International Tax

Ireland Tax Alert

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Budget 2016 includes introduction of knowledge development box and CbC reporting

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On 13 October 2015, Ireland's minister for finance presented the budget for 2016 in the context of the country being the fastest growing economy in Europe for 2015, with GDP growth at 6.2% and projected growth for 2016 at 4.3%, while recognizing that Ireland has an open economy and there are various international concerns regarding the global economic outlook.

The budget has a strong emphasis on the indigenous domestic sector, supporting entrepreneurs, assisting employees with their after-tax salaries and creating further incentives for innovation. The commitment to innovation includes the announcement of the knowledge development box (KDB), although the details of the KDB suggest that it is more likely to be used by, and be of benefit to, the indigenous industry rather than multinationals (MNCs) (although there will be a small number of MNCs whose fact patterns and/or commitments to mandating R&D to locate in Ireland will facilitate the use of the new lower corporation tax rate on relevant profits). (For prior coverage, see the tax alert dated 14 October 2014.) The proposed introduction of the KDB also is raising expectations, since the focus on patents and trademarks will direct attention to the government's continued funding program for innovation.

The minister also announced that country-by-country (CbC) reporting, based on the OECD's base erosion and profit shifting (BEPS) project, will be introduced.

The minister's acknowledgement of the challenges in attracting in talent from abroad, given the country's income tax and social security rates, is welcome although clearly this will be an ongoing challenge for an economy that requires talent in various sectors to drive future growth.

Knowledge development box

The Minister for Finance announced the introduction of a KDB that will be in compliance with the OECD "modified nexus" model. The Irish KDB will be the first OECD-compliant intellectual property (IP) box regime in the world and is intended to offer certainty to taxpayers and to enhance Ireland's popularity as an IP location, in conjunction with the 12.5% corporation tax rate, the R&D tax credit and the IP amortization regime.

The KDB will provide for a 6.25% corporation tax rate on profits arising from research and development projects relating to certain patents and copyrighted software carried out by an Irish company.

Full details of the Irish KDB regime will be included in the finance bill 2015 that will be presented by the end of October 2015, and it is expected that the KDB regime will have effect for accounting periods commencing on or after 1 January 2016.

Companies that will be eligible to benefit from the KDB regime should assess whether the KDB will provide an incremental tax benefit or option, taking into account the nature and location of the R&D activity carried out in generating the patent and/or copyrighted software IP assets, the projected profitability of the individual IP assets and the tax benefit that arises under the existing intangible assets regime.

In our view, the introduction of the Irish KDB regime is welcome, although the narrow scope of IP assets that will qualify for the regime ultimately will result in limited uptake outside of the pharmaceutical and technology sectors and potentially will be of more benefit to the indigenous sector than the MNC sector. The nature of the OECD modified nexus model on which the Irish KDB is based is that onerous “tracking and tracing” provisions likely will attach to the regime and will require a separate profitability stream to be computed for each individual IP asset for the purposes of determining the extent of any tax benefit available under the Irish KDB regime.

While the pharmaceutical industry, as a regulated industry, already has certain “serialization” features that will alleviate the tracking and tracing burden, no such features exist in the tech sector, which likely will result in extreme complexity in allocating income and expenditure to each copyrighted software/patent IP assets that are embedded in a particular product or service being offered for sale.

Focus will be placed on the finance bill to establish whether there is a pragmatic approach for dealing with the tracking and tracing provisions. Failing this, qualifying taxpayers, particularly in the technology sector, will need to ensure that their internal systems are aligned so that the relevant data can be collated in a reliable and efficient manner for purposes of computing the relief that may be due under the Irish KDB regime.

Since the KDB will have limited appeal for many MNCs given the mechanics of the calculation of the amount of income qualifying for the 6.25% corporate tax rate, attention is likely to shift to the use of financing techniques to manage effective tax rates.

Transfer pricing: Country-by-country reporting

The upcoming finance bill 2015 will contain legislation to give effect to CbC reporting in accordance with action 13 of the OECD BEPS project. MNCs (Irish-headquartered and foreign groups with Irish operations) with global revenues in excess of EUR 750 million will be required to file a CbC report for accounting periods commencing on or after 1 January 2016. The EUR 750 million threshold will be determined on a preceding year basis. The first reporting period will be the 2016 financial year. The deadline for filing the CbC report is 12 months after the end of the accounting period, i.e. 31 December 2017 for 31 December 2016 financial year ends.

For Irish-headquartered and Irish-parented MNCs, the onus will be on the top Irish company to file the CbC report with the Irish tax authorities within 12 months after the end of the relevant accounting period.

For foreign MNCs (e.g. US-headquartered MNCs), the onus will be on the parent company in the foreign jurisdiction (e.g. the US) to file the CbC report with the relevant foreign tax authorities. However, if the foreign tax jurisdiction has not enacted legislation to introduce CbC reporting or is not a member of the OECD, a secondary mechanism will apply, under which responsibility for filing the CbC report will be able to be placed on a lower group company, where that entity is nominated as the “surrogate parent” for CbC reporting purposes. This may have an impact on Irish group companies of foreign multinational groups in cases where the Irish entity is nominated as the surrogate parent, thus placing responsibility on the Irish company to file the CbC report.

Companies should start considering the impact of the increased transparency brought about by CbC reporting and whether internal systems and processes will need to be better aligned to meet the onerous demands of increased reporting requirements.

The announcement of CbC reporting was widely anticipated; many OECD countries are starting to introduce CbC reporting requirements in their domestic law. Companies need to consider the commercial challenges imposed by these reporting obligations in terms of potential increased tax scrutiny from domestic and foreign tax authorities and the need for systems to be appropriately adjusted to capture the required information.

International tax strategy

The minister published an update on Ireland’s international tax strategy, which contains the country’s approach to the implementation of the OECD BEPS reports and how Ireland will engage with the EU on other emerging trends. With respect to the BEPS actions that are described as “best practices” or “common approaches,” such as controlled foreign company regimes and interest deductibility rules, the international tax strategy document notes that these are not minimum standards requiring early action but that Ireland will continue to engage constructively with international developments on these issues.

Of significant interest is the reference to BEPS actions 8-10, which focus on transfer pricing; the strategy document notes that the OECD council will approve these actions in 2016 and at that stage Ireland will be expected to update references to the revised OECD transfer pricing guidelines and interpret Irish transfer pricing law in accordance with such guidelines, which will be as from 1 January 2017 at the earliest.

Other tax authorities take the view that new guidance is applicable to existing principles and many already are taking these new principles into account when conducting audits, which will present some challenges in resolving double taxation and in negotiation on transfer pricing disputes. Ireland’s government is very conscious of the need for further resources to ensure compliance with domestic rules and negotiation on cross-border and international rules, and budget 2016 allocates substantial funding to increasing its own compliance and technical resources.

Attraction of talent

The most significant impact of budget 2016 are changes to the Universal Social Charge (USC). The 7% USC rate will be reduced by 1.5% to 5.5%, and the rates of 3.5% and 1.5% will be reduced by 0.5% each to 3% and 1%, respectively. In addition, the entry point at which an individual will begin to pay USC will be increased.

The budget also contains a measure that will reduce the effective rate of tax and, thus, the total tax rate for those earning less than EUR 70,044 to 49.5%. This is the first time that the tax rate for middle income earners would drop below 50% since April 2009.

The top rate of tax of 52% for those earning in excess of EUR 70,044 has been retained, with a top rate of 55% for the self-employed earning more than EUR 100,000.

Although no changes have been announced to the special assignee relief programme for personnel transferring into Ireland from abroad, the reduction in the USC and the broadening of tax bands will benefit employees in all sectors, including the MNC sector.

Ireland has a favorable visa programme for highly skilled employees that is used extensively by MNCs. Ireland's generous view of the benefits of immigration and its positive impact for the economy means that Ireland is becoming better placed to serve the MNC community as a location and hub for talent, into the future, versus competitor countries.