewart, J. (2014b), PcW/World Bank Report Paying Taxes 2014: An Assessment, IIS Discussion Paper no. 442 available at <http://www.tcd.ie/iis/documents/discussion/pdfs/iisd442.pdf>.

Stewart, J. (1987), Corporate Finance and Fiscal Policy in Ireland, Aldershot: Avebury, Gower Publishing Group.