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An Overview of the Corporation Tax Base in Ireland

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Introduction

The volatility of Corporation Tax (CT) receipts has been the subject of considerable fiscal policy debate in recent times. CT is now the third largest tax category for the State in terms of annual revenues, and the most volatile of the major taxes. In addition, there has been a global emphasis on the tactics used by multinational corporations (MNCs) to reduce their CT liability. Actions underpinning the OECD’s BEPS (Base Erosion and Profit Shifting) Framework present both opportunities and risks for Ireland, given the growing reliance of the Exchequer on CT revenue, and the substantial contribution of foreign-owned MNCs to Irish CT receipts (at 77% of total CT revenue in 2017).

In this context, this Briefing Paper provides an overview of the CT structure in Ireland, including some of the more substantive deductions, allowances and credits that can be used to reduce the amount of CT paid. However, it is worth noting that the CT system is complex, and attempting to distillate the tax structure into a concise and accessible summary is a challenge.

This paper tracks the “walk” from gross trading profits to taxable income, and the ultimate amount of CT that companies are liable to pay (with reference to the period from 2012-2017). It further outlines the OECD BEPS Framework, and the potential implications of this Framework for Irish CT revenue. Finally, this paper examines the distribution of CT receipts in Ireland, including the concentration of these receipts, and outlines the approach to, and difficulties with, forecasting CT revenue.

Some of the key messages of this paper are summarised below:

- There is a sizeable walk from (gross) trading profits to taxable income, with substantial deductions in the form of capital allowances (including in relation to the acquisition of intangible assets e.g. intellectual property). From 2012-2017, while Gross Trading Profits grew by 119%, Taxable Income grew by 84%, with an increase in Capital Allowances (used) of 631%.
- At the sectoral level, the ratio of CT liability to trading profits is particularly low for the Manufacturing and Administrative and Support Services sectors. This is largely due to the level of capital allowances and trade charges deducted in these two sectors.

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2 In 2019, for the first time, the European Commission included a recommendation in its Country Specific Recommendations for Ireland, to address features of the tax system that may facilitate aggressive tax planning by companies.
3 As outlined in the most recent Fiscal Assessment Report of the Irish Fiscal Advisory Council (IFAC, June 2019), the over-performance of CT has been used to meet over-spend in health and other areas, and has served to mask dis-improvements in the Exchequer Balance.
4 Gross Trading Profits, as referred to throughout this paper, is inclusive of certain “add-backs” (such as depreciation/amortisation and certain disallowed expenses). These add-backs are amounts that are deductible under accounting rules in reporting company profits, but are not deductible for tax purposes (i.e. they are “added-back” in the assessment for tax purposes).
CT revenue is volatile and difficult to predict, with sizeable forecast errors in recent years. Receipts are also highly concentrated. The vast majority of CT revenue comes from foreign-owned MNCs. In addition, the top ten payers of CT accounted for 45% of receipts in 2018 (however the composition of this top ten has been changing year-on-year). Excluding additional receipts arising from a once-off change in accounting standards in 2018, this figure is 43%.

Given the difficulty in accurately forecasting CT revenue using standard macro models, and the high concentration of CT revenue around relatively few tax-payers, consideration might be given to the development of a micro-based approach to modelling CT receipts (e.g. involving the use of microsimulation methods).

The Revenue Commissioners calculate the effective rate as the amount of tax due in proportion to taxable income. This implies an effective CT rate for 2017 of 10.2% (rising from 10% for 2016, and 9.6% for 2015), with an effective rate of 12.7% for the top ten CT payers (and 12.3% for the top 100 CT payers).

While Ireland may have benefitted from actions underpinning the OECD’s first BEPS framework, BEPS 2.0 presents a sustainability risk for CT revenue in Ireland, and may also undermine our competitive advantage in attracting foreign-direct investment (FDI). Of particular concern, are efforts to allocate shares of taxable profits based on the location of a company’s sales, and the implementation of a global minimum effective tax rate.
This section provides an overview of the CT structure in Ireland, including the various deductions, allowances and credits that companies may use to reduce the amount of CT that they are liable to pay.

Company profits generally include income arising within the year from trading, investment and capital gains, and are reported net of current expenditure (e.g. labour costs). Different rates of CT are applied, depending on the source of profit. These include:

- 12.5% for trading income;
- 25% for passive (non-trading) income (e.g. interest payments, dividends, foreign income, royalties, miscellaneous items, and rental income) and income arising from “excepted trades” (e.g. minerals, petroleum activities, dealing in and developing land); and,
- 33% for capital gains (e.g. the proceeds from the sale of an asset).

Gross Trading Profits represent the starting point in calculating a company's CT liability. These profits are subject to certain adjustments prior to determining the amount of tax a company must pay.

Generally, deductions and allowances are applied in determining taxable income (this is the norm internationally), while certain reliefs and credits may then be applied in determining CT liability. Some of the more substantive deductions, allowances and credits are outlined below.

**Deductions**

The following deductions may apply, subject to certain terms and conditions:

**Losses:** Companies may use trading losses to offset profits arising in the same (or preceding) period. Unused losses can be carried forward and used to offset trading profits in the next period.

**Group Relief:** A company's losses may be used to offset the profits of another company in a group, where one group member controls at least 75% of the assets or income (providing both companies are subject to Irish CT, and are resident in the EU, Iceland or Norway).

**Trade Charges:** A company can deduct certain annual payments (deemed business expenses). These include interest payments and royalties (i.e. payments for the right to use intellectual property). Further deductions may be granted in respect of charitable donations.
Capital Allowances

Capital allowances may be applied in respect of certain capital expenditure. This includes expenditure that brings into existence an asset, or advantage, for the enduring benefit of trade. Generally, these capital allowances may be applied to expenditure related to plant and machinery (which also includes intangible assets, such as patents, trademarks, and intellectual property), and certain industrial buildings.

Capital expenditure is typically depreciated when reported in financial statements (i.e. the cost is spread over the useful life of the asset). The amount of depreciation in a particular accounting period may be claimed as a capital allowance. This depreciation reflects the loss in the value of the assets used by the company in earning income. The rate of depreciation varies, depending on the type of asset (e.g. for intellectual property assets, allowances may be claimed over a fixed write-down period of 15 years, at 7% per annum of qualifying expenditure, and 2% in the final year).

For intangible assets, a cap equal to 80% of trading income applies for expenditure incurred on or after 11 October 2017 (i.e. the amount of the capital allowance must not exceed 80% of trading income). However, unused capital allowances may still be carried forward into the next period, and treated as losses in determining taxable income in that period. The 80% cap applies in respect of unused allowances in subsequent periods also.

Tax Expenditures

Once taxable income has been determined, certain tax expenditures may be used to reduce a company’s CT liability. The more significant credits and reliefs available include:

- **Knowledge Development Box** – If a company creates a useable asset from research and development (R&D) activity that generates an income, a 50% tax deduction may be applied in respect of this income.
- **R&D Tax Credit** – If a company carries out R&D activities, a tax credit equal to 25% of qualifying expenditure may be used to reduce the company’s CT liability. Subject to criteria, the R&D credit can be reclaimed over 3 installments where it exceeds relievable CT.
- **Three-year Start-up Relief** – If a company is established and begins trading between 1 January 2009 and 31 December 2021, a CT relief may be claimed in respect of trading income and any gains from the disposal of assets used in the first three years of trading (linked to the amount of employers’ PRSI paid in the accounting period).
- **Film Relief** – If a company invests in a film production, a CT credit is provided equal to 32% of the lowest of:
  - eligible expenditure;
  - 80% of total film production costs; or,
  - €70 million.

The Film Relief is subject to minimum spending on the production of €250,000, and a minimum eligible expenditure amount of €125,000. This is a refundable credit (i.e. if the amount of the credit exceeds the CT liability, the exceeding difference will be paid directly to the company).

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5 These measures are referred to as tax expenditures, and cost a combined €750 million in revenue foregone in 2016 (the latest year for which complete information is available). For more on tax expenditures, see PBO Briefing Paper 13 of 2018: Tax Expenditures in Ireland: Key Issues for Consideration, 21 September 2018.
Box 1: THE STATUTORY VERSUS EFFECTIVE CORPORATION TAX RATE

As detailed, three rates of CT apply depending on the nature of income. The Revenue Commissioners are unable to provide the amount of tax generated from each income category; however, data is published on the amount of taxable income returned for each category. As expected, the bulk of taxable income comes from trading (€75 billion of €79 billion in 2017, or 94%).

As outlined in Coffey and Levey (2014), the statutory rate of tax is the rate that applies to taxable income after the application of certain tax credits. For this reason, the statutory (or headline) rate can differ to the actual rate observed in practice, depending on the design of certain reliefs and credits. This “effective” CT rate refers to the actual tax paid by companies as a percentage of taxable profits. However, there are different approaches to calculating the effective rate, depending on the measure of profits used (e.g. taxable income versus net operating surplus).

The Revenue Commissioners calculate the effective rate as the amount of tax due in proportion to taxable income. This implies an effective CT rate for 2017 of 10.2% (rising from 10% for 2016, and 9.6% for 2015). Note that this is the effective rate calculated across all companies, and different effective rates will apply to different companies (and across different sectors). An analysis by the Revenue Commissioners indicates an effective rate of 12.7% for the top ten CT payers (and 12.3% for the top 100 CT payers).

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6 Corporation Tax 2018 Payments and 2017 Returns (Revenue Commissioners, 2019).
8 Corporation Tax 2018 Payments and 2017 Returns (Revenue Commissioners, 2019).
The path from Gross Trading Profits to Taxable Income

This section outlines the “walk” from gross trading profits, detailing and quantifying the deductions and allowances made in determining taxable income from 2012-2017. It draws on data published by the Revenue Commissioners relating to CT returns in respect of accounting periods ended in 2017. Gross Trading Profits, as referred to throughout this paper, is inclusive of certain “add-backs” (such as depreciation/amortisation and certain disallowed expenses). These add-backs are amounts that are deductible under accounting rules in reporting company profits, but are not deductible for tax purposes (i.e. they are “added-back” in the assessment for tax purposes).

As a result of a variety of deductions and allowances, there is a sizeable distance between gross trading profits and taxable income. This walk from gross trading profits is illustrated in Figure 1A, while Figures 1B and 1C quantify the various adjustments made in determining taxable income, for each of the years from 2012 to 2017. The variables included in these figures are outlined below:

- **Gross Trading Profits** refers to companies’ profits at the aggregate level in gross terms (net of current expenditure arising from trade, e.g. labour costs);
- **Capital Allowances** refers to the deductions allowed for certain capital expenditure, and includes the categorisations ‘Plant and Machinery’ (which incorporates intangible assets), ‘Industrial Buildings’, and property scheme related capital allowances;
- **Losses Carried Forward** refers to losses generated in the preceding accounting period that were brought forward and used to lower CT liability (these also include any unused capital allowances brought forward from the preceding period);
- **Foreign Income** includes dividend payments from abroad while **Other (non-trading) Income** includes categories such as ‘Net Rental Income’, ‘Regrossed Capital Gains’ and ‘Gross Interest Received’;
- **Trade Charges** refers to deductions relating to certain annual payments made in the conduct of trade (e.g. interest and royalty payments);
- **Other deductions (current losses etc.)** refers to other allowable deductions, such as losses used from the current accounting period and group relief (i.e. the sharing of losses among members of a corporate group); and,
- **Taxable Income** is the final amount (prior to the application of CT credits, such as the R&D Credit) that is subject to tax at the respective rates of 12.5% and 25% for trading and passive (non-trading) income, respectively.

Taxable Income is calculated before the application of tax credits (e.g. the R&D Tax Credit) and certain reliefs (e.g. relief relating to double taxation). These credits and reliefs are applied to the Taxable Income figure, to subsequently calculate CT liability.

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9 Ibid.
10 Note that CT returns for accounting periods ended in 2018 are not due until late 2019. The data shown is generally on an individual entity basis (i.e. referring to individual companies rather than to groups of companies).
Gross Trading Profits, as referred to throughout this paper, is inclusive of certain “add-backs” (such as depreciation/amortisation and certain disallowed expenses). These add-backs are amounts that are deductible under accounting rules in reporting company profits, but are not deductible for tax purposes (i.e. they are “added-back” in the assessment for tax purposes).
Figure 1B. The walk from Gross Trading Profits to Taxable Income, 2012-2014

Source. PBO analysis of data from the Revenue Commissioners, 2019.

Notes. Figures 1A and 1B show the walk from Gross Trading Profits to Taxable Income for each of the years 2012-2017. The figure for Gross Trading Profits is inclusive of Balancing Charges. The red columns indicate a negative amount, while the green columns indicate a positive amount (i.e., deductions or additions in the determination of taxable income respectively). For each year, the first and last columns in blue, indicate the level of Gross Trading Profits and Taxable Income respectively.

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12 A Balancing Charge may be applied in the event that an asset, for which a capital allowance is claimed, is ultimately sold. The balancing charge is added to gross trading profits in the event that the proceeds from the sale of the asset exceed the amount of the capital allowance used.
Source. PBO analysis of data from the Revenue Commissioners, 2019.

Notes. Figures 1A and 1B show the walk from Gross Trading Profits to Taxable Income for each of the years 2012-2017. The figure for Gross Trading Profits is inclusive of Balancing Charges. The red columns indicate a negative amount, while the green columns indicate a positive amount (i.e. deductions or additions in the determination of taxable income respectively). For each year, the first and last columns in blue, indicate the level of Gross Trading Profits and Taxable Income respectively.

As shown in Figures 1B and 1C, Gross Trading Profits rose by 119% from 2012 to 2017 (with sizeable year-on-year increases), however, Taxable Income increased by a smaller amount (rising by 84% from 2012 to 2017). Over the same period, Capital Allowances increased by 631%, while Losses (Carried Forward, which includes unused capital allowances from the preceding period) increased by 38\%\textsuperscript{13}.

\textsuperscript{13} On average, Gross Trading Profits grew by 18% per annum, Taxable Income grew by 14% per annum, while Capital Allowances and Losses Carried Forward grew by 57% and 10% respectively per annum, over 2012-2017.
This sharp rise in Capital Allowances, particularly from 2015 onwards, is likely the result of the “on-shoring” of intellectual property (IP) assets by MNCs\(^\text{14}\) (as a result, Gross Capital Stock which includes intangible assets, increased by 35% from 2014 to 2015).\(^\text{15}\)

For 2017, despite a modest rise of 1.8% in Gross Trading Profits (or €2.8 billion), Taxable Income increased by 11.5% (or €8.2 billion). This appears to have been driven by a fall in the amount claimed in Trade Charges (and other deductions). There are only minor differences between the two years in the amount of Capital Allowances used, and in Losses Carried Forward from the preceding period (including the carry forward of unused capital allowances). Note that, as both losses and capital allowances carried forward are combined in CT returns data after the first year of claim, it is not possible to separately identify them in the total amount carried forward.

**Trading Profits and Corporation Tax Liability at the sectoral level**

At a sectoral level, analysis by the Revenue Commissioners\(^\text{16}\) indicates that the largest amount in losses carried forward is in the Financial and Insurance sector. This carry forward relates to legacy losses stemming from the financial crisis (generally, firms in this sector claim insignificant amounts in capital allowances). The second largest amount of losses carried forward, is in Administration and Support Services, which includes aircraft leasing firms that generally, along with Manufacturing, and Information and Communications, claim significant amounts in capital allowances. In addition, companies within these three sectors that had a low level of losses on their 2012 CT returns, still accounted for €12 billion in losses carried forward in 2016. Therefore, it is reasonable to assume that the bulk of this carry forward actually relates to unused capital allowances.\(^\text{17}\)

While sectoral level information on the specific amount of (within year) capital allowances used is unavailable (to protect the confidentiality of tax-payers), information on sectoral trading profits and CT liability is published. A comparison of these two amounts can provide additional insight into the likely size of capital allowances used in certain sectors.\(^\text{18}\)

Five sectors account for the vast majority of gross trading profits. Specifically, Manufacturing, Financial and Insurance Activities, Information and Communication, Wholesale and Retail Trade, and Administrative and Support Services accounted for 88% of gross trading profits in 2017 (a minor decrease from 90% in 2016).

\(^\text{14}\) This on-shoring of IP assets is likely a consequence of efforts (arising from OECD’s BEPS) to synchronise the location of taxable profits with the location of economic activity. This means that MNCs effectively shifted IP assets from identified tax havens to low-tax jurisdictions in which substantial business activity is taking place (such as Ireland). Capital allowances may then be claimed in respect of the depreciation of these assets.

\(^\text{15}\) Based on data from the CSO, 2019.

\(^\text{16}\) Corporation Tax 2018 Payments and 2017 Returns (Revenue Commissioners, May 2019).

\(^\text{17}\) Ibid.

\(^\text{18}\) Note that, as outlined previously, Taxable Income is the level of income that is subject to the specified rate of CT prior to the application of CT credits and deductions in respect of double taxation. The actual CT liability is the amount of CT that the sector is liable to pay (after the application of credits and deductions associated with double taxation relief).
Figure 2 shows the sizeable gap between adjusted trading profits and CT liability at the sectoral level. Focusing on the right-hand axis, which shows the CT liability for each sector as a proportion of sectoral trading profits, this gap is particularly striking for Manufacturing, and Administrative and Support Services. The latter includes firms involved in aircraft leasing, which are substantial users of capital allowances. The former is dominated by large MNCs, and can be explained by approximately €35 billion in capital allowances, €10 billion in trade charges, and €962 million in losses (both current losses and those carried forward).\(^{19}\)

**Figure 2. Adjusted Trading Profits versus CT Liability by Sector, 2017**

Source. PBO analysis based on data from the Revenue Commissioners, 2019.

Note. Profits are adjusted to reflect the differing treatment of certain items for accounting purposes compared to tax purposes.

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\(^{19}\) This is based on correspondence with the Revenue Commissioners (June 2019), and data obtained from: *Corporation Tax 2018 Payments and 2017 Returns*, Revenue Commissioners, May 2019.
Concentration of Corporation Tax receipts

A striking feature of Irish CT revenue is the extent to which CT receipts are concentrated around relatively few CT payers. Over the past five years (2014-2018), net receipts from the ten largest tax-payers have averaged 40% of total CT receipts. For 2018, this figure peaked at 45% (or €4.7 billion). Excluding additional receipts arising from a once-off change in accounting standards in 2018, this figure is 43%. Figure 3 shows the proportion of CT receipts accounted for by the top ten tax-payers from 2009-2018. Note that these are individual companies (rather than corporate groups).

The composition of the top ten changes considerably year-on-year, as shown in Figure 4. As an example, the top ten contributors in 2018, at 45% of total CT receipts, accounted for 24% of receipts in 2014 (while the top ten in that year accounted for 37%). This somewhat mitigates the level of concentration risk that revenues are exposed to, given that the same ten companies are not responsible for the majority of receipts in every year. However, it is possible that the top ten in each year could overlap to some degree, strengthening the level of concentration risk (this is impossible to assess given the currently available data, with restrictions in place that protect the confidentiality of tax-payers).

**Figure 3. Share of top ten payers of CT, 2009-2018**

Source. PBO analysis based on data from the Revenue Commissioners, 2019.
Another aspect to the level of concentration risk in CT receipts is the extent to which receipts are sourced from foreign-owned MNCs versus domestic firms. Figure 5 shows the breakdown of receipts in 2017 for foreign-owned and domestic MNCs, and for non-MNCs. As shown, foreign-owned MNCs dominate in almost every sector (particularly in Manufacturing, Financial and Insurance Activities, and Information and Communications), and at the aggregate level, accounting for 77% of total receipts in 2017 (or €6.3 billion).

Foreign-owned MNCs are also the largest claimants of capital allowances. Of €67.6 billion in plant and machinery and intangible capital allowances in 2017, €49 billion was claimed by foreign-owned MNCs. Analysis by the Revenue Commissioners shows that, for 2017, foreign-owned MNCs accounted for 45% of all tangible, and 98% of all intangible, capital allowance claims.

In terms of sectoral concentration, as shown in Figure 5, the vast majority of receipts come from companies in the Manufacturing, Financial and Insurance Activities and Information and Communication sectors, accounting for €5.5 billion, or 68% of total receipts in 2017.
Volatility and forecasting

Volatile tax revenues can complicate fiscal planning, as these revenues are generally harder to predict and can result in sizeable forecast errors.20 As explored in Box 1 of the PBO’s Quarterly Economic and Fiscal Commentary for Q1 2019,21 forecasts of CT revenue have been the least accurate of the larger tax categories (with an absolute average forecast error of 12.7% from 2000-2017).

Figure 6 shows the size and direction of forecast errors for CT revenue since 2000. As shown, since 2012 receipts have exceeded forecasts each year, capturing the effect of so-called “windfall” receipts or revenue surprises.

Source. PBO analysis based on data from the Revenue Commissioners, 2019.


Quarterly Economic and Fiscal Commentary Q1 2019, Parliamentary Budget Office (9 April, 2019).
Figure 6. Percentage forecast errors for CT revenue, 2000-2018

Source. PBO analysis based on forecasts provided in the Government’s Economic and Fiscal Outlook, published alongside the Budget for each year.

Note. The percentage forecast errors ($\% FE_{it}$) for a given revenue stream $i$ (e.g. CT) in year $t$ (e.g. 2015), can be calculated as:

$$% FE_{it} = \frac{(O_{it} - F_{it+1})}{F_{it+1}}$$

where $O_{it}$ is the outturn in year $t$ (e.g. 2015) for tax category $i$ (e.g. CT); and is the forecast for year $t$ (e.g. 2015) and tax category $i$ (e.g. CT) done in year $t-1$ (the year previous, e.g. 2014).

In their June 2019 report, IFAC highlight that forecasts of general government revenue have actually been accurate when forecasts of CT are excluded.\(^{22}\) IFAC explore the size of windfall CT revenues in Box B of their report, using a suite of alternative approaches.\(^{23}\) They find that (taking 2011 as a base year) annual CT receipts are between €3 billion and €6 billion larger (as of 2018), than what could be reasonably expected given the underlying performance of the economy.

\(^{22}\) *Fiscal Assessment Report*, Irish Fiscal Advisory Council (June 2019).

\(^{23}\) These different approaches are detailed in IFAC’s *Fiscal Assessment Report* (June 2019). One approach includes the estimation of a counter-factual revenue series (based on domestic Gross Value Added and nominal modified GNI*) that aims to disentangle the distortions associated with foreign-owned MNCs. Another method involves the assessment of the level of CT revenue that could be expected if international norms are applied to Ireland, by comparing Net Operating Surplus as a share of Gross Value Added across countries.
Generally, forecasts of tax revenue are based on the current level of receipts for a particular tax, grown by the projected growth rate of a relevant macroeconomic variable (known as a macroeconomic driver). At present, forecasts of CT are based on projections of a measure of companies’ profits, known as Gross Operating Surplus (GOS). As highlighted by Casey and Hannon (2016), some of the difficulty in accurately forecasting CT revenue relates to the difficulty in forecasting GOS itself. Specifically, GOS is impacted by myriad international factors that are beyond domestic control, and, as a measure of trading profits generally, it does not incorporate deductions made in respect of interest expenditure or depreciation (i.e. capital allowances).

In addition, the high concentration of CT receipts (as outlined in Figure 3 and Figure 4), and the sizeable deductions, reliefs, allowances and tax expenditures available in respect of CT (and the potentially complex interaction of these different components of the CT structure) further complicates revenue forecasting. This difficulty in accurately forecasting CT revenue is particularly concerning of late, as CT has surpassed Excise Duty to become the third most important revenue stream for the State, at €10.4 billion in 2018 (or 18.7% of total tax revenue).

Given the difficulty in accurately forecasting CT revenue using this macro approach, and the high concentration of CT revenue around relatively few tax-payers, consideration should be given to the development of a micro-based approach to predicting CT revenue (e.g. involving the use of microsimulation methods).

It follows that Government should avoid using potentially unsustainable revenue sources to fund either permanent increases in public expenditure or tax reductions. Rather, expenditure commitments of a permanent nature (e.g. public sector pay and pensions) should be linked to stable and less volatile revenue sources. If a new spending programme is funded using windfall tax receipts, additional revenue or spending cuts to other areas will be required to continue to fund this programme should these windfall receipts fail to materialise in future years. This is a key risk.

Given that CT receipts are predominantly sourced from MNCs, whose profitability and performance depends on global factors (including global economic conditions, and changes to international tax policy), an over-reliance on this revenue represents a significant fiscal risk for the State. In addition, and as outlined in IFAC’s June 2019 report, these windfall revenues also risk masking an otherwise weak Exchequer Balance, particularly if this revenue is used to offset unexpected expenditure pressures (specifically in relation to the Health vote). A more prudent use of these windfall receipts might involve setting them aside for debt reduction, for allocation to the Rainy Day Fund, or to fund one-off capital projects.

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24 Other factors are included, such as a control for policy changes and one-off items, a revenue elasticity, and a judgement factor applied by the forecaster (see Casey and Hannon (2016) for a breakdown of the Department of Finance’s tax revenue forecasting model).
26 Casey and Hannon (2016) propose alternative approaches to forecasting (e.g. the use of alternative macro-drivers, such as external demand and the real-effective exchange rate). However, these alternatives offer only modest improvements in the accuracy of forecasts.
27 In the Summer Economic Statement (June, 2019) the Department of Finance indicated that a sustainability analysis will be carried out in respect of CT revenue.
28 Fiscal Assessment Report, Irish Fiscal Advisory Council (June 2019).
This section provides an overview of the international CT landscape, in the context of changes (both implemented and proposed) to international tax law. It describes the most recent developments at EU, OECD and global levels that will likely impact on Ireland’s own CT rules and revenue. To provide the context to these changes, Box 2 provides an overview of some of the Base Erosion and Profit Shifting (BEPS) tools that are the target of multilateral anti-avoidance efforts.

Box 2: OVERVIEW OF BEPS TOOLS

Base Erosion and Profit Shifting (BEPS) describes the efforts by a company to erode taxable income and ultimately reduce the amount of tax it is liable to pay, including the movement of profits away from a high tax jurisdiction to a relatively low tax jurisdiction. The OECD describes BEPS as actions that concern “exploiting gaps and mismatches in tax rules”.29

This process risks eroding the tax base of relatively high tax jurisdictions, encouraging international tax competition to the benefit of companies, with potentially sizeable opportunity costs (in terms of revenue forgone) for national exchequers. In addition, these low tax jurisdictions risk international reputational damage in maintaining tax systems that facilitate BEPS activities. An OECD report (January 2017)30 estimates that revenue forgone under BEPS activity amounts to $100bn to $240bn per annum.

BEPS is more easily practised by firms in industries that hold sizeable intellectual property (IP, or intangible) assets (e.g. Information and Communications, Manufacturing, and Pharmaceuticals), as these assets tend to be mobile, and are relatively easy to transfer across jurisdictions. Three (OECD compliant) tools or mechanisms are generally used as part of BEPS activities. These include:

- An IP based tool, allowing profits to be filtered through an IP or intangible asset that is based in a low tax jurisdiction, e.g. all sales of an IT software package are routed through the low-tax jurisdiction in which the IP for the software is registered;

- A debt based tool, allowing profits to be extracted through a charge-out31 between two separate jurisdictions, of the same company, at an artificially high rate of interest, e.g. the sale of IT software takes place through a subsidiary in Country A. Country A then reimburses the IP holding parent in Country B for the sale at a higher interest rate. This removes any gains in Country A (profits) and shifts them to Country B, while sheltering Country A from taxes through debt write-offs; and,

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31 A charge-out refers to the allocation of costs among multiple users of a resource.
Box 2: OVERVIEW OF BEPS TOOLS  continued

- A transfer-pricing based tool, that allows for profits to be shifted to a low tax jurisdiction, by claiming that a process performed in the low tax jurisdiction (e.g. contract manufacturing) justifies large increases in the transfer-price at which the finished product is charged-out by the low tax to the high tax jurisdiction, e.g. a contract for IP is drafted by Company A in the low tax jurisdiction at a low cost, but is charged-out to Company B (which is part of the same group of companies) at a high cost, shifting profits to the low tax jurisdiction.

As a response to these activities, there has been movement made at a multilateral level (including via OECD BEPS Frameworks) towards updating and modernising the international tax regime.

The EU’s Common Consolidated Corporate Tax Base (CCCTB)

The Common Consolidated Corporate Tax Base (CCCTB) concerns the implementation of a single set of CT rules across the EU that would be used to calculate a company’s taxable profits. In addition, the consolidated taxable profits would then be shared between the Member States in which the company is active, using an apportionment formula (depending on the location of the sales, staff and headquarters of the company). Each individual Member State would then apply domestic tax rates to their apportioned share of taxable profits.

The original proposal for a CCCTB (March 2011) was vetoed by the UK and Ireland. The proposal was reintroduced in 2016. The relaunched CCCTB proposal can be divided into two separate EU Directives: a Directive for a Common Corporate Tax Base, and a Directive for a Common Consolidated Corporate Tax Base. Although presented by the European Commission as a single package, these two Directives will be discussed separately (with a discussion of the latter only commencing once the former has been agreed).

While discussions on CCCTB are ongoing and modifications are being negotiated among individual Member States, the implementation of the CCCTB has been assumed as part of the EU’s Multiannual Financial Framework (MFF) 2021-2027 (the EU’s budgetary plan). The MFF references the application of a 3% charge to Member States’ shares of taxable profits arising from the proposed CCCTB.

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32 Transfer-pricing describes a transaction between different companies of the same parent firm, separated by the "arms length principle" (that is, the amount charged for the transaction must be the same as if the companies were unrelated).
33 Contract manufacturing is a form of outsourcing, that involves one company (Company X) contracting another company (Company Y), to make certain products under the branding of the first company (Company X).
35 The proposal was last publicly discussed by the European Council in 2017, but was approved by the European Parliamentary Committee on Economics in February 2018.
36 For example, see recent Dáil Éireann discussion on CCCTB proposals, 19 February 2019.
While the EU views the CCCTB as part of the wider OECD BEPS agenda to counter profit shifting, the Irish Government contends that any changes to international CT should take place at the OECD rather than the EU level, in order to avoid trading difficulties with third-parties\textsuperscript{38} (and to enable Member States to remain competitive against jurisdictions external to the EU).

The CCCTB represents a key risk for the sustainability of CT revenue in Ireland. Foreign-owned MNCs accounted for 77% of Irish CT receipts in 2017. Any action that would more closely align company profits with the location of sales, could be detrimental to Ireland’s CT intake, given the small size of the Irish market (relative to Germany or France, for example), and could undermine our competitiveness in terms of attracting foreign direct investment.

The OECD’s BEPS

The OECD’s BEPS Package and Inclusive Framework (2013) outlined 15 Actions intended to equip governments with the domestic and international instruments required to address certain BEPS activities. These actions target the monitoring and strengthening of tax transparency, and range from minimum standards and revisions in respect of international tax law, to the design of common approaches to facilitate the convergence of national practices.

Four minimum standards were identified:\textsuperscript{39}

- To fight harmful tax practices (Action 5);
- To prevent tax treaty abuse including treaty shopping (Action 6);
- To improve transparency with country-by-country reporting (Action 13); and,
- To enhance the effectiveness of dispute resolution (Action 14).

Adherence to the Framework, and BEPS rules related to the implementation and governance of bilateral tax treaties, was transposed into law with the adoption of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, also referred to as the Multilateral Instrument (or MLI) in 2016. Ireland ratified the MLI in January 2019.

The MLI treaty functions as a means to implement the changes required to be made to tax treaties to protect against BEPS, in particular, BEPS Actions 2, 6, 7, and 15. Treaties which are covered by the MLI (i.e. a treaty listed by both parties as falling under the MLI), allow jurisdictions to swiftly implement measures to strengthen these existing treaties, to protect governments against tax avoidance strategies that use tax treaties to artificially shift profits to low or no-tax jurisdictions.\textsuperscript{40}

\textsuperscript{38} Minister for Finance, speaking to reporters on the issue at the World Economic Forum, January 2019.
\textsuperscript{39} For a summary of all BEPS actions, see Review of Ireland’s Corporation Tax Code (Coffey, 2017).
\textsuperscript{40} Currently, Ireland has signed 74 bilateral tax treaties or Double Taxation Agreements (DTAs), with 73 in effect.
At the EU level, a number of BEPS actions were implemented through EU legislation, including EU Directives on country-by-country reporting (Action 13) and anti-tax avoidance (Actions 2, 3, and 4). Under Action 13, a template was provided for country-by-country reporting by MNCs. This aims to provide local tax authorities with an insight into the financials of MNCs, and, through the sharing of this information across jurisdictions, international tax planning regimes, thereby enhancing tax transparency. The implementation of this country-by-country reporting was made mandatory under EU law in 2018.

To date, Ireland has largely benefitted from efforts underpinning BEPS to align company profits with the location of economic activity. In particular, 2015 saw the on-shoring of sizeable IP assets to Ireland. While this is unlikely to have contributed substantially in terms of additional CT receipts for the Exchequer, given the application of capital allowances in respect of the acquisition of these assets, it does give some indication of the direction of travel for MNCs in moving from no-tax to low-tax jurisdictions when faced with anti-avoidance efforts. Furthermore, anti-avoidance efforts more generally are likely to be playing some part in the over-performance of Irish CT receipts relative to projections in recent years.

**The OECD’s BEPS 2.0**

The OECD began consultations in relation to BEPS 2.0 at the beginning of 2019 and released the OECD/G20 BEPS Programme of Work in May. This outlines a number of options and approaches that could be adopted. The final report is expected to be published in 2020. The working plan consists of two main pillars:

- The first pillar concerns revisions to profit allocation rules. Specifically, this involves reallocating a share of profits from where a company is based to where sales or users are located;
- The second pillar concerns the implementation of a global minimum effective tax rate and a tax on base eroding payments.

The actions underpinning BEPS 2.0 could pose a risk to the sustainability of CT revenues in a small and open economy such as Ireland. Specifically, the allocation of CT receipts based on the location of a company’s sales or users would benefit larger markets that are net-importers. On the other hand, small export intensive economies such as Ireland would lose a portion of its tax base as a larger proportion of profits would be allocated to larger countries.

The current working programme doesn’t specify a level for the global minimum effective tax rate. It also isn’t clear whether it would be set globally or on a jurisdiction-by-jurisdiction basis. However, there is a strong possibility (depending on how it is designed) that it would undermine Ireland’s competitive advantage in attracting foreign direct investment and the effectiveness of the R&D tax credit and the Knowledge Development Box.

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41 See Ireland and the Taxation of Income from Intangible Assets, presentation by Seamus Coffey at the Department of Finance Sixth Annual Policy Conference 2019, 30 April 2019.

42 Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20.