Public Consultation Paper

Review of the corporation tax code

February 2017

Tax Policy Division,

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1. Introduction

On 2 September 2016 the Government decided to arrange for a review of Ireland's corporation tax code by an independent expert, to be appointed by the Minister for Finance. On Budget day, the Minister published the terms of reference of the review and announced the appointment of Mr. Seamus Coffey as the independent expert. The review shall make recommendations to the Minister by the end of the second quarter of 2017.

The terms of reference published by the Minister reflect the changes in the international tax landscape that have occurred since 2015, particularly the agreement of the Organisation for Economic Co-operation and Development (OECD) initiative to combat base erosion and profit shifting (BEPS). In November 2016, the Minister requested the independent expert to examine the increase in corporation tax receipts in 2015 and 2016, and this matter now forms part of the terms of reference.

The independent expert is now seeking the views of the public and the interested parties regarding the matters identified by the terms of reference of the review, which may assist in the formulation of recommendations to the Minister.

The Department of Finance is facilitating this public consultation. This document (i) reproduces the terms of reference of the review published on Budget day, incorporating the additional matter included at the Minister's request, (ii) briefly outlines the manner in which the public consultation process will take place, (iii) provides a short background on a number of matter under review to orientate the public and interested parties in formulating their responses, and (iv) suggests a number of broad questions for the public and interested parties to consider.

2. The Consultation Process

Consultation Period

The consultation period will run from 21 February 2017 to 4 April 2017, a period of 6 weeks.

How to respond

The preferred means of response is by email to: ctcodereview@finance.gov.ie

Alternatively, you may respond by post to:

Review of the corporation tax code,
Tax Policy Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2,
DO2 R583.

Please include contact details if you are responding by post.

Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Act 2014. Parties should also note that responses to the consultation may be published following the conclusion of the review.

Meetings with key stakeholders

The independent expert may invite key stakeholders to meet with him, including representative bodies, trade unions, non-governmental organizations, enterprises, tax professionals and other interest groups or individuals.

After the Consultation

Responses to the consultation document will assist the independent expert in formulating recommendations to the Minister.

3. Terms of Reference

REVIEW OF THE CORPORATION TAX CODE BY AN INDEPENDENT EXPERT

APPOINTMENT OF AN INDEPENDENT EXPERT

On 2 September the Government decided to arrange for a review of Ireland's corporation tax code by an independent expert to be appointed by the Minister for Finance. The Minister has decided to appoint Mr. Seamus Coffey to undertake the review.

TERMS OF REFERENCE

The review of the corporation tax code shall be conducted by an independent expert, to be appointed by the Minister for Finance, in respect of the following matters:

- achieving the highest international standards in tax transparency, including in the automatic exchange of information on tax rulings with other relevant jurisdictions, having regard to benefits which may accrue to developing countries from enhancing global tax transparency;
- ensuring that the corporation tax code does not provide preferential treatment to any taxpayer;
- further implementing Ireland's commitments under the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting (BEPS) project to tackle harmful tax competition and aggressive tax planning;
- delivering tax certainty for business and maintaining the competitiveness of Ireland's corporation tax offering; and,
- maintaining the 12.5% rate of corporation tax.

The review shall make recommendations to the Minister for Finance by the end of the second quarter of 2017.

The Department of Finance may, as required, facilitate a public consultation with citizens, civil society and stakeholders on any or all of the matters under review.

SUPPLEMENTARY TERMS OF REFERENCE

The role and sustainability of the corporation tax receipts shall also form part of the subject matter of the review.

4. Consultation themes and questions

Tax Transparency

Tax transparency broadly captures the degree to which the operation of legislative, legal, or administrative provisions in a state are effective in capturing and sharing the information necessary to ensure the collection of all tax owed by natural and legal persons, as determined by national and international law. Due to the level of international co-operation required to give effect to greater tax transparency it has been traditionally driven by multilateral institutions, such as the United Nations (UN), Organisation of Economic Co-operation and Development (OECD) and the European Union (EU).

The OECD Forum on Harmful Tax Practices (FHTP) was established following the publication of *Harmful Tax Competition: An Emerging Global Issue* by the OECD in 1998, which outlined a number of measures in evaluating harmful tax practices. Lack of transparency was identified as one of the key factors in a harmful tax regime, and respondents may find the report, and the four progress reports which followed it, a useful guide regarding international standards in tax transparency.[1]

Ireland is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, an international initiative with over 138 members. The Global Forum is the key international body seeking to implement improved tax transparency through common international standards regarding the automatic exchange of information and the exchange of Information on request. The Global Forum assists in the necessary technical work to implement the Common Reporting Standard (CRS), which ensures jurisdictions can share financial account information and participate in the MAATM. Automatic exchange of information is operationalised by the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS MCAA), signed in October 2014, and the Multilateral Competent Authority Agreement on Country by Country Reporting (CbC MCAA), which was required to give effect to Action 13 of the OECD initiative to combat BEPS, signed in January 2016.

Exchange of information may also take place between Ireland and those countries with which it has signed a Double Taxation Agreement or Tax Information Exchange Agreements. The relevant exchange of information article of Ireland's Double Taxation Agreement provides for the exchange of information between parties to the treaty and Tax Information Exchange Agreements facilitate the exchange of information on request.

At EU level, tax transparency is given effect through EU legislation. In 2011, Directive 2011/16/EU (the 'Directive on Administrative Co-operation' or 'DAC1') repealed and replaced Directive 77/799/EEC. The main provisions of DAC are:

[1] OECD (1998), *Harmful Tax Competition: An Emergency Global Issue*, Paris: OECD Publications, 28 - 29.

a. Provision for exchange of information 'that is foreseeably relevant to the administration and enforcement of the domestic laws of the Member States';
b. Spontaneous exchange of information where a Member State has information that may be useful for determining a loss, saving or increase in tax for another Member State;
c. Automatic exchange of information on specific categories of income and capital taxation from one Member State to another Member State regarding residents of the other Member State;
d. Exchange of information on request where a request is made by one Member State to another Member State regarding residents of the other Member State;
e. The Directive covers all taxes with the exception of VAT, customs duties, excise duties and compulsory social contributions.

DAC was amended through Directive 2014/107/EU ('DAC2') to extend DAC to interest, dividends, and other income as well as account balances and sales proceeds from financial assets, extending the specific categories encompassed by DAC. Directive 2015/2376 ('DAC3') provided for further amendments to DAC by extending the automatic exchange of information provision to cross-border tax rulings and to advance pricing agreements (APAs). Directive 2016/881 ('DAC4') provided for country-by-country reporting, largely based on the OECD BEPS recommendations in relation to country-by-country reporting contained in the Action 13 BEPS report. Ireland had already introduced country-by-country based on the OECD recommendations through the Finance Act 2015.

OECD initiative to combat BEPS

In light of the challenges to the international tax framework and public controversy regarding the taxation of the profits of multi-national enterprises (MNEs) in September 2013 the leaders of the G20 endorsed the OECD Action Plan to address base erosion and profit shifting (BEPS).[2]

More than 60 countries, including Ireland, participated in the technical groups which led, in October 2015, to the release, by the OECD and G20, of 13 reports covering 15 actions to combat BEPS. The 15 actions aim to (i) restore the coherence of corporate income taxation at the international level by ensuring that the interaction of national rules do not lead to the double non-taxation of corporate income, or less than single taxation, (ii) align the right to tax with corresponding economic substance, and (iii) improve tax transparency to facilitate the achievement of aims (i) and (ii).

The BEPS recommendations fall into a number of categories:

[2] G20 (2013), *Leaders' Declaration*, St. Petersburg, Russia; OECD (2013); *Action Plan on Base Erosion and Profit Shifting*, Paris: OECD Publishing.

- Certain BEPS actions have been agreed as setting new **minimum standards** which countries are committing to adhere to.
- Other BEPS actions are considered to be **best practices,** which outline what tax rules should be implemented in certain areas if countries choose to take action.
- Other actions are classified as **common approaches**, where it is expected that, over time, national practices will move towards the approach recommended in the relevant BEPS action.

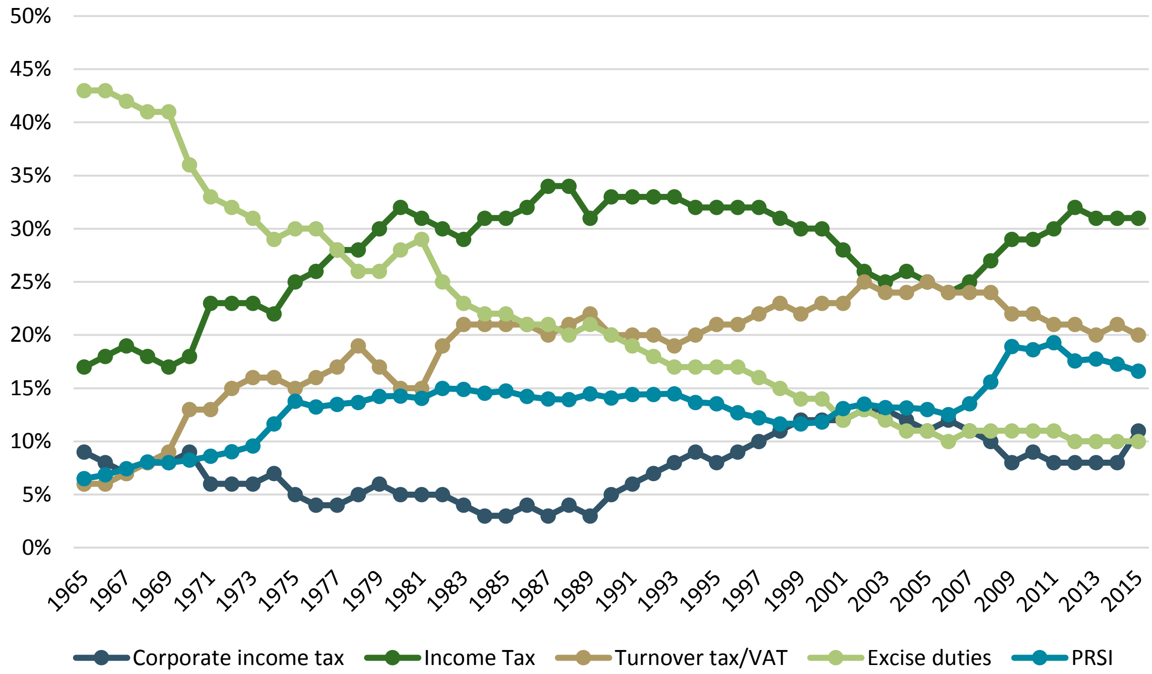
In 2016, the EU moved to implement a number of BEPS actions through European legislation, including Actions 2, 3 and 4 through Directive 2016/1164 ('the Anti-Tax Avoidance Directive') and Directive 2016/881 ('DAC4'). The BEPS reports may be found on the OECD website. The BEPS actions include:

- *BEPS Action 1 – Address the Tax Challenges of the Digital Economy;*
- *BEPS Action 2 – Neutralise the Effects of Hybrid Mismatch Arrangements (*Article 9 of the Anti-Tax Avoidance Directive);
- *BEPS Action 3 – Strengthen Controlled Foreign Company rules* (Article 7 of the Anti-Tax Avoidance Directive);
- *BEPS Action 4 - Limit Base Erosion via Interest Deductions and Other Financial Payments* (Article 4 of the Anti-Tax Avoidance Directive);
- *BEPS Action 5 – Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*
- *BEPS Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate circumstances*
- *BEPS Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status*
- *BEPS Actions 8, 9 & 10 – Aligning Transfer Pricing Outcomes with Value Creation*
- *BEPS Action 11 – Measuring and Monitoring BEPS;*
- *BEPS Action 12 – Mandatory Disclosure Rules* (provided for through Finance Act 2010 in Chapter 3 of Part 33 of the Taxes Consolidation Act 1997);
- *BEPS Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting (*country-by-country reporting provided for through Finance Act 2015 and later through DAC4);
- *BEPS Action 14 - Making Dispute Resolution Mechanisms More Effective;*
- *BEPS Action 15 – Develop a Multilateral Instrument.*

Role and sustainability of corporation tax receipts

Corporation tax receipts have historically made an important contribution to the tax revenues of many OECD members, including Ireland. Chart 1 indicates the contribution taxes on the income, profits and capital gains of corporate entities as a percentage of total tax receipts in Ireland between 1965 and 2015. For Ireland, taxes on the income, profits and capital gains of corporate entities encompasses income tax on company income and the corporation profits tax up to 1976, and the corporation tax on income and chargeable gains thereafter. Total tax receipts encompasses the total tax received by the State, including taxes flowing to the Exchequer, PRSI to the Social Insurance Fund, taxes flowing to other statutory funds, and rates raised by local authorities. Since 1993, corporation tax has contributed between 8% and 13% of total tax receipts.

Chart 1. Relative contribution of taxation of corporate income, personal income taxes, VAT, employee and employer PRSI, and Excise duties as % of total tax revenue, 1965 - 2015[3]



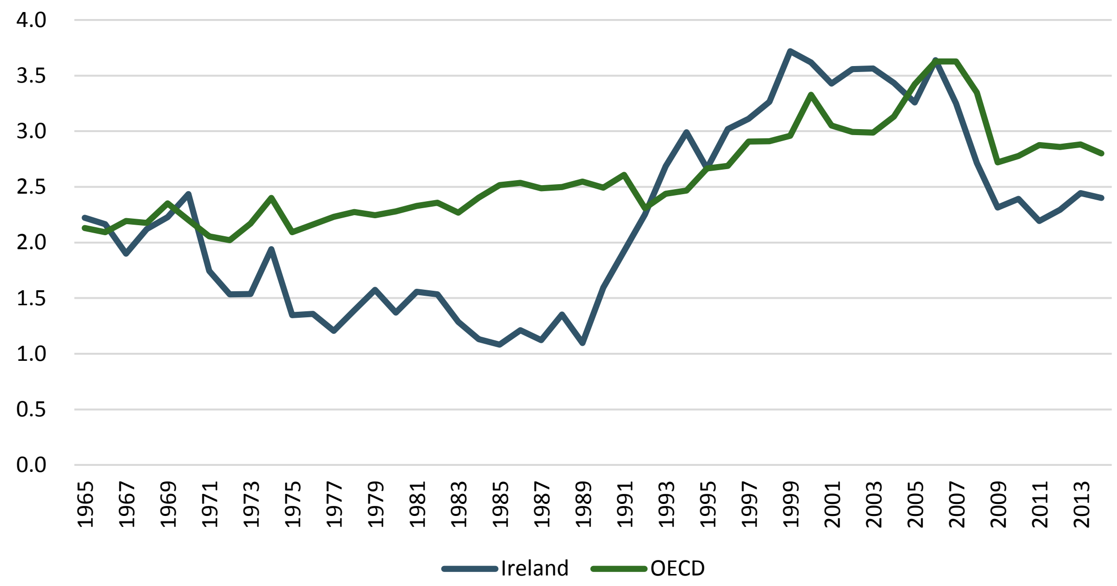
Source: OECD (2016), Revenue Statistics, 1965 – 2015.

Another useful way in which to measure the contribution of corporation tax receipts, particularly for cross-country comparisons, is as a percentage of Gross Domestic Product (GDP). As Chart 2 indicates since 1990, Ireland's corporation tax receipts as a percentage of GDP have been close to the OECD average. The chart also indicates the relative stability of the contribution of corporation tax receipts within the OECD, despite the widespread reductions in statutory corporate income tax rates since the early 1990s and the increased incidence in BEPS described by the OECD. Explanations of this relative stability include (i) the relative widening of the corporate income tax base globally through the restriction of provisions for tax depreciation ('capital allowances' in the Irish corporation and income tax codes), (ii) an increasing amount of business income being tax at company level (i.e. increased

[3] 'Corporate income tax' indicates a tax on the income, profits and capital gains of corporates, encompassing income tax on company income and the corporation profits tax up to 1976, and the corporation tax on income and chargeable gains thereafter; 'income tax' refers to income tax/levies charged on personal income; 'Turnover Tax/VAT' refers to the Turnover Tax and, from 1971, VAT; 'Excise duties' refer to all excise duties levied on specified goods and services; 'PRSI' refers to employer and employee PRSI contributions.

incorporations and use or corporate structure to receive business income), and (iii) increased taxable profits.[4]

Chart 2. Taxes on income, profits and capital gains of corporates as % of GDP, 1965 - 2013



Source: OECD (2016), Revenue Statistics 1965 – 2016.

In 2014, the corporation tax yield was €4,614 million, representing the fifth largest contributor to total tax receipts, and the fourth largest contributor to the Exchequer. In 2015, the corporation tax yield rose by 49% to €6,872m, representing the fourth largest contributor to total tax receipts, and the third largest contributor to the Exchequer. In 2016, the corporation tax yield rose to €7,351 million. This increase in corporation tax receipts has raised questions regarding the sustainability of corporation tax receipts, and as to whether the increase in 2015 and 2016 represents a step change or series of once-offs.

Irish corporation tax receipts are highly concentred, with 0.2% of corporation tax cases contributing 65.3% in net receipts. Foreign-owned MNEs accounted for 80% of net receipts in 2015.[5] The reliance on foreign-owned MNE exporters contributes to the volatility and unpredictability of corporation tax receipts, as receipts are exposed to (i) idiosyncratic shocks such as the 'patent cliff' and (ii) changes in the structure and strategies of MNE groups.[6]

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[4] Cf. Michael P. Devereux, Rachel Griffith, Alexander Klemm, Marcel Thum and Marco Ottaviani (2002), 'Corporate Income Tax Reforms and International Tax Competition', *Economic Policy*, Vol. 17, No. 35.

[5] Paul Tancred (2016), *An Analysis of Corporation Tax Receipts in 2014-2015.*

[6] Cf. Eddie Casey and Andrew Hannon (2016), *Analytical Note No. 10: Challenges Forecasting Irish Corporation Tax*, Irish Fiscal Advisory Council; Shane Enright and Mary Dalton (2014), 'The Impact of the Patent Cliff on Pharma-Chem Output in Ireland', *Journal of the Statistical and Social Inquiry Society of Ireland*, Vol. XLIII.

Delivering tax certainty and maintaining competitiveness

The concept of 'competitiveness' in tax policy is often applied broadly. For the purposes of the review 'competitiveness' will be evaluated by reference to the effectiveness of the corporation tax code in encouraging or maintaining economic activity, increasing or maintaining employment, and expanding or maintaining output in Ireland in the context of international capital mobility, the increasing importance of intangible capital in producing goods and supplying services in the global value chains of MNEs, and the further implementation of the actions agreed under the OECD initiative to combat BEPS.

Irish corporation tax is imposed on the worldwide profits, composed of income and chargeable gains, of companies resident for tax purposes in Ireland. A rate of tax of 12.5% is imposed on trading income (Case I and II of Schedule D) and certain dividends paid out of trading profits, a rate of tax of 25% is imposed on non-trading and 'excepted' trading income, and the prevailing rate of Capital Gains Tax (now 33%) is applied to the chargeable gains of companies. A company not tax resident in the State is subject to corporation tax on its chargeable profits, as defined by section 25 of the Taxes Consolidation Act 1997, where it carries on a trade in the State through a branch or agency. The terms of reference of the review confirm that the current rates of corporation tax will not form part of the review.

The Irish corporation tax code currently includes a number of tax expenditures targeted to achieve certain policy objectives: the Knowledge Development Box and the Research and Development Tax Credit are designed to increase Business Expenditure on Research and Development (BERD); film relief is designed to increase the number of film productions in Ireland; and the relief from corporation tax for certain start-up companies is designed to increase the number of new incorporated start-up companies.

Features of the benchmark tax code are important in maintaining the competitiveness of the corporation tax code. Taxable trading income is based on profits according to financial statements but subject to specific adjustments required or authorised by the tax code. In general, subject to the computation rules set out in Chapter 6 of Part 4 of the Taxes Consolidation Act 1997, revenue expenditure that is wholly and exclusively incurred for the purpose of a trade can be offset in calculating trading income. Deductions are not allowed for business entertainment expenditure or for capital expenditure. The depreciation or amortisation of capital assets, as computed for accounts purposes, is not an allowable expense in computing a company's income for the purposes of corporation tax. Instead, where certain conditions are met, depreciation for tax purposes is provided through capital allowances in respect of capital expenditure on plant and machinery, buildings and intangible assets.

A company that makes a trading loss in an accounting period can offset the amount of the loss against profits for the same or the previous accounting period in order to reduce its corporation tax liability. Any trading loss not set off can be carried forward for offset against future trading income of the trade concerned. Losses can also be surrendered between companies that are in a 75% group relationship provided both the surrendering and claimant companies are within the charge to Irish corporation tax and are resident in the EU, Iceland or Norway.

5. Consultation Questions

With the consultation themes in mind, the independent expert invites interested parties to make submissions regarding the following questions:

1. What additional legislative measures, if any, should Ireland take to achieve the highest international standards in tax transparency, having regard to the benefits which may accrue to developing countries from enhancing global tax transparency?

2. What additional legislative measures should Ireland take to further implement the actions of the OECD initiative to combat BEPS?

3. What legislative measures, if any, should Ireland take to maintain the competitiveness of the corporation tax code and deliver tax certainty for business in the context of the ongoing implementation of internationally agreed measures to combat BEPS?

4. What is your view of sustainability of corporation tax receipts over the short to medium term?

Respondents and interested parties are also invited to include additional matters which may fall under the terms of the review in their submissions.

Responses will assist the independent expert in making recommendations to the Minister.