



# Review of the Corporation Tax Code

Submission to Department of Finance



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## Introduction and background

*Social Justice Ireland* welcomes the opportunity to further engage with the Department of Finance on the implications of the recently published Review of Ireland's Corporation Tax Code (2017). This response complements previous engagements with the author for that report (meeting and consultation submission) and *Social Justice Ireland's* ongoing research and contributions to the reform of Ireland's taxation system.

- A copy of our submissions to the consultation (March 2017) is available here: <http://www.finance.gov.ie/updates/submissions-to-public-consultation-on-the-terms-of-reference-for-the-review-of-irelands-corporation-tax-code/>
- The most recent *Social Justice Ireland* analysis of the Irish taxation system, including an examination of the policy areas where we believe reform should occur, is available here as Chapter 3 of our 2017 Socio-Economic Review '*A New Social Contract for a New Century*': <https://www.socialjustice.ie/content/publications/socio-economic-review-2017-taxation>

In all cases, our contributions on this issue are guided by a core policy objective for the entire taxation system:

***To collect sufficient taxes to ensure full participation in society for all, through a fair tax system in which those who have more, pay more, while those who have less, pay less.***

We welcome the renewed focus on the international corporate tax system in recent years, albeit at the behest of the OECD and more recently the European Union and not – as it should have been – as a result of pro-active movement by government. We expressed disappointment at the time when in 2008/09 the issue of Corporate Tax was omitted from the terms of reference of the Commission on Taxation. The idea that Government would establish a Commission to examine the tax system and then deliberately exclude one part of that system as not appropriate for examination spoke volumes of the reluctance to countenance any alteration to what is a key component of Ireland's overall taxation system.

## Context

The context for Ireland's corporation taxation system and policy has changed dramatically in the last couple of years. This is because:

- i. The BEPS process has signalled a greater international focus on the system and the way in which some countries and large corporations have exploited the international system for some time.
- ii. The BEPS process has also signalled an unwillingness of most countries to continue to tolerate the abuses of the international corporate tax system; almost all of them entirely legal abuses, but abuses none the less.
- iii. The BEPS process has begun to see greater transparency in the international system and this is likely to grow further in the years to come.
- iv. The 2015 national income figures for Ireland highlighted, in a very public international way, the fact that the Irish corporate tax system has been, and is being, exploited by a number of companies who are strategically managing their international activities and tax affairs via Ireland, to the benefit of this country, at least in economic growth terms, but at a cost for many other countries.

- The national income numbers highlight an entirely unsustainable situation, one which will gain further attention as similar, relatively smaller, large growth figures are issued for 2016 etc.
- v. The publication of the European Commission's Apple tax investigation report which, ignoring the fine on Apple, as this is not of huge importance to corporate tax structures, simply highlighted that it was possible for a large multi-national company to operate out of Ireland and use the corporate tax system to record unacceptably low – in fact quite tiny – tax liabilities.
  - vi. The way in which these National income figures and the Apple report were greeted by our fellow European countries. Beyond the short-term stories of airplanes, fines and leprechaun economics, they saw these events for what they were; a clear demonstration of the way Ireland and its corporate tax system had been used in an unacceptable way to alter tax liabilities and undermine the revenue expectations of governments in other parts of the EU and beyond.  
Put simply, this has alienated many countries who are unlikely to tolerate this type of behaviour from corporations or countries in the years to come. It's a case of clear reputational damage.
  - vii. Forthcoming changes to the corporate tax structures in the United States and the United Kingdom – and some which have already been legislated for – will change the landscape for taxation in a way that affects Ireland.

Overall, the impact of these occurrences has been to fundamentally alter the context of international corporate taxation. For Ireland, it simply means that the future of the corporate tax system has shifted from being a national policy issue to an issue that sits in a very visible and scrutinised international tax and political context. Simply, up to relatively recently, it could be argued that Ireland designed its own corporate tax policy; it is clear that that is no longer the case and that any decisions here are now resting in a European and international context where our fellow member states will have a very clear say in the appropriateness and acceptability of Irish policy decisions in this area.

### **Current tax-take from large multinational corporations:**

*Social Justice Ireland* believes there is a short-term bubble in corporate tax revenue driven by the shifting structures of multinational companies (MNCs) and the way some are using Ireland to manage their tax and intellectual property affairs. This is not a sustainable source of revenue; it may last for a number of years, but it is a clear issue for the sustainability of the taxation system and the sustainability of revenue from it.

### **A Minimum Effective Rate**

As we have persistently pointed out, the amount of tax that many large MNCs are paying is unacceptably low. In our pre-Budget submissions over recent years, and in our core analysis and policy document the annual Socio-Economic Review, we have called for the establishment of a minimum effective tax rate for corporations. This approach works well for high earners (although the design of the high earners restriction is far from perfect) and there is no reason it should not work for corporations.

*Social Justice Ireland* is disappointed that a Minimum Effective Rate (MER) of Corporation Tax has not been introduced. We have suggested an MER of 6%, and have been surprised at the resistance

to such a proposal, particularly given that it would only affect companies who are currently availing of effective rates lower than that on a regular basis; something that we consider quite unacceptable.

Ireland's headline rate of 12.5% is already low by international standards and means that the extent to which the corporate sector contributes to government revenue is far lower than it might otherwise be. Aside from lowering Ireland's (already extremely low) tax to national income ratio, this places additional an burden on other areas of revenue generation such as personal income tax and VAT.

While a report from the Department of Finance in 2014 suggested an average effective rate of corporation tax of 11.9% on 'taxable income', it is unsurprising that the measure is close to the headline rate as 'taxable income' excludes income removed or offset from taxation through various tax breaks.

In practical terms, the provision of tax breaks and exemptions implies that corporations enjoy a substantial reduction in their tax liability. Data from Eurostat estimate an implicit corporate tax rate on business income of between 6% and 8.6%, although we believe it is likely to be as low as 3% for many large corporations while Small and Medium Enterprises (SMEs) pay close to 12.5% for the most part. The recent report for the C&AG report (2017) highlighted similar outcomes.

According to Revenue, "the effective tax rate for companies is always lower than statutory rate due to the application of certain reliefs and credits... 'Tax Due' as a proportion of taxable income from Revenue's Corporation Tax statistics data provides one of the best estimates of the effective rate of CT on the total profits that are subject to Irish tax (*An Analysis of Corporation Tax Receipts in 2014-2015, April 2016*)"

However, this approach reduces the denominator (tax base) by deducting tax reliefs from company profits. Company profits should be the denominator, and we do not believe that the Revenue approach stands up to economic scrutiny. **We take this opportunity to reiterate our call for a Minimum Effective Rate of Corporation tax of 6% on profit.** *Social Justice Ireland* believes that the issue of corporate tax contributions is principally one of fairness. Profitable firms with substantial income should make a contribution to society rather than pursue various schemes and methods to avoid these contributions.

The consultation document published in October 2017 notes several instances in which Ireland is taking a leadership role in areas of global tax reform. It also notes that Ireland "remains committed" to the BEPS process and to playing our full part in its implementation. The introduction of a minimum effective corporate tax rate would serve as another opportunity for Ireland to take a leadership role in implementing progressive moves relating to the international corporation tax system.

### Transparency

As noted in our previous submission, *Social Justice Ireland* believes that In the interests of transparency and of ensuring that preferential treatment is not accorded to any taxpayer, an analysis of some key expenditure variables of companies should be carried out. The following statistics are derived from the *Annual Business Survey of Economic Impact 2015, Department of Jobs Enterprise and Innovation, January 2017*:

	2000	2015
Services incl. royalties as percent of sales	23.8%	43.6%
(of which) Domestic services incl. royalties as percent of sales	7.8%	5.3%
(of which) Imported services incl. royalties as percent of sales	16%	38.2%

A company in Ireland can make patent royalty payments free from withholding tax to a company, which is based abroad, provided that certain conditions (not very onerous) are met. Is this mechanism being used extensively by certain companies to avoid Irish corporation profit tax? In the five years 2000-2004, an average of 18% of sales were spent on foreign services, including royalties; in the five years 2011-2015, this increased to almost 37%. Had the earlier 18% figure been applied to sales in 2011-2015, an additional €32m on average could potentially have been available each year for inclusion in the corporation profit tax base.

The survey form for the *Annual Business Survey of Economic Impact* distinguishes royalty payments separately from other services; however, the aggregate results do not show royalty payments separately. The Review should examine and report on this issue.

#### Reform the Research and Development tax credit

In the context of considerations of the future direction of Ireland's corporate taxation regime, we wish to draw attention to another specific policy proposal which we outlined in advance of recent Budgets. We believe that this reform which would bring greater fairness and transparency to the Irish corporate taxation system and further strengthen the fairness and sustainability of Ireland's overall taxation system.

A tax expenditure for companies engaged in research and development (R&D) was introduced in 1997 and has been revised and reformed on a number of occasions since. A curious component of the current structure is that firms may claim a tax refund on unused R&D credits - i.e. where they have not paid tax to cover the refund amount. Such a structure offers opportunities for certain firms to further reduce their effective tax rates.

**We believe that a reform to this structure is overdue and it should be removed from the structure of this tax break.**

#### OECD BEPS process:

As we have previously noted, we welcome the moves by the OECD to take a leadership role in this area in the last few years, and also welcome Ireland's stated commitment to playing a full part in its implementation.

The work of the OECD has highlighted the need and potential for reform. We welcome all of the 15 BEPS Actions and believe that Ireland should take a leadership role in implementing ALL of these actions.

In relation to Action 13 (*Transfer Pricing Documentation and Country-By-Country Reporting*) we welcome the development of Ireland being among the first countries to implement Country by Country Reporting.

On Actions 8-10 (*Aligning Transfer Pricing Outcomes with Value Creation*) we note the potential for significant lobbying, principally from MNCs and large accountancy firms.

While these actions carry challenges for Ireland, the reason they do so is because companies have used this country, and the transfer pricing and intangible valuation structures we have permitted, to their advantage and to the detriment of many other countries.

While these reforms are likely to cost revenue and economic activity for Ireland, they are overdue, fair and necessary. Policy needs to be mature in its appreciation of the need for reform in this area.

### **EU CCCTB process:**

We welcome the revival of the EU CCCTB process. Again, this signals a broader appreciation of the need for reform of the international corporate tax system. We believe that the general objective of the CCCTB proposals, which is to align better the profit taxes of firms with the location of their activities, make logical sense.

Again, we note the potential for significant lobbying, principally from MNCs and large accountancy firms, against these reforms.

Again, policy and policy makers need to be mature in appreciating that this reform, which is likely to come at a short-term cost to Ireland, makes sense in the medium to long term and is part of the development of a fairer and more transparent corporate tax system.

We note reports from the ESRI and others indicating that these reforms will have a negative impact for Ireland. This is correct, given the current unsustainable structures and process that are in place, but that in itself is not a good enough argument for not adopting and implementing the CCCTB proposals. There is an inevitability of reform and Ireland should take a mature and leadership role in this process.

### **Conclusion**

Overall, *Social Justice Ireland* believes that:

- the current corporate tax system is unsustainable;
- current levels of corporate tax revenues are unsustainable;
- Ireland's current structures of corporate taxation are no longer acceptable in a European and broader international context.

There is an overwhelming argument for reform that:

- ensures corporations pay a minimum effective tax rate in Ireland;
- ensures the Irish system is not exploited to the detriment of the economies of many of our key European and international allies;
- ensures Government embraces the logic of the proposed EU CCCTB reforms, which will better align taxation revenues to economic activities throughout Europe and although this will cost Ireland tax revenue, it is an inevitable consequence of the emergence of a better and fairer Europe-wide corporate tax system;
- ensure Government adopts more of the OECD BEPS proposals and take a more visible leadership position in implementing these;

- ensure that Ireland's corporate tax take is both sustainable and predictable on an annual basis to allow for long-term policy planning.

These are reforms which we believe would contribute to a fairer corporate tax system and a fairer society and assist in rebuilding the significant reputational damage Ireland has experienced as a result of the exposure of the set of corporate tax issues we outlined at the start of this presentation.

*Social Justice Ireland* welcomes any opportunity to engage further with the Department of Finance on these issues and other issues of taxation reform.

**Social Justice Ireland** is an independent think-tank and justice advocacy organisation of individuals and groups throughout Ireland who are committed to working to build a just society where human rights are respected, human dignity is protected, human development is facilitated and the environment is respected and protected.

*Social Justice Ireland,*  
Arena House,  
Arena Road,  
Sandyford,  
Dublin 18  
Phone: 01 213 0724  
Email: [secretary@socialjustice.ie](mailto:secretary@socialjustice.ie)  
Charity Number: CHY 19486  
Registered Charity Number:  
20076481  
**[www.socialjustice.ie](http://www.socialjustice.ie)**

