SOCIAL JUSTICE IRELAND

working to build a just society

The Knowledge Development Box Consultation

Submission to the Department of Finance

The Knowledge Development Box – Public Consultation

Comment on the general direction in which you would like to see tax policy in this area develop

Social Justice Ireland welcomes the opportunity to make a submission to the consultation process on the Knowledge Development Box (KDB) as a replacement to the so-called 'double-Irish' tax structure. The fiscal adjustments of recent years highlight the centrality of taxation in Ireland's budget deliberations and in policy development. For many years we have argued that the core policy objective on taxation should be: "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 constantly criticised the 'double-Irish' over the years and welcomed its removal, finally, from the Irish tax code.

The KDB policy now being considered is proposing to offer preferential effective tax rate(s) to income generated from intellectual property and patents under the premise of nurturing innovation, encouraging companies to locate high-value jobs in Ireland, and promoting economic growth. *Social Justice Ireland* accepts that the corporate sector is important for economic growth and employment in Ireland and that Ireland needs a competitive corporate tax offering to develop indigenous businesses and attract foreign direct investment (FDI). We can also see the attractions of putting in place a competitive offering for knowledge-based investment which is related to research and development (R&D) and innovation at a time when growth in OECD economies is increasingly driven by investment in assets.

The approach of developing a low effective tax rate/s, through the knowledge development box, however, raises a number of concerns in terms of corporation profit shifting activity, tax revenue, public services and social fairness. The KDB must be put in the context of the substantial R&D tax credits that Ireland already provides. These tax credits cover a large range of eligible expenditures and offer the same rate to all types of companies. The already-existing generous tax credit regime coupled with the KDB has the potential to undermine Ireland international reputation and see the country again represented across the world as a hub of corporate welfare and tax avoidance. This is a situation *Social Justice Ireland* strongly believes should be resisted.

A further argument against introducing a KDB is that the already-existing generous tax regime has failed to produce a significant indigenous business sector, with Ireland only producing 3 major transnational companies (CRH, Fyffes, Ryanair).

Over the past three years, a growing international focus on the way multi-national corporations (MNCs) manage their tax affairs has led to the OECD commencing its major examination of the system known as the Base Erosion and Profits Shifting (BEPS) process. In this process it is intended to establish the manner and methods by which MNCs exploit international tax structures to minimise the tax they pay. It is important that this work leads to the emergence of a transparent international corporate finance and corporate taxation system where multinational firms pay a reasonable and credible effective corporate tax rate – to date the OECD's BEPS publications have been welcome and focused on this objective.[1]

In tandem with this international reform process, the European Commission has begun a series of investigations into the tax management and tax minimisation practices of a number of large MNCs operating within the EU, including Ireland. *Social Justice Ireland* believes that nothing the

[1] See www.oecd.org/ctp/beps.htm

Irish Government does should be at odds with these processes that seek transparency and fairness in the corporate tax system.

Despite a low headline corporate tax rate (12.5%), there is limited data on the effective rate of corporate taxation in Ireland. A report from the Department of Finance in 2014 pointed towards four methods of calculating that rate. Although each of the methods were valid, it favoured one which reported an effective rate of 11.9 per cent on 'taxable income'. As 'taxable income' excludes income removed or offset from taxation through various tax breaks, it is unsurprising that the measure is close to the headline rate. However, in practical terms, the provision of tax breaks and exemptions is likely to imply 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 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.[2]

Social Justice Ireland believes that an EU wide agreement on a minimum effective rate of corporation tax should be negotiated and this could evolve from the ongoing discussions around a Common Consolidated Corporate Tax Base (CCCTB). We believe that the minimum rate should be set well below the 2014 EU-28 average headline rate of 22.9 per cent but above the existing low Irish level.[3] A headline rate of 17.5 per cent and a minimum effective rate of 10 per cent seem appropriate. This reform would simultaneously maintain Ireland's low corporate tax position and provide additional revenues to the exchequer. Were such a rate in place in Ireland in 2014, corporate tax income would have been between €1 billion and €1.8 billion higher – a significant sum given the socio-economic challenges outlined throughout this publication. Rather than introducing this change overnight, agreement may need to be reached at EU level to phase it in over three to five years. Reflecting this, we proposed prior to Budget 2015 that the effective rate be adjusted to a minimum of 6 per cent – an opportunity missed in Budget 2015 and one we regret.

Social Justice Ireland believes that the issue of corporate tax contributions is principally one of fairness. Through the recent recession, the contrast between a static corporate tax rate and the increases to almost all other areas of taxation was stark. From a societal perspective, it is important that corporations contribute in a reasonable and credible way to the costs of running the state in which they operate in and benefit from.

Overall, we would prefer this EU wide approach to the adoption of a Knowledge Box approach to corporate taxation.

In addition, some of the literature finds that patent boxes significantly reduce tax revenue for the government enacting the patent boxes (Griffith *et al.*, 2014), though there are measurement issues in covering innovation and tax planning. For example we find it very significant that 5 countries (Finland, Japan, Sweden, Denmark, Switzerland and Germany) have high Business Expenditure on Research & Development (BERD) but relatively low total government support to business R&D (as percentage of GDP) and no R&D tax incentives in 2011 (European Commission, 2014). Corporate welfare is not necessary for the development of a competitive business and industry sector; rather investment in infrastructure, education and skills development together withappropriate business regulations are the true drivers of business and economic growth.

Furthermore, there has been no study evaluating the cost, distributive impacts or appropriateness of the knowledge development box proposal. The Commission on Taxation (2009:230) and Collins and Walsh (2010:20-21) have highlighted the need for evaluation of tax relief.

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[2] See Eurostat online database, code: gov_a_tax_itr

3 Data from Eurostat (2014:36-37).

If a decision is made to proceed with the Knowledge Box proposal there needs to be prior evaluation of its costs and benefits. Detailed information should be collected and analyses, an annual report of the KDB should form part of the annual Budget process and there should be regular scrutiny of this area by an Oireachtas Committee. These actions would deepen the analysis of the KDB proposal, ensure it is assessed and evaluated annually. It would also improve the ability of the Oireachtas to regularly review it.

The government approach towards facilitating large corporations is in sharp contrast to the funding challenges to be faced by public services in the next few years. The current trajectory of government policy is for a reduction in total expenditure (including interest rates) and a reduction in total revenue (of which tax revenue is by far the largest component) to 2018. The Department of Finance's *Fiscal and Economic Outlook 2015* projects total revenue will fall to 32.1% of GDP and total expenditure falling dramatically to 31.8% of GDP in 2018. In contrast, the EU was estimated to have total revenue of 45.3% of GDP and total expenditure of 47.9% of GDP in 2013 (Eurostat, 2014).

Social Justice Ireland believes a new tax policy approach is required. Corporate taxation is central to any such approach. Rather than introduce a Knowledge Box with its attendant developments, *Social Justice Ireland* would prefer to see Government reduce tax supports to corporations, and recognise the need to increase the overall tax-take towards 34.9% of GDP in order to fund the public services that would enable Ireland to have a competitive economy and a high quality of life. *Social Justice Ireland* has long argued that Ireland's total tax-take is simply too low to pay for the services and infrastructure required to ensure economic development and social cohesion. We would prefer to see the development of an integrated EU-wide approach. As indicated above a headline corporate rate of 17.5 per cent and a minimum effective corporate rate of 10 per cent seem appropriate. This reform would simultaneously maintain Ireland's low corporate tax position and provide additional revenues to the exchequer.

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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.

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