Irish Tax Monitor

In this month's roundtable our panel outline the measures that could be taken in the Budget to make Ireland's tax regime for more competitive and attractive for corporates and individuals including a revamp of the R&D regime, cutting complexities created by the incorporation of BEPS rules into Irish tax law and reducing the personal tax burden. Uncertainty created around the tax neutrality of Section 110 companies is also examined as are recent Revenue changes regarding pensions. Another key topic examined is the effectiveness of Ireland's R&D tax credit regime and Knowledge Development Box under BEPS.

Corporate Tax

Corporate tax recommendations in a number of areas including R&D tax credits, SMEs, entrepreneurs and the green economy feature prominently in the Consultative Committee of Accountancy Bodies – Ireland (CCAB-I) submission. What measures, in your view, could be taken in the Budget to make Ireland's tax regime for corporates more competitive?

Brian McDonnell, Senior manager, R&D, Deloitte: Since its introduction in 2004, the R&D tax credit has encouraged companies to undertake high value R&D in Ireland. Most recent Revenue figures show that 1,616 claimants benefitted from the 25% tax credit in 2020. It represents an important stimulus for R&D investment in Ireland, however improvements can be made to help benefit claimants', regardless of their size, and to ensure Ireland's global competitiveness as a location for R&D.

As a self-assessed scheme there is uncertainty for claimants in respect of the qualifying nature of the costs claimed. Claimants would benefit from more clearly defined R&D legislation and guidance for the taxpayer would assist in ensuring that only qualifying R&D is claimed. More clarity surrounding the level and types of supporting documentation required would greatly benefit the claimants, as would greater availability of Revenue staff to address queries.

An increased R&D tax credit rate of 30% should be introduced for all companies to support the cost of conducting high value R&D activities, improving national competitiveness and securing further R&D investment.

The Deloitte Contributors in the September 2022 Roundtable Panel were:
Brian McDonnell, Senior Manager, R&D, Deloitte; Colm Stringer, Manager, Corporate Tax, Deloitte; Tatiana Kelly, Senior Manager, Tax Policy and Technical, Director, Global Employer Services, Deloitte; Karen Keegan, Senior Manager, Employment Tax, Deloitte; Marine Opperman, Assistant Manager, Corporation Tax – Financial Services, Deloitte.

We would also recommend removing or significantly increasing the limit on qualifying third party expenditure, which would help foster an R&D ecosystem in Ireland.

Brian McDonnell

There has been a trend of continued narrowing of allowable expenditure in claims by Revenue. Costs such as rent, travel and subsistence, and a range of indirect costs necessary for R&D to be undertaken are currently disallowed.

Broadening the range of allowable expenditure, would better support the true cost of undertaking R&D. This is especially important given the increased cost of doing business.

Current legislation precludes certain fields of scientific research being claimed. For example, complex R&D in computing may often seek to address challenges around user interaction in corporate disciplines in behavioural science. Broadening qualifying fields to include emerging technologies will provide further clarity to claimants.

The Climate Action and Low Carbon Development Act has set out a legally binding path to reach net-zero carbon emissions by 2050 and a 51% reduction in emissions by 2030. Recent EPA data suggests that this will not be achieved without the faster implementation of additional measures. New enhanced supports should be provided for "Green" projects. Support can be delivered through the existing R&D tax credit, however, it would greatly benefit from a more clearly defined scope to include sustainability innovation.

Colm Stringer, Manager, Corporate Tax, Deloitte: Ireland has had a securitisation tax regime for a number of years, which is largely contained within Section 110 TCA 1997. This section was introduced by Finance Act 1991 with the aim of facilitating securitisation activities in Ireland (i.e. acquisition and management of qualifying assets) in a tax neutral manner. Revenue's Tax & Duty Manual (Part 04-09-01) substantiates that this legislation was designed as a tax neutral regime for securitisation transactions.

Qualifying Section 110 Companies are subject to tax under Case III at the 25% rate of corporation tax. However, Section 110(2)(a) TCA 1997 outlines that the "profits or gains shall be computed in accordance with the provisions applicable to Case I". Therefore, although the profits of Section 110 companies are taxable at this higher rate, the computational rules that apply to trading companies are followed. As a result, whilst a deduction is therefore available for normal trading expenses, Finance Act 2019 was updated to include Section 81(2)(p) TCA 1997 which notes that a tax deduction should not be allowed in respect of any "taxes on income" (this would include withholding tax suffered on the receipt of distributions or interest received). This amendment gives rise to difficulties for many

Colm Stringer

Section 110 companies. As the profits or gains chargeable to tax at 25% under Case III by a Section 110 company are firstly computed in accordance with Case I/II rules (albeit that it is then chargeable to corporation tax under Case III at a rate of 25%), a tax deduction may no longer be available for withholding taxes suffered and an anomaly arises.

It is important to note that from the outset, a lot of these Section 110 structures are accurately set up to ensure no withholding tax is suffered on income flows into the structure – this tends to support the neutrality position. However, scenarios can arise where withholding tax is suffered.

It would appear therefore, that if a deduction is not allowed for withholding taxes suffered and credit relief / a deduction cannot be claimed under Schedule 24 TCA 1997, then that income which is not received by a Section 110 company (i.e. the withholding tax) would be subject to tax at a rate of 25%. This non-deductibility of withholding taxes for Section 110 companies could therefore;

- Discourage foreign direct investment into Ireland through such companies;
- Would be contrary to the objectives of this securitisation regime; and
- Could possibly place Ireland at a competitive disadvantage in attracting such investment.

Therefore for these reasons outlined by CCAB-I, allowing a WHT deduction on the receipt of distributions or interest received would help strengthen the position the securitisation regime has in Ireland.

Personal Tax

In its pre-Budget submission the Consultative Committee of Accountancy Bodies – Ireland (CCAB-I) identify the reforming of personal taxes as key to protecting Ireland's competitiveness. Can you comment, with reference to your own firm's pre-Budget recommendations, on measures that could be taken in the Budget to make Ireland's personal tax regime more competitive?

Paula Ruane, Director, Global Employer Services, Deloitte: As referenced in Deloitte's submission on Budget 2023, focus remains on the fact that Ireland has one of the highest personal tax burdens in the OECD.

Paula Ruane

Ireland's marginal tax rate of 52% is a disincentive to businesses locating in Ireland, foreign based talent including Ireland's diaspora moving to Ireland as well as a significant cost for SMEs hiring employees. With changes in working practices since Covid-19, many high value skilled roles can be carried out from anywhere and there is a risk that jobs will not be placed in Ireland if employment costs and individual tax rates are not reduced.

Not only is our marginal rate high,

but the level of income at which the top rate kicks in is comparatively low. It is time that a roadmap is set out to demonstrate how the personal tax burden might be reduced over the coming years.

PRSI and USC needs to be reviewed with consideration given to merging these to one social contribution. While Ireland's social security rate is lower than most other EU countries, it applies to all earnings. In many countries, there is an income cap on social security contributions.

Existing reliefs, bands, thresholds, and credits should be indexed based on movements in the consumer price index to ensure that the taxpayer's net pay is reflective of the rising costs of living.

Another area that should be reformed is the Special Assignee Relief Programme (SARP). SARP is an initiative aimed at encouraging skilled personnel to relocate to Ireland by granting an exemption from income tax for 30% of earnings between a €75,000 and €1m. Many of the conditions for SARP are restrictive compared to other regimes in the EU such as the Dutch 30% regime, and the initiative itself is due to expire on 31 December 2022. Enhancing the SARP regime to a simpler more effective regime would attract new skilled talent to Ireland.

BEPS

The Department of Finance's consultation on BEPS Pillar II implementation closed on 22nd July, focusing on the technical incorporation of the rules into Ireland's corporate tax system. In your view what main areas of Ireland's tax code require modification to ensure a smooth implementation of Pillar II requirements?

Tatiana Kelly, Senior Manager, Tax Policy and Technical Deloitte: Firstly, it is questionable whether the current R&D credit would fall to be regarded as a "qualified refundable tax credit" ("QRTC"). As currently written S.766 (2) TCA 1997 provides that the claimant's corporation tax liability must in the first instance be reduced by the amount of the R&D credit. Then, broadly, S.766 (4A) and (4B) TCA 1997 allow for a refund of any excess of the credit over the claimant's corporation tax liability within 3 years. However, S.766B TCA 1997 puts a limit on such refund by reference to certain corporate and payroll liabilities. As such, in certain circumstances it may be the case that not all of the R&D credit is refundable within 4 years. Thus, any amount in excess of this limit may not be a qualifying refundable tax credit. As a result, the Irish domestic law should be amended to ensure it can be

Tatiana Kelly

refundable in total without any limits within 4 years. This could involve allowing the taxpayer to set the R&D credits against other non-covered taxes of the taxpayer concerned at the discretion of the taxpayer and for refunds to be payable with no restriction or cap imposed by reference to corporate and payroll liabilities. The issue of qualified refundable credits was highlighted in the recently published Tax Strategy Group papers.

Secondly, the attractiveness of the KDB regime may be eroded as a result of the proposed rules. In particular, there is no specific carve out in the EU Directive on Pillar Two for patent boxes. While patent boxes are not restricted, if there is no carve-out, any income taxed at less than the 15% minimum rate by the country of the patent box could be subject to a GloBE tax liability. This potentially negates any benefit that a group within the Pillar Two rules (broadly, an MNE with €750m plus turnover) would obtain by using the Knowledge Development Box. In the absence of a carve out consideration could be given to amending the Irish KDB regime. In particular, consideration could be given to changing the method of granting the relief from giving a downward adjustment to giving a taxpayer a tax credit calculated as a percentage of qualifying profits. Such credit should be drafted consistently with the "qualified refundable credit" definition in the draft EU Directive on Pillar Two (see our comments on the R&D Tax Credit above). Such approach should make the relief more "Pillar Two neutral". Any changes to the existing regime would require its reassessment under Action 5 and this should be considered in due course.

Thirdly, while the digital games credit relief provided for in Finance Act 2021 has not yet been made effective in law, however such a credit should also be reviewed to ensure that it will be treated as a "Qualified Refundable Tax Credit" for the purposes of Pillar Two.

And lastly, as an overarching observation, existing tax legislation in Ireland is complex and multi layered. The introduction of Pillar Two rules into domestic law has the potential to add another layer of complexity. In the interests of taxpayer certainty and to ensure that the Irish tax regime remains workable and user friendly, we would recommend that serious consideration be given to streamlining and simplifying the Irish tax code. In particular, Ireland's interest deductibility rules are complex, cumbersome and are in need of urgent reform. As outlined in our pre-Budget 2023 submission, tax relief for interest is subject to a range of conditions which has resulted in significant taxpayer uncertainty and additional compliance costs. Simplification measures such as allowing relief for interest expenses as incurred, streamlining S.247/S.249 TCA97 rules and reviewing the distribution rules in S130(2)(d) TCA97 would, in our view, be beneficial. In addition, the existing regime for the provision of double tax relief on foreign income contained in Schedule 24 TCA97 is overly complex and results in increased compliance and costs for taxpayers. The adoption of a territorial regime of taxation for foreign dividends and foreign branch income on an elective basis and the broad simplification of other areas of the Irish double tax regime would be a welcome

step in reducing taxpayer compliance costs prior to the introduction of Pillar Two rules.

Pensions

The Revenue Commissioners recently updated the Pensions Manual to reflect amendments in Finance Act 2021. Can you outline the main implications of these changes?

Karen Keegan, Senior Manager, Employment Tax, Deloitte: The amendments to the Revenue pension manual reflect legislative changes in Finance Act 2021 regarding:

- the removal of the requirement that €63,500 be used to purchase an annuity pension or be transferred to an approved minimum retirement fund (AMRF) where an individual is availing of the option of transferring (part of) a pension fund to an approved retirement fund (ARF),
- the removal of the requirement to not have more than 15 years of scheme service to be permitted to transfer funds from an occupation pension scheme to a personal retirement saving account (PRSA). Now individuals with 15 years' service or more will be permitted to transfer their retirement funds to a PRSA,
- providing for a choice between an annuity pension and a transfer to an ARF for the family of a scheme member who dies in service, and
- the tweaking of rules originally legislated for in Finance Act 2019 to make it clear that tax relief is available for pension contributions made by a company to an occupational pension scheme to benefit current or former employees of another company in certain circumstances e.g., restructuring, mergers and joint ventures. The changes to the Revenue pension manual also reflect this change. The relevant legislation puts what was previously an administrative practice on a statutory footing.

Karen Keegan

The above changes are all welcome in that they remove restrictions and allow for more pension choice, and they provide for a legislative basis for tax deductions in respect of corporate contributions to schemes that provide for pensions for employees of other companies. There were also other minor changes to the pension manual. The details of the changes are summarised in e-brief no. 149/22.

Aircraft Leasing

What are the major tax implications for Ireland's aircraft leasing industry in the post-BEPS landscape? With regards to the integration of BEPS rules into Ireland's tax system, what steps need to be taken to ensure Ireland's aircraft leasing offering remains globally competitive?

Marine Opperman, Assistant Manager, Corporation tax – Financial Services, Deloitte: As market leaders, it may be tempting to take a view that it will be "business as usual" for the Irish aircraft leasing industry in the post-BEPS landscape. However, various other jurisdictions have since advertised themselves as attractive locations for this market, bringing with it competition. In the wake of the COVID 19 pandemic, it has been demonstrated that employees can work effectively from virtually anywhere in the world.

With respect to BEPS, all eyes are undoubtedly on the adoption of Pillar Two. Despite a turbulent journey, it appears more likely than not that Pillar Two will be adopted, with the EU looking towards 2024 for implementation. Pillar Two proposes a 15% minimum effective corporation tax rate to multinational groups with turnover of €750 million or more (with the Irish 12.5% corporation tax rate remaining applicable otherwise).

Logically then, Ireland's leasing industry in a post-BEPS world will

Marine Opperman

likely be influenced by how Ireland implements Pillar Two. The EU's draft directive for Pillar Two included a number of carve outs, including a measure of the value of tangible assets, but there is uncertainty as to whether this carve out would apply to lessors, which could be significant. Another significant consideration is whether Ireland will increase its headline corporate tax rate by 2.5%, or introduce a top-up tax. This point is material for in scope entities: from an accounting perspective a headline tax rate change would impact the deferred tax workings and thus the profit and loss account, inevitably affecting current year tax calculations. A top up tax could result in cash tax payable which again would be something for lessors to consider. As such the implementation of the rules will be critical and we continue to monitor developments closely.

In our experience the Irish Government is very aware of the potential impact of Pillar Two on stakeholders. In taking a long-term view, Ireland Inc. should remain adaptive and resilient on all fronts, including continuing to enhance the tax treaty network and positioning itself as an attractive location for, and retaining, industry talent.