OPENING STATEMENT to Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach, 28th November 2017

Seamus Coffey

A review of Ireland's corporation tax code was announced by the Government on the 2nd of September 2016. On the 11th of October the then Minister for Finance set out the terms of reference and announced my appointment to undertake the Review. The Review was delivered to the Minister for Finance on the 30th of June and published on the 12th of September.

The terms of reference of the Review encompass meeting international standards for tax transparency, ensuring that the corporation tax code does not provide preferential treatment to any taxpayer; implementing Ireland's commitments under the OECD's Base Erosion and Profit Shifting (BEPS) project and various EU tax directive, delivering tax certainty for business and maintaining the competitiveness of Ireland's corporation tax offering.

During the Committee Stage of the Finance Bill 2016 last year, a number of members of this Committee raised the matter of the role and sustainability of corporation tax receipts, in light of the increase of the corporation tax yield in 2015 and this matter was added to the terms of reference of the Review.

In undertaking the Review, a number of consultations were held with stakeholders including representatives from non-governmental organisations, accountancy firms, trade unions and representative bodies. The Department of Finance facilitated a public consultation which ran from 21st of February to the 4th of April. 16 submissions were received. Discussions were also held with officials from the Revenue Commissioners, the Department of Finance, the Department of Jobs, Enterprise and Innovation, the IDA, Enterprise Ireland and the OECD.

PREFERENTIAL TREATMENT

The terms of reference provide that the Review should ensure that the corporation tax code does not provide preferential treatment to any taxpayer. A feature of the corporation tax code may be considered preferential if it offers a tax preference in comparison with the general principles of the code. It is important to ensure that any such preferential treatment is justified from a policy perspective and is not actively harmful or constituting harmful tax competition.

The criteria applied by both the OECD Forum on Harmful Tax Practices and the EU Code of Conduct for Business Taxation to identify a potentially harmful tax regime provide the internationally accepted criteria for identifying whether features of the tax code constitute harmful tax competition. Any proposed measures should be carefully scrutinised to ensure that they do not constitute a potentially harmful preferential tax regime. Ireland's Knowledge Development Box was evaluated the OECD Form and the EU Code of Conduct (Business Taxation) Group who both concluded that it was not harmful.

TAX TRANSPARENCY

The ability of tax authorities to collect and share information is necessary to ensure the correct allocation of taxing rights and attribution of profits across borders, and concomitantly the collection of all taxes legally owed.

Ireland was subject to a Global Forum peer review in 2010 facilitated by the OCED. Ireland was one of 16 jurisdictions to receive a rating of compliant - the highest rating achievable. In August of this year, the Global Forum published its peer review report for Ireland as part of the second round of reviews which are assessed against enhanced standards. Again, Ireland received the highest rating achievable: compliant. Ireland should take account of the recommendations of the peer review.

Ireland should continue its commitment to support proposals for a Directive providing for mandatory disclosure rules in line with the recommendations outlined in the G20/OECD BEPS Action 12 Report.

TRANSFER PRICING

Given Ireland is required to legislate to apply the 2017 OECD Transfer Pricing Guidelines in domestic legislation it is timely to consider additional changes which may be made to Ireland's domestic transfer pricing rules.

At present, Ireland's position in the global value chain of MNEs in sectors which rely heavily on intellectual property is such that large amounts of royalties are paid out of Ireland by MNE affiliates to members of the same MNE group in other jurisdictions. The recipient of the royalty payments receives a significant return relating to the ownership of the IP. For Irish corporation tax purposes, such royalties are deductible by the Irish royalty importer as either an ordinary business expense or, in the case of patent royalties, as a ‘charge on income’.

Where the recipient of the royalty payments does not perform the requisite DEMPE functions [Development, Enhance, Maintain, Protect and Exploit] or control economically significant risks the application of the OECD 2017 Transfer Pricing Guidelines may result in the recipient of the royalty payments being attributed a return which only reflects the risk-free or risk-adjusted return with respect to the recipient’s funding activity. Assuming transfer pricing rules apply to all trading transactions, the introduction of the 2017 OECD Transfer Pricing Guidelines may have the impact to adjust the ‘consideration payable’ (the outbound royalty) downwards, having regard to the DEMPE functions and control of the associated risks by the recipient of the royalty payments. Depending on the facts and circumstances this could have a significant impact on MNEs operating in Ireland and the quantum of outbound royalty payments which are deductible for Irish tax purposes.

On transfer pricing:

- Ireland should provide for the application of the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8, 9 and 10 in Irish legislation.
- Domestic transfer pricing legislation should be applied to arrangements the terms of which were agreed before 1 July 2010.
- Consideration should be given to extending transfer pricing rules to SMEs, having regard to whether the associated imposition of the administrative burden associated with keeping transfer pricing documentation on SMEs would be proportional to the risks of transfer mispricing occurring.
- Consideration should be given to extending domestic transfer pricing rules to nontrading income where it would reduce the risk of aggressive tax planning.
- Consideration should also be given to extending transfer pricing rules to capital transactions, having regard to whether such an extension would improve the existing provisions which already apply arm’s length values to companies’ transactions relevant to chargeable gains and capital allowances.

If it is decided to implement any or all of these recommendations on transfer pricing, this should take place no later than the end of 2020, which is the year to which the OECD and G20 have agreed to extend their co-operation on BEPS to complete the current work.

EU ANTI-TAX AVOIDANCE DIRECTIVE

There are various components of the Anti-Tax Avoidance Directive that Ireland will have to transpose into domestic law over the coming years. These include an interest limitation rule, anti-hybrid rules, the introduction of controlled foreign corporation (CFC) rules, an exit tax and a general anti-avoidance rule (GAAR). Various deadlines have been set for these to be achieved and, in transposing these, Ireland should have regard to the recommendations of the Reports on BEPS Actions 2, 3 and 4.

The Exit Tax was proposed to provide that Member States are in a position to tax the economic value of any capital gain created in their territory where the gain has not been realised at the time of the transfer out of the Member State. ATAD provides that Member States must impose an exit tax on the transfer of an asset out of its territory, the chargeable basis of the tax being the market value of the transferred assets less their value for tax purposes.

Ireland already imposes an exit tax which operates by deeming the disposal of an asset and its reacquisition at market value for CGT purposes where a company, within the meaning of the legislation, ceases to be resident in the State. The scope of the charge in this section is not wide enough to encompass all the transactions covered by the Directive. Accordingly, the transposition of the exit tax will require legislative amendments which will be required by 1 January 2020. ATAD does not specify the calculation of the value of the assets for tax purposes or the rate of the exit tax, which leaves discretion in these areas to Member States.

COMPETITIVENESS

Of the 34 members of the OECD, six, including Ireland, impose corporate income tax on a worldwide basis, with relief from double taxation provided via the credit method. The other 28 OECD member states operate a territorial corporate income tax base, although the types and share of foreign income taxed vary from state to state depending on national policy choices. A number of OECD member states have moved in recent years towards a participation exemption for foreign dividends and/or exemption of branch profits including Germany since 2001, and Australia, New Zealand, Japan and the UK since 2009.

During the public consultation a number of stakeholders suggested moving to a territorial base. The difficulty of computing the credit for foreign income, particularly when income arises from multiple jurisdictions, was highlighted as a competitive disadvantage. Schedule 24 of the Taxes Consolidation Act 1997, which gives effect to the computation of the foreign credit, has been amended multiple times since 1997 in light of policy changes and to take account of judicial decisions. Accordingly, the operation of the relief for foreign credit has become more complex, which is seen as a burden on business.

In the context of the introduction of the Controlled Foreign Company rule provided by the Anti-Tax Avoidance Directive, consideration should be given to whether it is appropriate to move to a territorial corporation tax base in respect of the income of the foreign branches of Irish-resident companies and, in respect of connected companies, the payment of foreign-source dividends. In doing so, regard should be had to whether moving to a territorial corporation tax base would require additional anti-avoidance measures. In deciding whether to move to a territorial corporation tax base, a balance must be struck between the prospective reduction in compliance burdens for Irish-resident outbound investors through an exemption of foreign income, the prospective increase in compliance burden necessitated by the introduction of any additional anti-avoidance measures required, and any potential revenue impact.

An alternative to a territorial corporation tax base is to review Schedule 24 of the Taxes Consolidation Act 1997 with a view to effecting a policy and revenue neutral simplification of the computation of the foreign tax credit for all forms of foreign income. This would achieve the competitiveness advantages associated with moving to a territorial corporation tax base, whilst avoiding the introduction of additional complexity to the corporation tax code by new anti-avoidance measures.

CERTAINTY

A number of submissions to the public consultation emphasised the importance of public consultation and stakeholder engagement in the design and implementation of tax legislation. This can increase certainty for taxpayers and ensure that the views of all sections of the community are taken into account, including the views of those NGOs active in developing countries.

It is recommended that a number of proposed changes suggested in the Review are carried out subject to consultation to reduce uncertainty regarding the proposed changes and to better inform policy-making.

A number of consultees foresaw potential for increased uncertainty regarding the application of international tax standards as BEPS actions continue to be implemented, particularly in the area of transfer pricing disputes. In recent years the quantity of new and outstanding Mutual Agreement Procedures initiated under the relevant article of double tax agreements has increased. The Mutual Agreement Procedure is important to ensuring the correct application and interpretation of the relevant DTA. From the perspective of the taxpayer it is important in ensuring the prevention of double or more than single taxation, and from the perspective of the contracting party it assists in ensuring that the correct amount of tax is allocated to each contracting party. Both the risk of uncertainty and double taxation may deter cross-border investment where the relevant DTA is subject to inconsistent interpretation or application by one or both of the contracting parties.

To reduce uncertainty and ensure that Ireland protects its corporation tax base, Ireland should ensure an adequately resourced Competent Authority.

RECEIPTS

There were a number of independent factors that arose together that contributed to the level shift increase in Corporation Tax receipts in 2015. It is unlikely that any reversal of these factors would similarly coincide. While this suggests that Corporation Tax receipts are sustainable at a new higher level, at least in the medium term to 2020, the inherent volatility of Corporation Tax receipts will remain and some of the factors that led to the 2015 level shift could unwind individually. Given this uncertainty we can never be sure of the sources and permanency of such revenues and it would be wise that policy should be suitably cautious in terms of introducing increases in spending or permanent reductions in taxation.

Figures from the Revenue Commissioners show that there was a €26 billion increase in intangible-asset related gross trading profits in 2015. This was offset by an increase in the amount of capital allowances for intangible assets of a similar scale. These gross trading profits are included in Ireland's Gross

National Income but the use of capital allowances results in a much smaller amount being included in the taxable income base for Ireland’s Corporation Tax. Given Ireland’s contribution to the EU Budget is calculated by reference to Gross National Income, this increase in profits has an impact.

From an industrial policy perspective, the decision of companies to locate some of their intangible assets in Ireland can be considered another spoke in the wheel. Although these assets are inherently mobile the decision to locate them here strengthens existing investment in Ireland. The link to future investment is less clear but ongoing changes at international level in how the corporate income tax is assessed have the link between profit and substance as a key motivation. Many companies who are likely considering the location of their intangibles in this changed environment already have significant operations in Ireland. This substance will likely be a factor some companies will consider when making these decisions and it is likely that further substance will follow to the location chosen.

In order to ensure some smoothing of corporation tax revenues over time, the Review recommended that the limitation on the quantum of relevant income against which capital allowances for intangible assets and any related interest expense may be deducted in a tax year be reduced to 80%. This recommendation is being implemented via Section 21 of the Finance Bill 2017.

I look forward to our discussion and hope I can address any questions on the Review you might have.