OECD BEPS and Irish Corporation Tax

1. Introduction

This PBO Note examines the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) Project. This follows the Irish government signing up to the BEPS Statement in October 2021, a two-pillar plan for changing international corporation taxation.[1] The OECD has published a report on Model Rules of Pillar Two "Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" in December 2021. Pillar Two aims to ensure that large multi-national companies pay a minimum level of corporation tax in each jurisdiction they operate in.

The OECD BEPS project has significantly changed international tax rules, the biggest reform in over a century. The OECD BEPS project is in response to concerns about the level of tax avoidance in the multi-national sector. Aggressive tax planning by companies and the increasing importance of digital services have driven the OECD to develop reforms to limit international tax competition and protect their tax bases. The OECD BEPS reforms in 2015 caused significant change to international tax law. One of the key changes was that multi-national companies with group revenues of at least $750 million are now required to report income, profit and taxes on a country-by-country basis. The country-by-country report is shared with tax administrations in the relevant jurisdictions for transfer pricing and BEPS risk assessment. As a result of this requirement, greater clarity is available about the quantity of tax paid, and where.[2]

The current OECD BEPS reforms aim to change profit allocation rules for multi-national companies (Pillar 1) and to impose a global minimum corporation tax rate (Pillar 2) by 2023. It is projected that, overall, countries will receive annually an additional $150 billion of corporation tax revenues. Ireland and 25 other Member States of the European Union have signed up to the OECD BEPS Statement.[3] The European Commission is planning to put forward a directive that would implement Pillar 2 (global minimum corporation tax rate) in the EU.[4] Pillar 1 will be developed through a legal binding multi-lateral convention, expected by the OECD in the summer of 2022.[5]

The major political issue is the US participation in the OECD BEPS project. The Biden's administration "Build Back Better Bill" includes a minimum corporation tax plan (Pillar 2), however the passage of the Bill through the US Congress is not guaranteed.[6] A failure to ratify the OECD BEPS changes in the U.S. could cause tensions and complications with the overall multi-lateral process. Ireland is also a key gateway for US multi-national companies into the wider European market.

1 Department of Finance (2021) Ireland joins OECD International Tax agreement
2 OECD (2021) Action 13 Country-by-Country Reporting
3 Cyprus is the only EU country that has not signed up to the OECD BEPS Statement
4 European Commission (2021) Questions and Answers on Minimum corporate taxation
5 Financial Times (2022) Legislators face battle to implement historic global tax deal
6 Irish Times (2022) Biden's political problems could jeopardise OECD corporate tax deal

The PBO Note builds on from previous PBO Notes on the OECD BEPS process and Irish Corporation Tax.[7] Irish economic development in recent decades has relied significantly on competitive tax policy to attract foreign direct investment and generate business activity. **The OECD BEPS reforms could have a very significant impact, including a detrimental impact, on the Irish economy and the tax revenue.**

For Ireland, corporation tax revenue has dramatically increased from €3.9 billion in 2009 to around €15 billion in 2021. **There are two main risks with Irish corporation tax revenue, firstly it is a volatile tax and secondly, it is highly concentrated, around relatively few corporation taxpayers.** There is a concern by the Parliamentary Budget Office and other fiscal institutions about the State becoming too reliant on this highly volatile tax, mirroring the experience of relying on stamp duty and transaction-based taxes in the Celtic tiger era.[8]

The PBO Note is divided into an Introduction, OECD BEPS section, Irish Corporation Tax section, BEPS impact on Corporation Tax Revenue section, and a Conclusion.

2. OECD BEPS

Base Erosion and Profit Shifting (BEPS) activities are efforts by a company to erode taxable income and ultimately reduce tax liability. Some enterprises have exploited gaps and mismatches between jurisdictions' tax systems. The OECD has estimated that there is annual corporation tax avoidance of $100-240 billion, equal to 4-10% of international corporation tax revenue.[9]

BEPS is also the acronym of the OECD/G20 Inclusive Framework to address this tax avoidance activity. In 2021, 141 member jurisdictions, including Ireland, of the OECD/G20 Inclusive Framework on BEPS have agreed to the OECD Statement *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*.[10] These economies account for more than 94% of global GDP.

The countries have agreed to a detailed implementation plan, consisting of a number of actions to change the basis of corporation taxation and address difficulties arising from the digitalisation of the economy.

The OECD BEPS proposals fall under **two main pillars, with key elements listed below:**

- The **first pillar changes profit allocation rules for certain multi-national companies.** This involves reallocating a share of profits to where sales or users are located, previously it was allocated where a company is based. The OECD estimates that more than $125 billion of residual profit will be reallocated to market jurisdictions under Pillar One.[11]
- The **second pillar concerns a global minimum corporation tax rate set at 15% on all MNEs with annual revenue over €750 million.** Around $150 billion of additional revenue are expected from Pillar Two.[12]

7 PBO (2021) An Update on the OECD BEPS proposals, PBO (2020) An Overview of the OECD BEPS Negotiations and PBO (2019) An Overview of the Corporation Tax Base in Ireland.
8 PBO (2019) An Overview of the Corporation Tax Base in Ireland.
9 OECD (2021) Understanding tax avoidance
10 OECD (2021) Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy
11 OECD (2021) OECD Secretary-General Tax Report to G20 Leaders
12 *Ibid.*

Some further technical changes are also included in these pillars, including mandatory and binding dispute resolution, removing existing Digital Services Taxes, and permission for tax incentives for substantial business activities.

The OECD will provide a model convention and legislation to enable countries to transpose the two pillars of the OECD BEPS agreement into their national law. A model convention is guidance on the details of the proposals and generally provide a basis for application of the measures into law and practice. A model convention provides the framework for a consistent approach to issues and difficulties that emerge in the implementation of the international tax changes.[13]

The timetable for the provision of the details of the two pillars is in Table 1, with the expectation that the OECD BEPS process will be implemented from the start of 2023. However, the timetable is very ambitious for such a significant change to international taxation. Previous changes to the international tax rules have taken on average of two years for countries to implement them, with some countries taking as long as seven years.[14]

Table 1: Timetable for OECD BEPS implementation

Timelines	Pillar One	Pillar Two
	Profit allocation	Global minimum corporation tax rate
December 2021		• Model rules to define scope and mechanics for the Global Anti-Base Erosion (GloBE) rules. The GloBE rules ensure that multi-national companies pay a minimum level of tax on their profits regardless of their headquarters or location. • Model treaty provision to give effect to the Subject to Tax Rule (STTR). This enables countries to impose limited taxation on certain payments.
Early 2022	• Text of a multilateral Convention (MLC) and Explanatory Statement to implement Pillar One • Model rules for domestic legislation necessary for the implementation of Pillar One	
Mid-2022	• High-level signing ceremony for the multilateral Convention	• Multi-lateral instrument (MLI) for implementation of the Subject to Tax Rule (STTR) in relevant bilateral treaties
End 2022	• Finalisation of work on Pillar One	• Implementation framework to facilitate co-ordinated implementation of the GloBE rules

Source: OECD (2021) OECD presents international tax update to G20 Leaders

13 OECD (2017) Model Tax Convention on Income and on Capital: Condensed Version 2017
14 Financial Times (2022) Legislators face battle to implement historic global tax deal

Pillar 1 – profit allocation

The **allocation of taxable profits and the associated taxing rights** are traditionally based where goods and services are produced, which was generally close to the consumer. This pattern of commercial transactions changed significantly with trade globalisation and businesses digitalisation, as production can be entirely divorced from sales location. The role of the consumer has also changed. Previously the consumer was simply the receiver of the good or service, whereas now in the digital era, data from consumer behaviour is valuable and is being tracked and monetised.[15]

The first pillar means that **taxation would not depend on the physical location of the company, but on its commercial activity in that jurisdiction.** Tax revenue will be generated in the country where that product or service is used or consumed, initially for multi-national companies in scope. For those multi-national companies, 25% of residual profit is to be reallocated to market jurisdictions, as long as the company derives at least €1 million in revenue from that jurisdiction.[16] Residual profit is profit in excess of a certain profitability threshold percentage, in this case profit that is in excess of 10% of revenue.[17]

Scope

Pillar One will cover multi-national companies with global turnover above €20 billion and profitability above 10% (i.e. profit before tax/revenue). In time, the turnover threshold will be reduced to €10 billion. There will be a one-year review of the scope after 7 years of the implementation of Pillar One.[18] In addition, two sectors are excluded from the scope of Pillar One: the extractive industry and the regulated financial services.

Multi-Lateral Convention (MLC)

In early 2022, the text of a Multi-Lateral Convention (MLC) is expected to be published to enable a quick and consistent implementation of Pillar One by the countries of the OECD/G20 Inclusive Framework. The implementation of OECD BEPS through a multilateral framework means that countries do not need to have an existing tax treaty between them. The Convention will outline the rules for profit allocation which should improve tax certainty and transparency. The Convention will help to eliminate double taxation and provide consistency and certainty which will facilitate business development and internationalisation.

The Convention will outline the processes for dispute prevention and resolution between the countries and the dispute resolution mechanism is binding and mandatory. Furthermore, the Convention will require all member jurisdictions to remove any Digital Services Taxes and to commit not to introduce such measures in the future. It is expected that the Convention will be signed in 2022 by the member jurisdictions and come into effect in 2023.

15 PBO (2021) An Update on the OECD BEPS proposals

16 Countries with GDP lower than €40 billion will have a lower limit – the multi-national company only needs to derive €250,000 in revenue from them.

17 OECD (2021) Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy

18 OECD (2021) OECD presents international tax update to G20 Leaders

Pillar 2 – global minimum rate

The second pillar of the OECD BEPS is the **global minimum corporation tax rate of 15% which would apply to multi-national companies with revenue above €750 million.** This global minimum corporation tax rate is projected to increase the annual international corporation tax revenue by $150 billion.[19]

The **second pillar would reduce tax differentials between jurisdictions** and also the opportunity for profit shifting by multi-national companies. This will bring tax certainty for taxpayers and tax authorities and stabilise the international corporation tax system.

The OECD has published a report on Model Rules of Pillar Two.[20] The report includes key rules and definitions. The Model Rules provide the foundation for a co-ordinated system of international corporation tax that will result in large multi-national companies paying a minimum level of corporation tax in each country they operate in. This is implemented through a top-up tax on profits in a country where the effective corporation tax rate is below the global minimum rate of 15%.

Design

The **design of Pillar Two is around a number of rules,** an Income Inclusion Rule (IIR), Undertaxed Payment Rule (UTPR) and a treaty-based rule – Subject to Tax Rule (STTR):

The **Income Inclusion Rule** imposes on a parent entity a top-up tax on the taxed income of a subsidiary within the group, if the subsidiary is operating in a low tax country, i.e. lower than the global minimum corporation tax rate of 15%. For example, if the effective corporation tax rate for an entity in a country is below the minimum corporation rate of 15%, then the group must pay a top-up tax to bring up the tax payment to the minimum corporation rate. This rule applies even if the subsidiary is in jurisdiction that has not signed up to the OECD/G20 BEPS.

The **Undertaxed Payment Rule (UTPR)** protect jurisdictions against base erosion through intra-group payments to low-taxed entities. The rule works by allowing countries to effectively collect part of the top-up tax due at the group level if some of its entities are based in countries which have a below the minimum level of corporation tax and do not have any top-up corporation tax. The amount of top-up tax that a country can collect from the entities of the group in its border is calculated on a formula based on employees and assets. The Undertaxed Payment Rule (UTPR) is a backstop rule to the Income Inclusion Rule (IIR).

In addition, the entity of the multi-national companies located in the jurisdiction is denied a deduction (or required to make an equivalent adjustment) as a result of the entity having an additional cash tax expense equal to the UTPR Top-up Tax Amount for the Fiscal Year allocated to that jurisdiction.

The **Subject to Tax Rule (STTR)** enables countries to tax certain related party payments below a minimum rate. For preventing a reduction in their tax base, developing economies have the option of a treaty based STTR on certain payments made to related parties abroad such as interest and royalties. These payments have a tax base erosion and profit shifting risks and the STTR will enable developing countries to retain their taxing rights. These taxing right may have otherwise been ceded under a tax treaty. A model treaty provision on STTR will be published by the OECD and supported

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19 OECD (2021) OECD Secretary-General Tax Report to G20 Leaders
20 OECD (2021) Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules

by commentary that explains the implementation of STTR. A multilateral instrument will be also published by the OECD in 2022 to enable STTR to be incorporated into double taxation treaties.

The rules are applied to entities that are part of a multi-national group, if the ultimate parent entity has an annual revenue of €750 million or more in the consolidated financial statements in at least two of the four preceding fiscal years to the tested fiscal year.

The below table gives the operating provisions of Pillar 2, in terms of covered entities, financial accounting, covered taxes, effective tax rates and the rules. In summary, the tax is calculated as a top-up tax and applied at a country level. The standardized corporation tax base and definition of covered taxes enable identification of the effective tax rate of multi-national companies in the countries that they operate in. If it is below the minimum rate of 15%, the top-up tax brings that effective rate up to the minimum rate, not including opt-outs or exclusions. The overall design of Pillar 2 facilitates a co-ordination of the application of the rules.

Table 2: OECD proposed operating provisions of Pillar 2

1 - Constituent Entities within scope
1a - Identify MNE Groups within scope
1b - Identify Constituent Entities
1c - Remove any Excluded Entities
1d - Identify location of each Constituent Entity
2 - GloBE Income or Loss
2a - Determination of Financial Accounting Net Income
2b - Adjust Financial Accounting Net Income or Loss to GloBE Base
2c - Allocate GloBE Income or Loss to Permanent Establishments or Flow-through Entities, if necessary.
3 - Covered taxes
3a - Identification of Covered Taxes (i.e., taxes attributable to Income of a Constituent Entity)
3b - Adjust Covered Taxes for temporary differences and prior year losses
3c - Allocate Covered Taxes as necessary
3d - Take post-filing adjustments into account
4 - Effective Tax Rate and Top-up Tax
For each Low-Taxed Constituent Entity, the Top-up Tax is computed by
4a - Calculating the Top-up Tax Percentage for each Low Tax Jurisdiction[21]
4b - Applying the Top-up Tax Percentage to the Excess Profits of the Jurisdiction
4c - Deducting the amount of Top-up Tax imposed under a qualified domestic minimum tax
4d - Allocating the Jurisdictional Top-up Tax to the Constituent Entities in the Jurisdiction in proportion to their GloBE Income
5 - Income Inclusion Rule (IIR) and Undertaxed Payment Rule (UTPR)
5a - Identification of the Parent Entity liable for the Top-up Tax under the IIR
5b - Determination of amount of Top-up Tax paid by the Parent Entity under the IIR
5c - Identification of the remaining amount, if any, that is allocable under the UTPR
5d - Liability for residual Top-up Tax in the UTPR Jurisdictions through a UTPR adjustment

Source: OECD (2021) Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules

21 A jurisdiction is a low corporation tax country if the rate is lower than the global minimum corporation tax rate of 15%.

Scope

Pillar Two's minimum corporation tax rate of 15% will apply to multi-national companies with revenue above €750 million as determined under BEPS Action 13 (country by country reporting) from the first round of the BEPS process in 2015. Jurisdictions will have the capacity to apply the Income Inclusion Rule (IIR) to the multi-national companies headquartered in their jurisdiction, even if the threshold is not met.

Opt–outs & exclusions

As with Pillar One, **there are a number of opt-outs and exclusions.** Firstly, the OECD BEPS rules in Pillar Two are not applied to the ultimate parent entity of a multi-national enterprises group if they are a government body, international organisations, non-profit organisations, pension funds or investment funds. These bodies are ultimately non-profit or part of the regulated financial service sector. The income from the international shipping sector is also excluded.

An amount of income that is 5% of the carrying value of tangible assets and payroll is not included in the OECD BEPS rules. The OECD BEPS rules are not applied to jurisdictions where the multi-national company has revenue less than €10 million and profits of less than €1 million.

European Union Directive

In December 2021, the **European Commission proposed a Directive on minimum effective corporation tax rate** for large multi-national companies.[22] The use of a Directive would enable the European Union to implement the Pillar 2 of the OECD BEPS agreement which all EU Member States, except for Cyprus, have signed up to. The Directive would closely follow the OECD BEPS agreement and details how Pillar 2 would be implemented in the EU. This includes a common set of rules on the calculation of the effective corporation tax rate across the Union.

The main difference between the OECD BEPS and the EU Directive is that the Directive adjusts the scope of the corporation tax rules to include purely domestic groups (i.e. not multi-national companies) and the OECD BEPS rules only apply to foreign subsidiaries of multi-national companies.[23] This difference is required to prevent discrimination between domestic and cross-border multi-national groups to comply with the fundamental freedoms of the European Union, e.g. capital, labour.

For large-in scope domestic groups, ultimate parent entities in EU Member States will be subject to the top-up tax from the Income Inclusion Rules (IIR). This is applied to low-taxed constituent entities within the multi-national companies. The EU Directive will enable EU Member States to apply top-up tax domestically to constituent entities located in their jurisdiction, instead of collecting the tax at the level of the ultimate parent entity.

For implementation, the proposed Directive would need to be unanimously agreed by all the Member States in the EU Council. In addition, the European Parliament and the European Economic and Social Committee will need to be consulted.

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22 European Commission (2021) Minimum corporate taxation
23 European Commission (2021) Questions and Answers on Minimum corporate taxation

3. Corporation Tax in Ireland

The changes in international corporation tax proposed by the OECD/G20 BEPS project are very significant for Ireland. The low rate of Irish corporation tax has helped attract substantial levels of Foreign Direct Investment (FDI), alongside other elements attracting FDI to Ireland. Corporation tax contributed to an increasingly significant share of overall Irish tax revenue and has contributed to funding increases in permanent public spending. However, there are two main risks with Irish corporation tax revenue, first it is a volatile tax and secondly, it is highly concentrated, around relatively few corporation taxpayers.

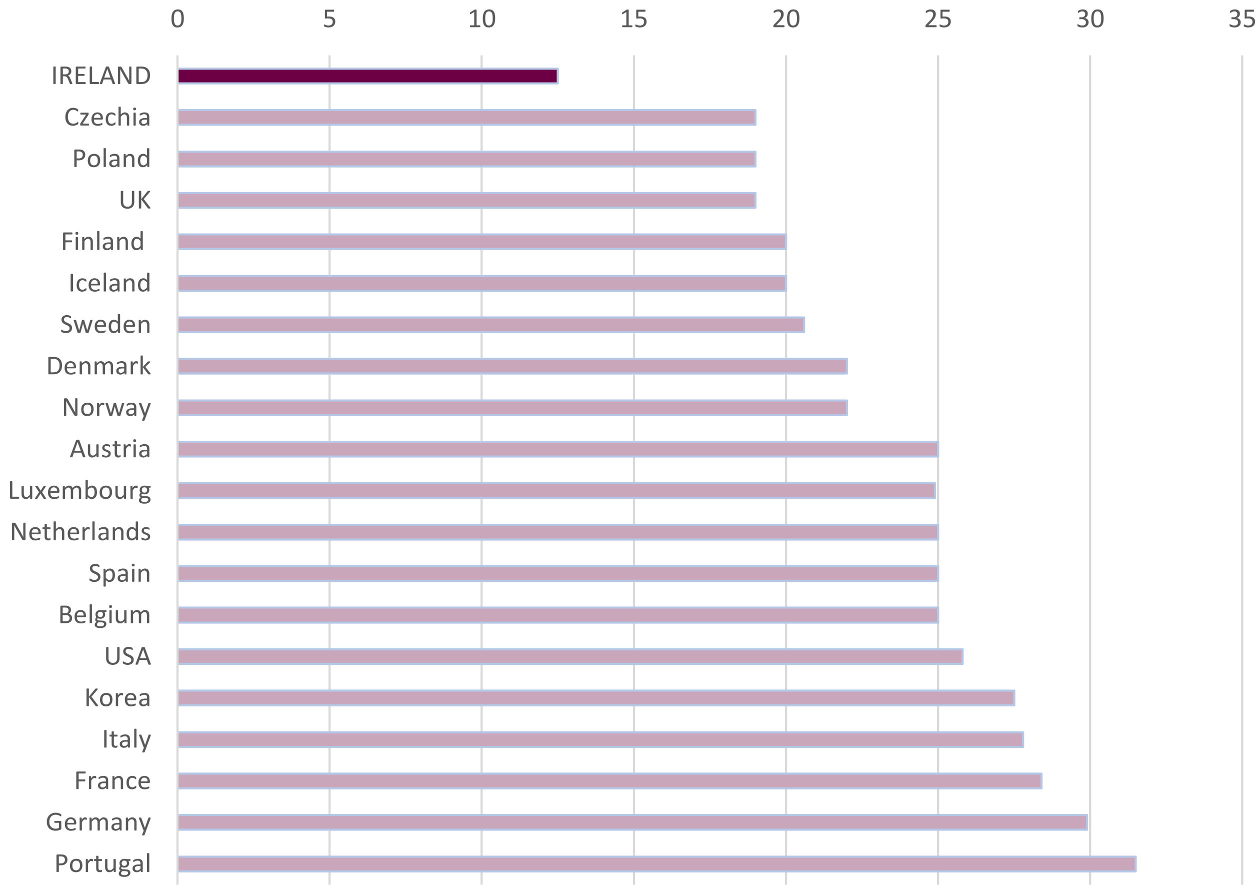
Corporation Tax Rate

Ireland's corporation tax rate is 12.5% which is low compared to many developed economies, see Figure 1. This competitive rate has helped to attract significant FDI and transform the nature and prosperity of the Irish economy. The OECD BEPS reforms will increase the effective rate to 15% for large multi-national companies and this is a significant change facing the Irish economy. This corporation tax change could make Ireland less attractive for foreign direct investment.

In response to this significant challenge for the Irish economy, there are some tax and non-tax factors that could mitigate against the fiscal impact of a global minimum rate of 15%. In terms of tax, Ireland has a 25% R&D tax credit, a Knowledge Development Box, reliefs for foreign tax credits, a significant tax treaty network and good transfer pricing implementation.[24] In addition, Ireland is a common law and English-speaking country in the Eurozone and European Union, effectively resulting in Ireland becoming a key gateway for American multi-national companies into the wider European market. After the United Kingdom's exit from the European Union, a number of multi-national companies have invested in Ireland. For instance, in the financial sector, 36 companies have relocated or are considering relocating some part of their operations and functions from the UK to Ireland.[25]

24 IDA (2021) Corporate Tax Rates
25 EY (2021) *EY Brexit Tracker: Dublin remains most popular EU relocation city for UK FS firms*

Figure 1: Combined (national, regional, local) Corporate Income Tax Rate of Selected OECD Economies (%)



Source: OECD (2021) Statutory Corporate Income Tax Rates

Corporation Tax Revenue

The Irish Exchequer has become increasingly reliant on Corporation Tax as a source of revenue. Net receipts for corporation tax was €15.3 billion in 2021, amounting to 22 percent of exchequer tax receipts.[26] This is an extraordinary figure with just over one in five euros raised for the exchequer last year coming from corporate tax receipts. Corporation tax receipts are at their highest share of total tax receipts, as well as highest absolute amount. It is the third largest revenue stream for the exchequer, after Income Tax and Value-Added Tax (VAT). By comparison, corporation tax raised €4.6 billion in 2014, representing 11.2% of the total tax take in that year.

The annual growth rate of Corporation Tax revenue in 2021 was 29.5%, whereas the average annual growth rate over the years 2016-2019 was 10.1%. A factor in growth rate between 2016-2019 could be onshoring of business activity by multi-national companies from 2015 onwards, as a result of the first round of BEPS reforms. The first round of agreed BEPS proposals caused significant change to international tax law. Multi-nationals with group revenues of at least $750 million have been required to report income, profit and taxes on a country-by-country basis.[27]

A key issue with corporation tax revenue in Ireland is the overreliance on a small number of firms. There is ongoing concern about the State becoming too reliant on this highly volatile and concentrated tax, mirroring the experience of relying on stamp duty and other transaction-based taxes in the Celtic tiger era. In 2020,

26 Department of Finance (2022) End-2021 Exchequer Returns Summary
27 PBO (2020) An Overview of the OECD BEPS Negotiations

the top 10 companies contributed 51% of net corporation tax receipts (around €5.9 billion) and amounted approximately to 10% of exchequer tax receipts in 2020.[28] The top 100 companies contributed 79% of net corporation tax receipts and foreign owned companies contributed 82% of net corporation tax receipts, up from 77% in 2019.[29] From 2012 to 2018, 10 firms have on average contributed up to 35 per cent of corporation tax liability.[30]

It is important to point out that the composition of the top ten companies changes considerably year-on-year. It is not the same companies that make up the top ten every year. 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.[31]

Corporation tax receipts and permanent spending

The unexpected corporation tax receipts have partly mitigated against the immediate fiscal impact of spending overruns and increased permanent spending. Spending overruns, possibly due to unpredictable events or poor expenditure planning, are being accommodated by the significant increase in corporation tax receipts. The high corporation tax receipts allow for/compensate for increased expenditure without resorting to borrowing, other taxation or reductions to other areas of government spending. The key difficulty is that corporation tax is volatile revenue and may not be an appropriate tax stream to fund permanent expenditure.

Higher than predicted corporation tax receipts have particularly contributed to fund health expenditure overruns.[32] Health spending tends to be permanent spending whereas corporation tax revenue may be temporary. Corporation tax is the most volatile of the major taxes. As the PBO (2019) has previously stated, the Government should avoid using potentially unsustainable revenue sources to fund permanent increases in public spending. Rather, such spending commitments should be linked to stable and less volatile revenue sources.[33] If corporation tax revenue was to decrease permanently, this could lead to higher levels of government deficits, the need for tax increases in other areas and/or reduction in government spending. Placing such windfall tax receipts in the Rainy Day Fund would ensure that the State is not as exposed in the event of a fall in corporation tax revenues.

Corporation tax revenue at risk

Analysis of corporation tax receipts by the Central Bank of Ireland and the Irish Fiscal Advisory Council would indicate a significant amount of corporation tax revenue is at risk from international tax reforms or sudden changes in the global economy. However, this analysis does not estimate the impact of the OECD BEPS process on future projections of Irish corporation tax revenue.

The Central Bank notes that corporation tax growth has driven almost half of all tax revenue growth since 2014 and corporation tax revenue faces significant risks in the near future. The Central Bank looks at a number of different scenarios with reductions

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28 Office of Revenue Commissioners (2021) Corporation Tax – 2020 Payments and 2019 Returns
29 Irish Fiscal Advisory Council (2021) Fiscal Assessment Report 2021
30 PBO (2021) An Update on the OECD BEPS proposals
31 PBO (2019) An Overview of the Corporation Tax Base in Ireland
32 E. Casey and K. Carroll (2021). "The path for Ireland's health budget". Irish Fiscal Advisory Council Analytical Note Series No. 14. Dublin
33 PBO (2019) An Overview of the Corporation Tax Base in Ireland.

of corporation tax revenues and an external negative shock to the Irish economy. One scenario discussed by the Central Bank, sees a rapid decrease in corporation tax revenue. This scenario is based on a fall in corporate tax revenue of €4.7 billion between 2022 and 2025. This scenario, alongside an external shock, could cause a challenging position for the public finances and debt sustainability.[34]

The Irish Fiscal Advisory Council estimated between €3bn and €6.5bn of Corporation Tax revenue could be transitory and vulnerable to a shock. The Council state that the BEPS process represents a potential risk to tax revenues and could include a downward adjustment that takes place suddenly rather than gradually. There is also a major risk arising from corporation tax revenue being concentrated in a small number of companies and the Council state that five stylised multi-national companies leaving Ireland could directly reduce corporation tax revenue by €3 billion.[35]

One scenario outlined by the Council is that corporation tax receipts grow in line with the amount that can be explained by the domestic economy's performance rather than the multi-national sector. In this scenario, corporation tax revenue decreases by €875 million annually between 2022 and 2025 relative to baseline, when forecasts of total receipts grow in line with nominal GNI*. This results in a cumulative decrease in corporation tax revenue of €3.5 billion. This reduction is on top of the €2 billion reduction in corporation tax revenue projected by the Department of Finance due to the impact of the BEPS reforms.[36]

The Council also outlines a long-term scenario analysis where corporation tax revenue was to grow in line with nominal GNI* from 2025 to 2050. The debt ratio would increase by about 26 percentage points by 2050.[37] This shows how a reduction in corporation tax over the period 2022 to 2025 would significantly increase government debt and pose a significant fiscal challenge for the Irish State.

34 Conefrey, T. Hickey, R. & Walsh, G. (2021) "An Analysis of Medium-Term Risks to Public Finances" Economic Letters, Vol. 2021 No.6, Central Bank of Ireland.
35 Irish Fiscal Advisory Council (2021) Fiscal Assessment Report
36 Irish Fiscal Advisory Council (2021) Long-term Sustainability Report: Fiscal challenges and risks 2025-2050
37 *Ibid.*

4. Current Projections of BEPS impact on Corporation Tax Revenue

Irish economic policy has relied heavily on a competitive corporation tax rate to attract foreign investment, and the public finances have become more reliant on surging corporation tax revenue. This approach means that the OECD BEPS process could have a significant impact on both the Irish economy and tax revenue.

There are significant difficulties in predicting the impact of BEPS reforms on future corporation tax revenue, even to forecast whether BEPS changes will increase or decrease corporation tax revenue. The OECD BEPS first pillar reallocates a portion of profits to where sales are located, instead of where the company is based. This could make Ireland a less attractive location for multi-national companies. The second pillar concerns a global minimum corporation tax rate of 15% for companies with revenue over €750 million. This has potential positive and negative effects. The higher rate could lead to an increase in corporation tax revenue. However, the higher rate could also reduce the competitive tax advantage of Ireland to the multi-national companies.

To illustrate the difficulty in forecasting corporation tax revenue, the below paragraphs outline the corporation tax forecasts of SPU 2021 (April 2021) and Budget 2022 (October 2021) for the period 2021 to 2025. The corporation tax revenue forecast figures are provided in Table 3.

SPU 2021

In Stability Programme Update (SPU) 2021, corporation tax revenue was projected to consistently increase in the period 2021 to 2025. However, the SPU 2021 forecasts for corporation tax were published before the detailed Pillar Two of OECD BEPS was developed and before Ireland indicated that it would sign up to Pillar Two. At the time, the estimates could be considered optimistic due to the potential impact of the BEPS reforms.

Budget 2022

In Budget 2022, strong growth is projected to continue in the early 2020s. Forecasts for corporation tax were revised upwards compared to the previous SPU estimates. **The Budget 2022 forecasts includes a reduction of annual corporation tax receipts by €2 billion by 2025 due to OECD BEPS reforms.** However, this revenue foregone figure of €2 billion relative to the baseline by 2025 was calculated before OECD BEPS Pillar Two was finalised, including the global minimum corporation tax rate of 15%. The revenue impact is phased in from 2023. Given the prevailing vulnerabilities in this volatile and risky tax stream, Budget 2022 forecasts for corporation tax revenue in 2024-2025 may not be fully incorporating the potential impact of OECD BEPS reforms.[38] Although, it is important to note the baseline of corporation tax revenue has significantly increased. **The net receipts for corporation tax was €15.3 billion in 2021, which exceeds the forecast for each year of 2021-2025 period published in Budget 2022.**

The corporation tax revenue increased by 29.5% on the 2020 figure, compared to an overall tax increase of 19.7%.[39] This highlights the level of volatility and uncertainty in corporation tax forecasting. The pandemic could be a contributing factor as there was increased activity in the IT and the pharmaceutical sectors, which are significant industries of the Irish economy. There is uncertainty about the level of activity and

38 PBO (2021) Post-Budget 2022 Commentary
39 Department of Finance (2022) End-2021 Exchequer Returns Summary

the corresponding corporation tax paid in the sectors in a potential post pandemic economy. **In summary, Corporation Tax has significantly outperformed the projected expectations, which possibly indicates the factors driving the surge in corporation tax revenue are not fully identified or understood.**

Table 3: Projected Corporation Tax Revenue (2021-2025) and Actual (2021)

Corporation Tax Revenue	2021f	2022f	2023f	2024f	2025f
Projections € millions					
SPU 2021 (April 2021)	11,640	11,795	12,035	12,275	12,490
Budget 2022 (October 2021)	13,890	14,080	14,170	14,675	15,170
Actual € millions	**2021**				
Actual Outturn	15,324				

Sources: Department of Finance (2021) Stability Programme Update 2021, Department of Finance (2021) Budget 2022 – Economic and Fiscal Outlook & Department of Finance (2022) Department of Finance Databank

At the same time, it must be acknowledged that there are immense challenges in forecasting BEPS impact on future corporation tax revenue. The challenge in forecasting arises from the multiple dynamic impacts on a diverse range of sectors across the Irish, European, and global economies. In addition, the OECD BEPS process could have an impact on the number of international tax disputes, depending on how clear the guiding principles and formulas for profit re-allocation are. International tax disputes consume resources and time for on both tax authorities and multi-national companies.[40]

40 Kilty, S. - Irish Times (18/10/2021) "OECD tax reform is a jigsaw puzzle that has yet to be finished"

5. Conclusion

In summary, the changes in international corporation tax proposed by the OECD/G20 BEPS project will be very significant for Ireland.

The implementation of the BEPS changes over the next few years could change the investment strategies and tax planning by multi-national companies. The reduction in the level of corporation tax autonomy and competitiveness by countries could significantly change the decisions about investment by multi-national companies. Corporation tax could be less important in investment decisions and other factors such as infrastructure and human capital would become more important. This new environment could challenge the Irish economy, particularly in light of the comparative gaps in capital infrastructure.[41]

Given the proposed increased corporation tax rate, it is still possible that the OECD BEPS project might have a limited effect or a positive effect on Irish corporation tax revenue. Ireland as a business friendly, common law and English-speaking country in the Eurozone and European Union, could remain a key gateway for American and other multi-national companies into the wider European market. However, as the low rate of Irish corporation tax has previously attracted substantial levels of Foreign Direct Investment,[42] there is a chance that OECD BEPS could have a detrimental impact on the Irish economy and corporation tax revenue.

41 World Economic Forum (2020) Global Competitiveness Report 2019
42 McAleese, D. (2000) "The Celtic Tiger: Origins and Prospects" Policy Options Politiques