

**REVIEW OF IRELAND'S CORPORATION TAX CODE
PRESENTED TO THE MINISTER FOR FINANCE AND PUBLIC
EXPENDITURE AND REFORM BY MR. SEAMUS COFFEY**

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**LETTER FROM THE INDEPENDENT EXPERT TO THE MINISTER FOR
FINANCE AND PUBLIC EXPENDITURE AND REFORM**

30 June 2017

Mr Paschal Donohoe T.D.,
Minister for Finance and Public Expenditure and Reform,
Government Buildings,
Merrion Street,
Dublin 2.

Dear Minister,

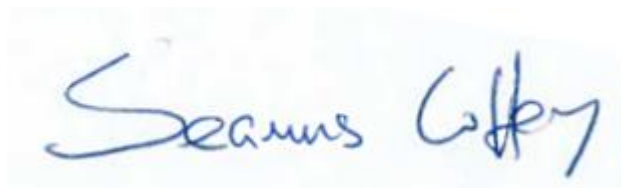
I am very pleased to provide the attached review of the corporation tax code which your predecessor as Minister, Mr. Michael Noonan T.D., appointed me to undertake last October.

Over the past months I have consulted with a wide range of stakeholders which has assisted me greatly in formulating my recommendations. Indeed, in light of this experience I have recommended further consultation on a number of the areas to better inform policymaking and provide certainty in what is a time of great change in the international tax environment.

I believe that the approach of frequently reviewing key areas of policy is a sound one. There is a strong rationale for conducting another review of the corporation tax code following the implementation of our commitments under the OECD/G20 initiative to combat base erosion and profit shifting.

I hope that these recommendations will assist you in formulating corporation tax policy at this time.

Yours sincerely,



Seamus Coffey

SUMMARY OF RECOMMENDATIONS

Ensuring the corporation tax code does not provide preferential treatment to any taxpayer

- 1) Any proposed measures should be carefully scrutinised to ensure that they do not (i) constitute a potentially harmful preferential tax regime, as identified by the OECD Forum on Harmful Tax Practices, or (ii) a potentially harmful tax regime, as identified by the EU Code of Conduct for Business Taxation.

Enhancing tax transparency

- 2) Ireland should take account of any recommendations of the peer review being undertaken by the Global Forum on Transparency and Exchange of Information for Tax Purposes.
- 3) Ireland should continue its commitment to support proposals for a Directive providing for mandatory disclosure rules in line with the recommendations outlined in the G20/OECD BEPS Action 12 Report.
- 4) The passage of the Taxation and Certain Other Matters (International Mutual Assistance) Bill through Dáil and Seanad Éireann should be facilitated.
- 5) Following the enactment of the Taxation and Certain Other Matters (International Mutual Assistance) Bill, Ireland will be able to, and should, withdraw its reservations regarding Sections II and III of the Convention on Mutual Administrative Assistance in Tax Matters, namely those sections encompassing the recovery of tax and service of documents. However, the reservation on Article 12, which allows one state to request another state take measures of conservancy, for example through the seizure of assets of a taxpayer before final judgement is given, should be retained.

Further implementing Ireland's commitments under the OECD/G20 BEPS project

Recommendations 6, 7, 8, 9, 10 and 12 are made in concert with Recommendation 16, which suggests that further consultation should be undertaken on certain matters with a view to improving tax certainty:

- 6) Ireland should provide for the application of the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8, 9 and 10 in Irish legislation.
- 7) Domestic transfer pricing legislation should be applied to arrangements the terms of which were agreed before 1 July 2010.
- 8) Consideration should be given to extending transfer pricing rules to SMEs, having regard to whether the concomitant imposition of the administrative burden associated with keeping transfer pricing documentation on SMEs would be proportional to the risks of transfer mispricing occurring.
- 9) Consideration should be given to extending domestic transfer pricing rules to non-trading income. There is a strong rationale to extend domestic transfer pricing rules to non-trading income where it would reduce the risk of aggressive tax planning.

Consideration should also be given to extending transfer pricing rules to capital transactions, having regard to whether such an extension would improve the existing provisions which already apply arm's length values to companies' transactions relevant to chargeable gains and capital allowances.

- 10) There should be a specific obligation on Irish taxpayers who are subject to domestic transfer pricing legislation to have available the transfer pricing documentation outlined in Annex I and II of Chapter V of the OECD 2017 Transfer Pricing Guidelines to ensure implementation of BEPS Action 13.
- 11) If it is decided to implement any or all of Recommendations 6, 7, 8, 9 and 10, this should take place no later than end 2020, which is the year to which the OECD and G20 have agreed to extend their co-operation on BEPS to complete the current work.
- 12) In transposing the Anti-Tax Avoidance Directive, Ireland should have regard to the recommendations of the Reports on BEPS Actions 2, 3 and 4.

Delivering tax certainty and maintaining competitiveness

- 13) In the context of the introduction of the Controlled Foreign Company rule provided by the Anti-Tax Avoidance Directive, consideration should be given to whether it is appropriate to move to a territorial corporation tax base in respect of the income of the foreign branches of Irish-resident companies and, in respect of connected companies, the payment of foreign-source dividends. In doing so, regard should be had to whether moving to a territorial corporation tax base would require additional anti-avoidance measures. In deciding whether to move to a territorial corporation tax base, a balance must be struck between the prospective reduction in compliance burdens for Irish-resident outbound investors through an exemption of foreign income, the prospective increase in compliance burden necessitated by the introduction of any additional anti-avoidance measures required, and any potential revenue impact.
- 14) An alternative to a territorial corporation tax base is to review Schedule 24 of the Taxes Consolidation Act 1997 with a view to effecting a policy and revenue neutral simplification of the computation of the foreign tax credit for all forms of foreign income. This would achieve the competitiveness advantages associated with moving to a territorial corporation tax base, whilst avoiding the introduction of additional complexity to the corporation tax code by new anti-avoidance measures.
- 15) To reduce uncertainty and ensure that Ireland protects its corporation tax base, Ireland should ensure an adequately resourced Competent Authority.
- 16) A key element of reducing uncertainty in tax matters is pro-active consultation regarding proposed measures. It is recommended that a number of proposed changes suggested in this review are carried out subject to consultation to reduce

uncertainty regarding the proposed changes and to better inform policy-making. In particular, it is recommended that consultation be carried out on:

- i. the implementation of the Anti-Tax Avoidance Directive, with a view to better understanding the effect of the proposed technical changes to the Irish corporation tax code;
- ii. the implementation of Actions 8, 9 and 10 of the G20/OECD BEPS initiative;
- iii. additional considerations regarding Ireland's domestic transfer pricing rules; and,
- iv. the effects of moving to a territorial corporation tax base and of reviewing Schedule 24 of the Taxes Consolidation Act 1997 to effect a policy and revenue neutral simplification of the computation of the foreign tax credit.

The role and sustainability of corporation tax receipts

17) Although it is impossible to be definitive and the volatility in receipts will remain the level-shift increase in Corporation Tax receipts seen in 2015 can be expected to be sustainable over the medium term to 2020.

18) In order to ensure some smoothing of corporation tax revenues over time, it is recommended that the limitation on the quantum of relevant income against which capital allowances for intangible assets and any related interest expense may be deducted in a tax year be reduced to 80%.

1. INTRODUCTION

1.1 Terms of Reference

1.1.1 On 2 September 2016, the Government decided to ‘arrange for a review of Ireland’s corporation tax code by an independent expert to be appointed by the Minister for Finance’. As part of the decision, the Government provided that ‘the review will exclude any possibility of a change to the 12.5% corporation tax rate’. On 11 October 2016, the Minister for Finance, Mr. Michael Noonan T.D., announced the appointment of the independent expert and published the terms of reference of the review, which required recommendations to be made to the Minister by the end of the second quarter of 2017. The terms of reference of the review encompass the following matters:

- achieving the highest international standards in tax transparency, including in the automatic exchange of information on tax rulings with other relevant jurisdictions, having regard to benefits which may accrue to developing countries from enhancing global tax transparency;
- ensuring that the corporation tax code does not provide preferential treatment to any taxpayer;
- further implementing Ireland’s commitments under the Organisation for Economic Co-operation and Development’s Base Erosion and Profit Shifting (BEPS) project to tackle harmful tax competition and aggressive tax planning;
- delivering tax certainty for business and maintaining the competitiveness of Ireland’s corporation tax offering; and,
- maintaining the 12.5% rate of corporation tax.

1.1.2 During the Committee Stage of the Finance Bill 2016, held in November 2016, a number of members of the Dáil Select Committee on Finance, Public Expenditure and Reform, and Taoiseach raised the matter of the role and sustainability of corporation tax receipts, in light of the increase of the corporation tax yield from €4,614 million in 2014 to €6,872 million in 2015. The matter of the role and sustainability of the corporation tax receipts was added to the terms of reference of the review.

1.2 Approach taken

Consultations

1.2.1 In undertaking the review a number of consultations were held with stakeholders identified as having previously made knowledgeable and informed contributions to the development of Irish corporation tax policy, including representatives from international non-governmental organisations (NGOs), accountancy firms, and representative bodies. Meetings were facilitated with these stakeholders between January and March 2017 to hear their perspectives on the terms of reference. The Department of Finance facilitated a public consultation seeking the views of the public and the interested parties on the matters identified by the terms of reference of the review. The consultation period ran from 21 February 2017 to 4 April 2017, a period of six weeks. 16 submissions were received.

1.2.2 Discussions were held with officials from the Revenue Commissioners, the Department of Finance, the Department of Jobs, Enterprise and Innovation, Industrial Development Authority (IDA) Ireland, Enterprise Ireland and the OECD. Ongoing assistance was furnished by officials of the Revenue Commissioners and the Department of Finance, including the provision of a small secretariat.

1.2.3 Appendix I outlines a list of the stakeholders consulted and those who responded to the public consultation.

Scope of the review

1.2.4 The review had regard only for the matter encompassed by the terms of reference, and for matter pertaining to the corporation tax code itself, as contained in the Taxes Consolidation Act 1997 (TCA 1997), which includes the provision of the tax code relating to direct taxes and the taxation of capital gains, and those statutory instruments made by Government Ministers or the Revenue Commissioners consequent to provisions in the Act. The review did not examine matters relating to the administration of taxes in Ireland, which are a matter for the Revenue Commissioners, who are statutorily independent in the performance of their functions under enactments relating to taxation, as provided for by section 101 of the Ministers and Secretaries (Amendment) Act 2011.

1.3 Context of the review

1.3.1 This review was undertaken against the background of a rapidly changing international tax environment. When the review was announced in September 2016, the primary international challenge in international tax was the implementation of the agreed actions under the OECD/G20 initiative to combat BEPS at a national, European Union (EU) and international level. Since that time, the United Kingdom has formally signalled its intention to exit the EU, the European Commission has re-launched its proposal for an EU-wide common consolidated corporate income tax base, and the United States (US) is considering the most substantial changes to the US corporate income tax code since the 1980s. While the terms of reference of the review did not directly provide for such matters, they did form part of the context in which the review was undertaken.

Common Consolidated Corporate Tax Base (CCCTB)

1.3.2 In October 2016, the European Commission re-launched its legislative proposal for a Common Consolidated Corporate Tax Base (CCCTB), which comprises two discrete legislative proposals: first, a proposed Council Directive on a Common Corporate Tax Base, which would replace the extant corporate income tax base of all EU Member States with a common corporate income tax base to apply to all company groups with a turnover greater than €750 million; and consequent to the adoption of a common base, a proposed Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), which would apportion taxable profits of companies between Member States by reference to a formula based on the location of sales, employees and fixed capital assets of a taxable company, rather than by reference to the existing international standard for attributing profits within groups of companies, the arm's length principle.

United States tax reform

- 1.3.3 In May 2017, the President of the US proposed a revision of the US corporate income tax code to *inter alia*, move from a worldwide corporate income tax base to a territorial corporate tax base, reduce the highest rate of federal corporate income tax from 35% to 15%, and expand the corporate income tax base through the removal of certain deductions. The majority political party in the House of Representatives has proposed a revision of the US corporate tax code to convert the current residence-based classical corporate income tax to a destination based cash-flow tax, which has the potential for extensive impacts on trade, currency markets, and through an adjustment to relative prices within and between industries, on the structure of industrial production globally.

Brexit

- 1.3.4 In June 2016, the United Kingdom held a referendum on whether to remain in or leave the EU. On 29 March 2017, on foot of the referendum result, the United Kingdom notified the European Council of its intention to withdraw from the EU as provided for by Article 50 of the Treaty on European Union (TEU). Negotiations regarding the terms of the United Kingdom's exit from the EU began on 19 June 2017. The final outcome of the negotiations, particularly regarding the future relationship of the United Kingdom and EU, remains uncertain.

1.4 Structure of the Review

- 1.4.1 The Report is structured as follows:

- i. Chapter 2 briefly outlines the historical background to the development of the corporation tax code, some of the main features of the corporation tax base, the main tax expenditures provided under the code, and international features of the corporation tax code;
- ii. Chapter 3 provides an overview of the 15 Actions agreed as part of the G20/OECD initiative to combat BEPS;
- iii. Chapter 4 outlines the main criteria which may be used to ensure that the corporation tax code does not provide preferential treatment to any taxpayer;
- iv. Chapter 5 examines the implementation of measures to improve tax transparency;
- v. Chapter 6 outlines the measures required to further implement BEPS Actions 8, 9, 10 and 13 and additional amendments to Ireland's domestic transfer pricing rules which may be considered;
- vi. Chapter 7 outlines some of the technical options to be chosen as Ireland implements BEPS Actions 2, 3, and 4 through the transposition of the Anti-Tax Avoidance Directive;
- vii. Chapter 8 examines delivering tax certainty for business and maintaining the competitiveness of Ireland's corporation tax offering; and,
- viii. Chapter 9 provides a medium-term perspective on the role and sustainability of the corporation tax receipts.

2. THE IRISH CORPORATION TAX CODE

2.1 Historical Background

2.1.1 The State has imposed a tax on company income since the establishment of the Irish Free State in December 1922. Article 74 of the Constitution of the Irish Free State provided for transitional provisions related to imposition and collection of tax previously imposed under the British administration in Ireland. Subsequently, section 15(1) of the Finance Act 1923 retained those taxes previously imposed under the British administration in Ireland, which included the Corporation Profits Tax (CPT), a tax on limited liability companies introduced by the United Kingdom in 1920. Both the CPT and income tax (applicable to the taxable profits of unincorporated and corporate persons) were applied to the taxable profits of corporations until 1976, when the Corporation Tax Act 1976 provided for the introduction of the current corporation tax.

Origins of the corporation tax

2.1.2 In 1957, the Minister for Finance appointed a Commission on Income Taxation ‘*to enquire generally into the present system of taxation of profits and income, its scope and structure, including the provisions for collection and for the prevention of evasion; its effects on the national economy, and the equity of its incidence; to recommend such amendments of the law as appear desirable and practicable; and if it is considered that the taxation of profits and income should be terminated, or modified in any manner involving loss of revenue, to recommend alternative means of raising equivalent revenue*’. During the course of the work of the Commission on Income Taxation the Government had signalled that it was considering separating the taxation of corporate and personal income to facilitate greater flexibility in adjusting the fiscal stance and to reduce the complexity involved in subjecting company profits to two separate taxes with two different tax bases. The Commission on Income Taxation recommended that if this was to be effected then economic double taxation should be mitigated through a tax credit in respect of the corporate tax against income tax borne by the shareholder. The introduction of a separate layer of corporation tax in Britain through the Corporation Tax Act of 1965, replacing the application of the income tax and ‘Profits Tax’, a successor to the Corporation Profits Tax, gave an added impetus to the development of a separate company tax in Ireland.

Box 1. Justifications for the Corporate Income Tax

Applying a separate layer of taxation to the profits of incorporated businesses has long been controversial in both economic and legal literature. Justifications for CIT have traditionally rested on *a priori* assumptions regarding the nature of the corporation itself, namely whether (i) the corporation should be viewed as an aggregation of its individual shareholders, (ii) as a separate entity to its shareholders controlled and organised by the managers of the corporation, or (iii) an artificial entity granted unique benefits by the State (Avi-Yonah, 2004a). Accordingly, the corporate income tax can be viewed as (i) an administratively simple means to tax the capital income of shareholders and prevent the diversion of personal income, or (ii) as a mechanism to

reduce the economic resources in the hands of corporate managers, or (iii) a payment to reflect the benefits conferred by the state on corporations.

Aggregation theory

During the nineteenth century the aggregation theory of the corporation was reflected in the common practice, where an income tax system was introduced, such as through the Income Tax Act of 1803 and the Income Tax Act of 1842, which applied the British income tax to Ireland, of integrating the taxation of corporate and personal income. At this time corporate entities frequently distributed the entirety of their annual profits and were financed entirely by bank loans or debt issuance. In particular in Britain the aggregation theory underlay the taxation of companies, such that the income tax completely integrated personal and corporate taxation (Daunton, 2001: 89).

Current iterations of the aggregation theory are often based on modern economic literature. The 'theory of the firm' emerged to attempt to explain why firms, in which hierarchies rather than the price mechanism were used to direct intra-firm resource allocation, existed in a specialised market economy (Coase, 1937). One way to explain the existence of the firm - the 'modern theory of the firm' - posits that the incorporated business is an entity which acts as a 'nexus of contracts' for individual factors of production, with the role of managing the firm explained as the process of continuously negotiating contracts to organise the factors of production (Alchian & Demsetz, 1972; Jensen & Meckling, 1976; Easterbrook & Fischel, 1991; Torger, 1990).

The first Commission on Taxation endorsed the aggregate view of the corporation, concluding that 'in principle, there is no case for [corporation tax] but that tax should continue to be collected at the company level as a prepayment of shareholders' liability in order to avoid companies being used as a means of delaying tax due by shareholders' (Commission on Taxation, 1982). If the effective incidence of CIT is believed to fall on capital income, the CIT may also be seen as a useful way to redistribute income from holders of capital to other members of the community. Finally, as taxing rights to distributed profits are generally based on the residence principle (i.e. taxed in the country of residence of the shareholder) it is also argued that a separate layer of CIT provides a basis to tax foreign shareholders.

Separate entity theory

The separate entity theory rests on the separation of ownership and control of incorporated businesses (Berle & Means, 1932/1991). This view became particularly salient in the context of the increasing importance of large, publicly traded corporations in the economy. When the US subjected all profits to full corporate and personal income taxation this was often associated with a particularly American view of the corporation as a separate economic entity to its shareholders (Bank, 2011). It remains a popular view that when the US imposed a federal excise tax on companies operating in the corporate form in 1909, the precursor to a then constitutionally barred CIT, it was intended as a regulatory act to reduce the resources available to corporate management (Bank, 2001). It has been suggested that this regulatory function may provide the main justification for the modern CIT in a US context (Avi-Yonah, 2004b).

Artificial entity theory

The artificial entity theory of the corporation was explicitly used to justify the introduction of the corporation tax in Ireland. The first *White Paper on Company Taxation* which preceded the Corporation Tax Act 1976 stated:

'A company owes its existence to the State as well as its all-important characteristic of limited liability, its perpetual life, the easy transfer of ownership of shares, access to the capital market and the possibilities of numerous business activities through the medium of subsidiaries or intercompany shareholdings. All these features have enabled companies to develop and to reach new markets on a scale far beyond what would be feasible for an unincorporated business. The separate existence of companies is not merely a legal fiction, but a fact which accounts for a considerable part of the profits of large companies. Once the concept is accepted that a company is created by the State, that it is given special privileges on its creation and that it has an existence apart from the members that form it, the idea of a special company tax on profits, with shareholders

bearing income tax on their dividends, has a logical basis. (Department of Finance, 1972: 3).'

In public finance theory, the benefit principle states that the level of tax owed to the state should be commensurate to the public benefits conferred by the state (Musgrave & Musgrave, 1989). The benefit principle is possible to apply when there is a direct link between the public service provided and the benefit conferred – however, it is difficult to apply once the benefit becomes immeasurable. Notwithstanding, the benefit principle is often used to justify the imposition of CIT where the state provides significant benefits to mobile international capital through, *inter alia*, the provision of infrastructure, industrial grants, financing, facilities to enable specialised human capital formation, and the rule of law including a functioning regulatory system and framework for the legal protection of intellectual property (OECD, 2015a).

The Corporation Tax Act 1976

2.1.3 Following the Sixth and Seventh Reports of the Commission on Income Taxation, two White Papers on Company Taxation were published, the first, published in 1972, proposed a new single corporation tax to replace the income tax and CPT and the second, published in 1974, outlined the detailed proposals of the Department of Finance (Department of Finance, 1972, 1974a). The European Economic Community (EEC), to which Ireland acceded in 1973, was, at that time, considering both a programme of company tax harmonisation in the medium term and a programme to harmonise the relief of cross-border company tax in the shorter-term. In this context, Irish policymakers sought to introduce a single corporate income tax with a single set of computational rules to facilitate any cross-border arrangements. The second White Paper outlined a scheme of corporation tax which formed the basis of the Corporation Tax Act 1976.

2.1.4 Although the new corporation tax replicated most of the features of the income tax and CPT, a number of notable policy choices were made in its design. First, the new tax gave some recognition that commonly controlled companies should be treated as a single economic operator by allowing one member of a group of companies to surrender certain specified losses or deductions to another member (this had proven too complex to introduce when there were two taxes on profits in operation). Second, the partial integration of the personal income tax and corporate income tax was maintained through the provision of dividend credit to recognise a portion of the corporation tax paid at the company level. Third, to prevent the deferral of personal taxation through corporate vehicles a surcharge on the undistributed earnings of closely held companies (those under the control of five or fewer natural persons) was introduced, replacing existing anti-avoidance legislation. Fourth, the existing system of capital allowances and existing incentives for companies was retained. Fifth, marginal relief from corporation tax for profits between £5,000 and £10,000 was provided to encourage re-investment. Sixth, interest paid on 'permanent loans' such as debentures issued by companies were permitted to be deducted in the calculation of taxable company income. Finally, liability to corporation tax was determined by reference to relevant accounting periods, as per the CPT, rather than on the income tax basis of years of assessment.

2.1.5 Following the publication of the White Paper on Capital Taxation the Government decided to introduce a tax on realised capital gains on assets and to replace the estate duty with the capital acquisitions tax (Department of Finance, 1974b). Accordingly, when the corporation tax was provided for in the Corporation Tax Act of 1976 taxable corporate profits were defined to include income computed in accordance with the Corporation Tax Act, and chargeable gains computed in accordance with the Capital Gains Tax Act 1975. Between 6 April 1974 and 6 April 1976, companies in Ireland were liable to income tax, CPT, and Capital Gains Tax (CGT) (in respect of disposals made on or after 6 April 1974). Given the CPT liability paid was allowable as a deduction in computing profits subject to income tax the combined rate applying to company income was 49.95% (23% CPT + (35%*77%) income tax). Following the commencement of the Corporation Tax Act 1976, Irish resident companies became liable to corporation tax on worldwide profits, namely income on all sources and on chargeable gains. The initial corporation tax rate was set at 50% to bring it as close as possible to the combined rate of income tax and CPT.

Corporation tax incentives

2.1.6 Between 1922 and 1956, the State pursued a policy of import-substituting industrialisation by restricting the ownership of new firms to Irish residents, imposing, in line with general drift towards protectionism, new customs tariffs on goods to protect or encourage domestic producers of those goods, and introducing limited income tax reliefs designed to encourage the equity financing and domestic ownership of Irish companies (Daly, 1984). From the 1950s, the State pursued a policy of promoting capital investment in manufacturing assets and exports by attracting Foreign Direct Investment (FDI) from foreign, and particularly US, firms, in the context of national and global trade liberalisation. The regime for the taxation of companies was one of the constituent elements of this policy.

2.1.7 Fiscal incentives and tax expenditures were provided through the tax system to companies for capital investment, trading activities, and exports by reference to the type of trading activity undertaken, type of capital investment, and location of the capital investment or trading activity. These fiscal incentives were supplemented by, and interacted with, grants provided for capital investment by the IDA. By the 1980s, this policy mix was increasingly criticised for misallocating resources towards foreign firms vis-à-vis domestic firms (National Economic and Social Council, 1982). The combined effect of these fiscal incentives sharply reduced the effective cost of capital in the Irish manufacturing sector and accordingly sharply shifted the labour-capital cost ratio towards capital (Ruane & John, 1984; Flynn & Honohan, 1984). The extensive provision of reliefs also eroded the corporate tax base during the 1970s and 1980s, such that Ireland applied a high tax rate to a relatively narrow tax base.

- 2.1.8 The primary fiscal incentives provided to companies were the system of accelerated capital allowances, the Export Sales Relief (ESR), ‘Shannon Relief’, and the manufacturing relief. The system of capital allowances which broadly applied between 1956 and 1992 was composed of (i) the ‘initial allowance’, (ii) annual wear and tear allowance, or, in lieu of both, (iii) an accelerated wear and tear allowance popularly referred to as ‘free depreciation’. Introduced in the Finance Act 1956, the initial allowance provided for a deduction of 20% for capital expenditure incurred on plant and machinery (excluding motor vehicles), subsequently increased over a number of years to 100% in 1972. An initial allowance of 10% for capital expenditure incurred on industrial buildings and hotels, subsequently increased to 20% in 1972 and reduced to 10% in 1973, to 50% in 1975 and 100% in 1978. The annual wear and tear allowance for plant and machinery were provided at rates of 10%, 12.5% or 25%, depending on the nature of the plant or machinery, on a declining balance basis having deducted the ‘initial allowance’ utilised. In 1956, an annual capital allowance of 2% in respect of capital expenditure on industrial buildings and hotels was introduced, subsequently extended to 10% for hotels in 1960, with the type of qualifying building gradually expanding over time.
- 2.1.9 An election to utilise ‘free depreciation’ represented an alternative to the use of the initial allowance and wear and tear allowance and allowed taxpayers to claim an increased wear and tear allowance of up to 100%. In 1967, the option to elect for ‘free depreciation’ for new plant and machinery was provided where that plant and machinery was used in certain areas, namely those areas defined as ‘undeveloped areas’ in section 3 of the Undeveloped Areas Act 1952, later encompassed by areas defined as ‘designated areas’ in the Industrial Development Act 1969. In 1971, the option to elect for free depreciation was extended to the rest of the country. In 1971 an ‘investment allowance’, a deduction for 20% capital expenditure incurred on plant and machinery for use in designated areas was introduced and was allowed in addition to other capital allowances. Between 1988 and 1992, the initial allowance and ‘free depreciation’ were phased out through annual reductions in their values (extended to 1996 where plant or machinery was provided for the use in trading operations in the Shannon Customs-free area or the International Financial Services Centre).
- 2.1.10 Introduced in 1956, ESR applied to all tax on profits of companies derived from new export sales of manufactured goods to reduce the quantum of taxable profits by 50% and, from 1957, 100%. Companies could not deduct income tax out of dividends paid out of profits which qualified for ESR, or, where paid out of profits which partially qualified for ESR, could only deduct that proportion which related to non-ESR profits, ensuring the pass-through of the benefit of the ESR in respect of income tax. In 1957, the rate of relief was increased to 100% and in 1958 the number of years for which relief could be claimed was increased from five to ten and the period for which relief was available was extended to 1970. By 1970, ESR applied for a period of fifteen years, with tapered relief for a further five years and

an expiry date for the relief of 5 April 1990. The scope of the manufactured goods to which the relief applied expanded over the years to include, *inter alia*, fish production, mushroom cultivation, the repair of ships, engineering services, and book publishing.

- 2.1.11 The Customs-Free Airport Act 1947 provided for the establishment of a customs-free airport, and subsequent secondary legislation designated the Shannon Airport area as customs free with a view to maintaining the attractiveness of the airport to transatlantic flights. In 1958, the profits of trading activities carried out in the customs-free area were exempt from tax where they were designated as ‘exempted trading operations’ by the Minister for Finance under section 3 of the Finance (Miscellaneous Provisions) Act 1958, with an expiry date of 5 April 1990. Exempted trading operations were defined as trades related to the supply of services related to aircraft provided from the airport, and the repair and maintenance of aircraft within the area and manufacture of goods for export or import/export of goods within the area.
- 2.1.12 Protocol 30 of the Act concerning the Conditions of Accession and the Adjustments to the Treaties adopted by the EEC upon Ireland’s accession to the EEC provided, in applying those parts of the Treaty of Rome relating to State aid (Article 92 and 93) ‘it will be necessary to take into account the objectives of economic expansion and the raising of the standard of living of the population’.¹ Notwithstanding, in the late 1970s Ireland agreed with the European Commission that ESR and Shannon relief would be allowed expire in 1990, as already provided for in legislation, and that no company commencing to trade on or after 1 January 1980 should qualify for the relief. The ESR had been considered by the Commission to be an unlawful State aid, insofar as a selective advantage was given to exporters of manufacturing goods.
- 2.1.13 In December 1978, the Minister for Industry, Commerce and Energy announced that the ESR would be replaced by a new relief. Accordingly, the ESR was replaced by ‘Manufacturing relief’ through Chapter VI of Part I of the Finance Act 1980. Manufacturing relief was provided by way of a deduction on corporation tax from sales of goods by companies undertaking qualifying trading activity from 1 January 1981 with the effective rate of corporation tax applying to income from such sales was 10%. Manufacturing relief, when introduced, was due to expire in 2000. As this relief applied to all producers of manufacturing goods, it was not considered to confer a selective advantage when introduced. The trades to which manufacturing relief applied were expanded beyond those which would traditionally be considered manufacturing and the number of deemed manufacturing activities applied to, *inter alia*, activities such as computer software development and fish farming. In 1981, activities licenced by the Minister for Finance under the pre-existing legislation

¹ *Documents concerning the accession to the European Communities of the Kingdom of Denmark, Ireland, the Kingdom of Norway and the United Kingdom of Great Britain and Northern Ireland*, O.J. L73.

applying to the Shannon Free Airport zone were included within the scope of manufacturing relief, and from 1987, the relief was further extended to apply to income derived from certain activities undertaken in the Custom House Docks Area (the IFSC) certified by the Minister for Finance.

2.1.14 The European Commission considered that the extension of the manufacturing relief to IFSC related activity and to activities at Shannon Airport on State aid constituted compatible State aid on the basis of Article 92(3)(a) TEC, which provides that an 'aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment' should be considered compatible with the common market. The Commission decided not to object based 'not only on the serious economic and social situation in Dublin but also on the developmental benefits of the project in the overall Irish context' and, as regards the Shannon Free Airport zone, after '[taking] account of the contribution made by these firms to the continued development of activities in the airport zone, which is of considerable importance to the successful development of the region' (European Commission, 1987, 181). Furthermore, the Commission decided not to raise an objection to the extension of the time period under which the IFSC and Shannon relief could be utilised. However, the Commission's view changed over time. In 1998, the European Commission issued proposals for appropriate measures under Article 93(1) of the Treaty establishing the European Community (TEC) indicating that it considered manufacturing relief, in addition to its extension to IFSC and Shannon relief activities, as constituting State aid, and provided for the final year for qualification for each category of activity (2002, 2005 or 2010 depending on the qualifying activity and when it first began) under the manufacturing relief.

2.1.15 The interaction of ESR and manufacturing relief with the corporation tax base created opportunities for tax-based financing and tax-based leasing. Tax-based leasing was incentivised as companies with profits taxable at the standard rate of corporation rate could shield more of their tax liability from corporation tax using accelerated capital allowances than companies with income qualifying for ESR or manufacturing relief. A practice developed of domestic financial institutions purchasing plant and machinery, claiming accelerated capital allowances and IDA grants, and leasing the plant and machinery to ESR or manufacturing relief claimants. Tax-based financing predominantly involved the advancement of loans to ESR companies. Section 84 of the Corporation Tax Act 1976, an anti-avoidance measure, deemed certain specified payments as dividend distributions. ESR distributions were considered tax-free in the hands of the recipient and accordingly interest payments on section 84 loans advanced to ESR companies were considered tax free in the hands of the lender.

Box 2. Commissions on Taxation of 1980 and 2009

Public disquiet regarding the structure of the tax system in early 1980 led to the establishment of a Commission on Taxation by the Minister for Finance in March 1980 ‘to enquire generally into the present system of taxation and to recommend such change as appears desirable and practicable so as to achieve an equitable incidence of taxation, due attention being paid to the need to encourage development of the national economy and to maintain an adequate revenue yield’. The Commission identified the Haig-Simon definition of comprehensive income (income as consumption plus changes in net worth), which effectively encompasses all forms of income from whatever source arising, as the appropriate measure of income upon which to base the tax system. Accordingly, the Commission proposed a significant reform of the whole tax system by bringing more income within the charge to income tax, introducing a single rate of personal income tax, integrating the personal and corporate income tax systems, and introducing a direct expenditure tax to replace the higher rate of income tax. The First and Second Reports of the Commission, delivered in 1982 and 1984 respectively, made a number of recommendations regarding corporation tax including: (i) to set the corporation tax at the single rate of personal tax recommended by the Commission; (ii) to completely integrate the personal and corporate income tax systems through full imputation; (iii) to introduce Advance Corporation Tax (ACT) designed to address the scenario where no corporation tax liability arose but where a shareholder nonetheless received a credit against dividend income for imputed corporation tax; (iv) to replace free depreciation and initial allowances and align capital allowances with economic depreciation with indexation of allowances to account for inflation; (v) to abolish the close company surcharge and charge close companies as partnerships; (vi) to restrict tax-subsidised lending; and (vii), in respect of all tax liability, to move to a system of self-assessment.

In February 2008, the Minister for Finance established a Commission on Taxation ‘to review the structure, efficiency and appropriateness of the Irish taxation system’. In the area of business taxation the Commission recommended, *inter alia*: (i) that the rate of corporation tax on chargeable gains arising from the disposal of trading assets should be liable to the rate of corporation tax on trading income rather than the CGT rate; (ii) the removal of the close company surcharge on the trading income of professional service companies; (iii) that depreciation as per company accounts should be used to calculate annual capital allowances instead of the statutory depreciation schedule; and, (iv) allowing the pooling of the foreign tax credit in respect of foreign tax borne on royalty payments.

Base-broadening and rate-cutting

- 2.1.16 Following the publication of the First and Second Reports of the Commission on Taxation established in 1980 (see Box 2) and in the context of the fiscal crisis of the 1980s, the State gradually began to expand the corporation tax base. Between 1982 and 1986 restrictions were applied to tax-based financing, IDA grants were disallowed for the calculation of capital expenditure available for capital allowances, and the ACT was introduced.² In 1986 and 1987, successive Ministers and Governments committed to a comprehensive review of the direction of corporation tax policy. These reviews took place in the context of a general shift in industrial policy in the late 1980s and early 1990s, which, in the area of corporation tax, aimed at broadening the corporation tax base by restricting and standardising the tax treatment of capital expenditure, tax-based financing and tax-based leasing

²The Advance Corporation Tax (ACT) was introduced in Finance Act 1983, which required Irish resident companies making distributions to shareholders to pay an amount of ACT equivalent to the tax credit attached to distributions. This ensured that no credit would be provided where corporation tax was not borne. Where ACT was not repaid the company could set-off ACT paid against liability to corporation tax in the same period.

and gradually reducing the corporation tax rate (Industrial Policy Review Group, 1992; Government of Ireland, 1993). This policy, in concert with the phasing out of the ESR in 1990 and compositional changes in tax revenue, gradually increased the contribution of corporation tax as a percentage of total tax revenue (see chart 2.1a). In 1997, in light of the prospective phasing out of the manufacturing relief, the Government decided to transition, over a period of years, to a 12.5% rate of corporation tax on trading income and a 25% rate on passive income and to remove the tax credit for dividends (see chart 2.1b).

Chart 2.1a. Corporation tax as a % of GDP and as a % of total tax (inc. social security), 1974-2016

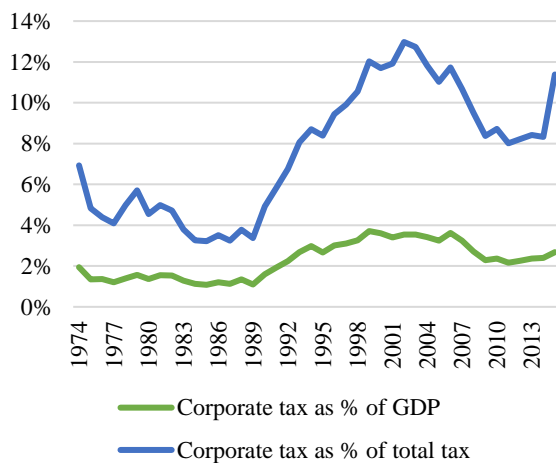
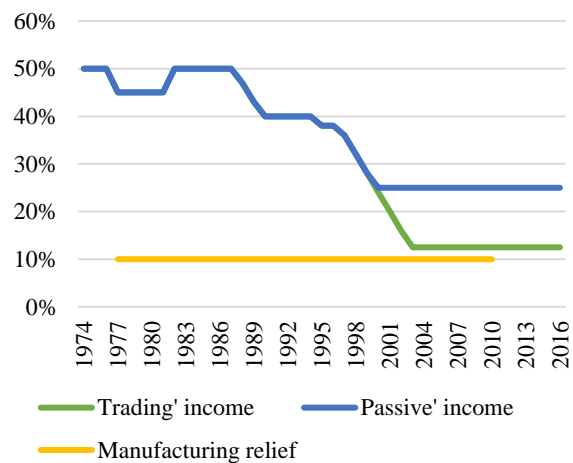


Chart 2.1b. Rate of corporation tax on trading income, passive income, and manufacturing relief, 1974-2016



Source: OECD Revenue Statistics.

Source: Revenue Commissioners

2.2 The Corporation Tax Base

Summary

2.2.1 The Irish corporation tax is imposed on the worldwide profits, composed of income and chargeable gains, of companies resident in Ireland. A company not resident in the State is subject to corporation tax on its chargeable profits, as defined by section 25 TCA 1997, where it carries on a trade in the State through a branch or agency. A rate of tax of 12.5% is imposed on trading income (Case I and II of Schedule D) and certain foreign-source dividends paid out of trading profits, a rate of tax of 25% is imposed on non-trading and 'excepted' trading income, and the prevailing rate of CGT (now 33%) is applied to the chargeable gains of companies.

2.2.2 Taxable trading income is based on profits according to financial statements but subject to specific adjustments required or authorised by the tax code. In general, subject to the computation rules set out in Chapter 6 of Part 4 TCA 1997, revenue expenditure that is wholly and exclusively incurred for the purpose of a trade can be offset in calculating trading income. Deductions are not allowed for business entertainment expenditure or for capital expenditure. The depreciation or

amortisation of capital assets, as computed for accounts purposes, is not an allowable expense in computing a company's income for the purposes of corporation tax. Instead, where certain conditions are met, depreciation for tax purposes is provided through capital allowances in respect of capital expenditure on plant and machinery, buildings and intangible assets.

- 2.2.3 A company that makes a trading loss in an accounting period can offset the amount of the loss against profits for the same or the previous accounting period in order to reduce its corporation tax liability. Any trading loss not set off can be carried forward for offset against future trading income of the trade concerned. Losses can also be surrendered between companies that are in a 75% group relationship providing both the surrendering and claimant companies are within the charge to Irish corporation tax and are resident in the EU, Iceland or Norway.
- 2.2.4 The Irish corporation tax code currently includes four major tax expenditures targeted to achieve certain policy objectives: the Knowledge Development Box (KDB) and the Research and Development (R&D) Tax Credit are designed to increase Business Expenditure on Research and Development (BERD); film relief is designed to increase the number of film productions in Ireland; and the relief from corporation tax for certain start-up companies is designed to increase the number of new incorporated start-up companies.

Definition of company

- 2.2.5 Incorporated businesses are conferred with a number of characteristics including legal personality, meaning such entities may hold property in their own right, sue and be sued, enjoy the protection of certain fundamental rights conferred by law, and, in some cases, the limitation of the liability of shareholders or members of a corporation for the losses and debts incurred by that corporation. The conferral of legal personality enables incorporated businesses to be subjects of taxation in their own right, separate to their shareholders. CIT codes apply separate taxation to specified types of incorporated businesses.
- 2.2.6 Corporation tax applies to companies, as defined by section 4(1) TCA 1997 as 'any body corporate', with exclusions for specified corporate bodies such as the Health Service Executive. The definition of 'body corporate' captures bodies conferred with a legal identity separate to the identity of their members including companies established under the Companies Act 2014, companies established by statute or incorporated by charter, and societies registered under the Industrial and Provident Societies Acts 1893 to 2014 such as cooperative societies. The approach to the classification of companies enables the application of specified computational rules to specified types of company identified by the Irish corporation tax code.
- 2.2.7 Unincorporated businesses such as sole proprietorships and self-employed persons are not subject to corporation tax and consequently profits and gains arising from

their trade or profession are assessed as income chargeable to income tax. Table 2.1 indicates the number of active enterprises by legal form and number and type of persons engaged as indicated by the Central Statistics Office Business Demography data. This indicates that there were nearly 100,000 private and public limited companies active in the State in 2014.

Table 2.1. Number of active enterprises, persons engaged net of employees (proprietors and family members), and employees by legal form in the business economy (NACE sectors B to N), 2014³

Legal Form	Active Enterprises	Proprietor/Family member	Employees
Individual proprietorship	130,002	130,088	68,213
Other legal forms of ownership	9,336	12,456	163,154
Public and private limited companies	98,911	71	960,309

Source: CSO series BRA12

Determining residency

2.2.8 Up to 1999, the provisions for whether a company was resident in Ireland for tax purposes stemmed from case law, which provided that a company's residence was 'where the central management and control actually abides'. The test for the location of management and control used was one of fact and was determined by reference to the residence of those exercising the highest level of control of the company. Section 23A TCA 1997 was inserted through section 82 of the Finance Act 1999 to provide a statutory basis for the treatment of certain categories of company as resident for tax purposes, in addition to the continuing case law-based general rule. Section 82 provided that a company incorporated in the State will be regarded as tax resident in the State, except: (a) where it is to be treated as resident elsewhere for tax treaty purposes ('the treaty exemption') by virtue of the terms of the relevant double taxation treaty; and, (b) where the company, or a related company (i.e. one company is a 50% subsidiary of another company or two companies are 50% subsidiaries of the same company), carries on a trade in the State ('the trading exemption') and is ultimately controlled by persons resident in an EU Member State or treaty country, or the company or a related company is a quoted company in a relevant territory.

2.2.9 Section 23A TCA1997 was amended by section 39(1) of the Finance (No. 2) Act 2013 to provide that a company incorporated in the State and neither resident in the State nor in any tax treaty-partner jurisdiction should be deemed to be resident in Ireland. The section had effect from 24 October 2013, as respects a company incorporated on or after that date, and 1 January 2015, as respects a company incorporated before 24 October 2013. Section 23A TCA 1997 was further amended by section 43(1)(a) of the Finance Act 2014 to provide that a company incorporated in the State is tax resident in the State except where the a double taxation agreement provides that, for the purposes of the agreement, the company should be resident in

³ The definition of active enterprises used by the CSO is that agreed in the context of preparing a proposal for a Framework Regulation Integrating Business Statistics: an enterprise is considered to be active if 'in a certain period it generates turnover, employs staff or makes investments in the period'.

the treaty partner. A company not incorporated in the State but centrally managed and controlled in the State continued to be tax resident in the State. Section 43(2) of Finance Act 2014 provided that the section would apply to (i) companies incorporated after 1 January 2015, or (ii) where companies are incorporated before 1 January 2015, after 31 December 2020 or from the date (after 31 December 2014) of a change in ownership of the company where there is a major change in the nature and conduct of the business of the company.

Determining the location of the tax base

- 2.2.10 The basis of specification of a jurisdiction's CIT base determines the extent to which that jurisdiction seeks to tax the profits of corporations. There are three primary options for the location of a tax base: a pure source-based or territorial tax base, which allocates taxing rights to the jurisdiction in which corporate income is generated; a pure residence-base or worldwide tax base, which allocates taxing rights to the jurisdiction in which the ultimate recipient of the profits resides (the corporate headquarters *or* where the personal shareholder resides); and a pure destination-based tax base (more closely associated with consumption taxes such as Value-Added Tax (VAT)), which allocates taxing rights to the jurisdiction in which the goods or services are ultimately provided. In practice, most jurisdictions will not locate their tax base according to such strict criteria and will vary the location of their CIT tax base depending on, *inter alia*, the type of income to which CIT applies and whether the income in question is received from a subsidiary.

Box 2.2. Historical basis for determining the location of the tax base

Historically, when countries whose outbound foreign investment exceeded inbound foreign investment, commonly referred to as capital exporting countries or creditor countries, introduced an income tax they did so on a residence basis to capture the worldwide income of their residents to ensure that income earned on investments abroad was subject to tax in the country of residence of the investor. The UK was the largest capital exporter up to the advent of World War I. Accordingly, the UK Income Tax Acts of 1803, and later of 1846 and 1852 provided for a system of taxing the income of all UK residents (whether a natural or legal person), wherever arising, by reference to the source of the income, with some sources of income, such as profits arising from a trade, taxed immediately as it arose, and others, such as income from foreign property, only when remitted. This created uncertainty regarding the taxation of incorporated businesses undertaking their activities abroad, and UK tax law developed to account for the appropriate basis and test for the tax residence of incorporated businesses, and to provide for which forms of income should be taxed on a remittance basis and which should be taxed as they arose. The remittance basis of taxation for taxpayers with a UK domicile was removed by section 5 of the Finance Act 1914, and the UK moved to introduce a 'colonial' tax credit to compensate taxpayers for tax paid in other jurisdictions within the British Empire. The US, which operated a worldwide system of taxation, allowed a deduction from income only for foreign tax paid. However, in 1918 the US introduced a unilateral credit for foreign taxes paid through the Revenue Act of 1918, effectively offsetting tax paid in another jurisdiction and placing the burden of eliminating double taxation of US residents on the US (Graetz & O'Hear, 1997). This reflected a preference on the part of the US for source-based taxing rights, despite its position as a capital exporter post-World War I. Britain, the world's largest capital exporter up to World War I, sought to maintain residence-based taxing rights.

An alternative system of taxation emerged in France, Belgium, Italy and Romania which distinguished between 'impersonal' or schedular taxes on income, and 'personal' taxes on income such as those imposed by the UK, US or Germany. Schedular taxes were imposed on income arising from 'real property', such as real estate or securities, so that the legal incidence was attached to the property rather than the person in receipt of the income. Accordingly, a jurisdiction operating a

system of ‘impersonal taxes’ tied the taxing rights to income arising from a particular property to the jurisdiction in which the property was located. This logic was extended to the taxation of corporate income. For example, in France, when ‘impersonal taxes’ were extended to commercial and industrial profits in 1917, liability to tax on profits in France arose when those profits were generated by an establishment located in France on French activity, regardless of the residency of place of incorporation of the company.

2.2.11 Irish corporation tax is imposed on the worldwide profits, ‘wherever arising’, as provided by section 26(1) TCA 1997, composed of income and chargeable gains, of companies defined as resident as per section 23A TCA 1997. A non-resident company in the State is subject to corporation tax on its chargeable profits, as defined by section 25 TCA 1997, where it carries on a trade in the State through a branch or agency, though chargeable gains accruing to the company on the disposal of assets which were not used for the purposes of the trade or held, used or acquired for the purpose of the branch or agency are not considered chargeable profits. Accordingly, Ireland operates a residence-based corporation tax code. Similar to other residence-based corporation tax codes, in general the profits of foreign subsidiaries of Irish companies are not subject to Irish tax until the profits are distributed to the Irish company.

Determining taxable profits

2.2.12 Internationally, corporate income taxes are levied on taxable profits defined by statute. Nearly all OECD members define taxable profits as income from trading, investment and capital gains, net of current expenditure such as labour costs, computed on the basis of profits according to financial statements subject to adjustments provided for by statute. The financial statements, upon which taxable profits are based, are usually prepared on the basis of generally accepted accounting principles or a specified accrual-based accounting standard, which provide that corporate income should only be included when it is earned, and not when the cash is paid or received by a corporation. Accordingly, profits computed according to most CIT codes reflect income when it is earned, and accounts for expenses when they are incurred. In general, except where adjustments are provided for by legislation, the Irish corporation tax code recognises accounting profits prepared in accordance with Irish generally accepted accounting practices or International Financial Reporting Standards as taxable profits. Trading losses are computed in the same manner as trading profits. A trading loss may be claimed against trading profits from any trade in the current year, claimed against trading profits of the preceding accounting period, be carried forward for and claimed against profits of the same trade for the first future accounting period in which they can be utilised, or used to offset the loss against the profits of another group member where the group is subject to control, within the meaning of section 11 TCA 1997, by one group member of 75% or more of the assets or income.

Revenue and capital expenditure

2.2.13 Unlike current expenditure incurred wholly and exclusively for the purpose of a trade capital expenditure is not allowable as a deduction when arriving at taxable profits. These statutory adjustments have been a feature of the tax code since the enactment of the Income Tax Act 1842, and were specifically outlined in Rule 3 of Cases I and II of Schedule D of that Act. Tests for distinguishing the difference between capital and ‘current’ (or ‘revenue’ – such that the expenditure is expensed immediately) expenditure derive from accumulated case law rather than statute, the most frequently cited of which defines capital expenditures as bringing into existence an asset or an advantage for the enduring benefit of a trade.⁴

2.2.14 Special provision is made in the CIT code for reliefs for capital expenditure through the system of capital allowances. Chapter 4 of Part 9 of TCA 1997 provides for the rules relating to relief for capital expenditure, including allowances for plant and machinery, specified intangible assets and industrial buildings. Section 316 TCA 1997 provides some additional rules for the interpretation of ‘capital expenditure’ and ‘capital sums’. It should be noted that generally tax law will ensure that there is no ‘double deduction’ allowed (i.e. expenditure cannot be treated as a trading expense *and* a capital allowance). Unused capital allowances are carried forward as losses. Capital expenditure and depreciation expenses previously debited in the profit and loss account of a company are added back in the computation of trading profits (i.e. Case I) for tax purposes, and then may, subject to the provisions of TCA 1997, qualify for capital allowances. A balancing charge, provided by section 288 TCA 1997, arises in a chargeable period where an asset in respect of which a capital allowance has been provided (i) ceases to be used, (ii) ceases to belong to the company concerned, (iii) in the case of an intangible asset the rights related to use of the asset are granted to another person for a capital sum, or (iv) where the trade to which the asset relates ceases. Where such an event occurs, a balancing charge generally arises where the sale price exceeds the tax written down value of the asset in question.

2.2.15 The tax code provides that certain revenue expenditure, such as annual patent royalties, may not be deductible but rather should be deducted as a ‘charge on income’ under section 243 TCA 1997 on a paid basis (i.e. when actually paid out of profits in the accounting period).

Sources of income: trading, non-trading and chargeable gains

2.2.16 As provided for by section 76(1) of the TCA 1997, income is computed in accordance with income tax principles, and as such is computed according to the Schedules and Cases which apply for Irish income tax purposes. The familiar Schedules and Cases stem from the British Income Tax Act of 1803, which categorised income by reference to its source into Schedules, which in turn facilitated the taxation of certain sources of income at source. The division of

⁴ Atherton v British Insulated and Helsby Cables Ltd 10 TC 155.

corporate income by use of the scheduler system facilitates the application of different rates of corporation tax and computational rules to income by reference to its source. A crucial distinction in the Irish CIT code is between income chargeable under Case I and II of Schedule D, or trading income, taxable at 12.5%, and income chargeable under Case III (interest, dividends, discounts, foreign income), Case IV (royalties, miscellaneous income) and Case V (rental income) of Schedule D, or 'passive income', and income arising from 'excepted trades' (working minerals, petroleum activities, dealing in and developing land), ordinarily taxable at 25%.

- 2.2.17 Chargeable gains of companies, with the exception of 'development land' within the meaning of section 648 TCA 1997, are considered within the charge to corporation tax rather than capital gains tax, and are computed in accordance with the CGT Acts, which broadly provides for tax of 33% on a realised capital gain arising from the disposal of an asset.

Definition of trading

- 2.2.18 Given the application of different rates to trading and non-trading activity, the definition of trade in the CIT code is important. A trade is defined as 'every trade, manufacture, adventure or concern in the nature of trade' by section 3(1) TCA 1997 and relevant case-law, informed by the 'badges of trade' (factors identifying whether an economic activity is a trade) identified by the 1955 UK Royal Commission on the Taxation of Profits and Income, which summarised case-law up to that date. Within the concept of trading different computation rules have been applied to different trades. For example, 'manufacturing relief' was applied to the profits of companies arising from specified trades between 1981 and 2010. At present, the corporation tax code still provides for the application of different computational rules and capital allowances for certain types of trade, such as farming and shipping.

Treatment of debt and equity

- 2.2.19 Deductions are not provided for equity financing, whether internal or external. A company may obtain relief from interest incurred wholly and exclusively for business purposes, interest allowable in computing Case V (rental income), or yearly interest allowable in computing certain Case III income (interest, dividends, discounts, foreign income). In certain other circumstances interest payments other than those relating to Case V and trading income may be treated as a 'charge on income' under section 243 TCA 1997 and may be deductible when paid out of profits. Section 247 TCA 1997 provides for a deduction of interest as a 'charge on income' out of profits on certain qualifying loans including, *inter alia*, loans used to acquire share capital in a company with characteristics prescribed by that section.

Relative integration of corporate and personal income

- 2.2.20 CIT codes may provide for no, partial or complete integration of the taxation of corporate and personal income. The *classical CIT* subjects profit in the hands of the corporation to corporation tax and distributed profits (i.e. dividends) in the hand of

the shareholder to personal income tax (PIT), without relieving either taxable subject from taxation. This produces *economic double taxation*, namely the taxation of two taxpayers, the incorporated entity and the shareholder, on the same income. Economic double taxation may be eliminated or mitigated by a jurisdiction providing for the CIT taxation of only the undistributed profits of the corporation..

2.2.21 A number of methods have been prescribed by jurisdictions to reduce or eliminate economic double taxation: (i) the *split-rate* method applies a lower rate of corporation tax on distributed profits, effectively reducing the tax burden at the company level to reduce economic double taxation; (ii) the *imputation* method relieves economic double taxation at the level of the shareholder by providing shareholders with a tax credit to recognise tax paid by the company (this may be full or partial); (iii) the *exemption* method simply exempts distributions from liability to income tax; (iv) the *corporate deduction* method provides a deduction at the corporate level in respect of payment of dividend; (v) the *partial inclusion* method ensures that only a portion of the dividend received by a shareholder is liable to PIT. Increasingly, and against previous expectations, an increasing number of OECD members do not mitigate economic double taxation as between personal income and corporate income tax (see Table 2.2).

Table 2.2. Methods of integrating PIT and CIT⁵

Country	System	Country	System	Country	System
Australia	FI	Greece	MCL	Netherlands	CL
Austria	CL	Hungary	OTH	New Zealand	FI
Belgium	CL	Iceland	CL	Norway	OTH
Canada	FI	Ireland	CL	Poland	MCL
Chile	FI	Israel	CL	Portugal	N/A
Czech Republic	CL	Italy	CL/PIN	Slovak Republic	N/A
Denmark	MCL	Japan	PI	Slovenia	CL
Estonia	NST	Korea	PI	Spain	N/A
Finland	PIN	Latvia	CL	Sweden	CL
France	PIN	Luxembourg	PIN	Switzerland	MCL
Germany	CL	Mexico	FI	Turkey	PIN
		United States	MCL	United Kingdom	PI

Source: OECD Revenue Statistics, 2016.

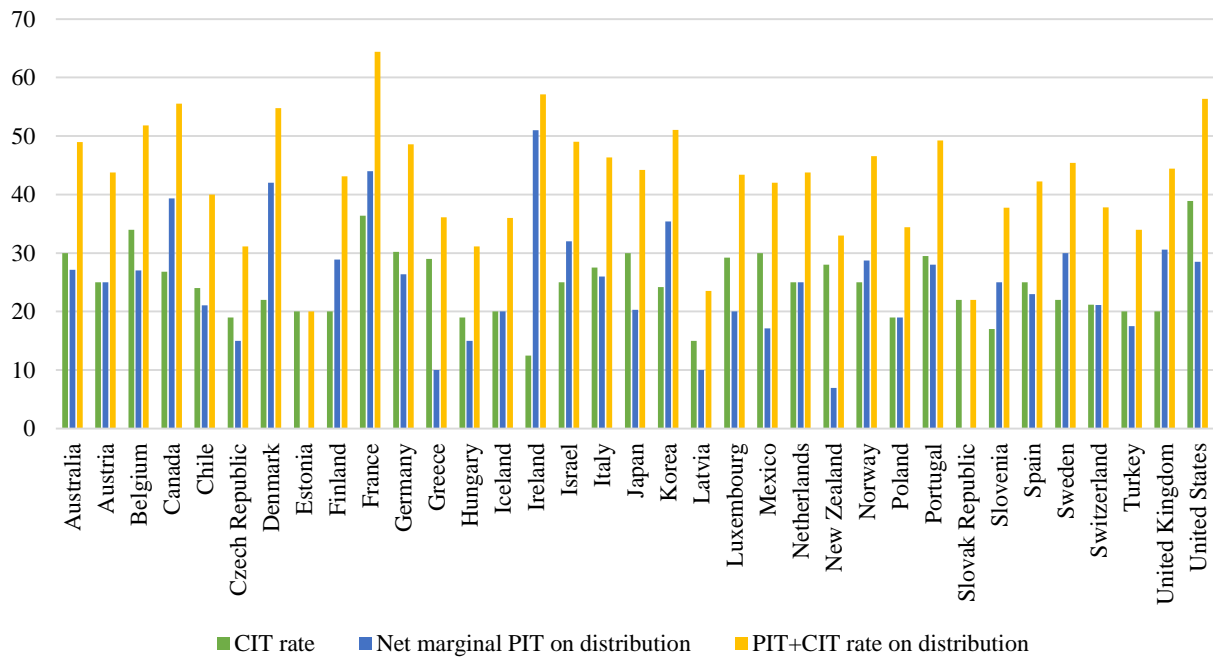
2.2.22 The combination of the classical system with high rates of marginal PIT leads to a relatively high rate of tax on distributed profits at the marginal PIT rate where a tax-resident corporation pays a dividend to a tax-resident personal income taxpayer. Chart 2.2 indicates the corporation tax rate on distributed profits, the net marginal

5 CL - Classical system; MCL - Modified classical system (dividend income taxed at preferential rates compared to other forms of capital income); FI - Full imputation; PI - Partial imputation; PIN - Partial inclusion (a part of received dividends is included as taxable income at the shareholder level); SR - Split rate system (distributed dividends are taxed at higher rates than retained earnings at the corporate level); NST - No shareholder taxation of dividends (no other tax than the tax on corporate profits); CD - Corporate deduction OTH - Other types of systems.

rate of personal income tax on distributed profits and the combined corporation tax rate and net marginal rate of PIT on distributed profits.

2.2.23 The Irish CIT code, both when the combined Income Tax and Corporation Profits Tax applied to corporate income, and when corporation tax was introduced, provided for partial imputation to relieve economic double taxation up until 5 April 1999, when the Dividend Withholding Tax (DWT), provided for in Chapter 8A of Part 6 and Schedule 2A TCA 1997, came into effect. The phasing out of the partial imputation was announced in Budget 1998 following the Government Decision of May 1997 to reduce the general rate of corporation tax and explore the removal of partial imputation. This ensured that the marginal combined tax rate on Irish profits paid by an Irish resident investor and Irish resident corporation were not unduly reduced by the move to a 12.5% rate of corporation tax.

Chart 2.2 The corporation tax rate on distributed profits, net personal tax, and combined top marginal personal income tax rate and corporation tax rate on distributed profits⁶



Source: OECD Revenue Statistics, 2016.

2.2.24 Where the CIT tax code provides for a deduction of the cost of employing labour (as all CIT codes presently do), a tax on corporate income acts as a tax on capital income. Other forms of capital income include net interest payments, the profits of

(Pre-tax distributed profit - distributed profit + net marginal rate of personal income tax on distributed profits) / Pre-tax distributed profit * 100

Where pre-tax distributed profits equals $100/(1-u)$ where u denotes the corporate income tax rate on distributed profits, and where distributed profits equals 100.

unincorporated business not attributable to the labour of the owner, income from property, dividends, royalties, and increasingly, the profits and rents accruing to collectively held investments vehicles such as mutual funds. Following the phasing out of partial imputation, the Irish CIT code has the characteristics of a classical corporation tax code with, as of 2016, a marginal tax rate of 57.13% applying to profits distributed to a company shareholder (taking account of CIT and PIT). From the perspective of taxing capital and personal income, this reflects policy-makers' preference for levying higher rates of tax on the capital income of Irish resident natural persons.

Close companies

2.2.25 Under the pre-1976 partial imputation system companies were obliged to withhold a portion of company income subject to income tax distributed to shareholders to discharge the shareholders' individual income tax liability. Accordingly, undistributed income was subject to tax in the hands of the company while distributed income was subject to tax in the hands of the shareholder, with the company facilitating the collection of tax by withholding a portion of the dividend. The introduction of a higher rate of income tax (the 'super-tax' or 'sur-tax') to specified income of high earners in 1909 complicated this practice, as companies continued to withhold income at the standard rate, leaving higher rate earners liable to income tax at the higher rate on distributed profits. This created an incentive for taxpayers liable to the sur-tax to defer liability by sheltering income in the corporate form. Accordingly, section 21 of the Finance Act 1922 was introduced to allow the Revenue Commissioners to collect sur-tax from closely-held (i.e. a small number of shareholders) companies in respect of undistributed profits to which the sur-tax would have applied if it had been distributed.

2.2.26 These anti-avoidance provisions were maintained and expanded through the Corporation Tax Act 1976. At present, Part 13 TCA 1997 contains provisions to prevent avoidance or postponement of personal income tax through closely-held companies by imposing a 20% surcharge on undistributed investment and rental income, and a 15% charge on specified undistributed income of service companies (i.e. deriving its income from specified service activities such as carrying on a profession). Closely held companies are defined as companies under the control of five or fewer participators – the definition of company, control, and participators are set out in Part 13 TCA 1997. The quantum of the incentive to defer personal income tax is determined by *inter alia*, the difference between the marginal rate of income tax and the rate of corporation tax and the time value of money (i.e. current and future expected interest and inflation rates). An incentive may also exist to defer income and realise it as a capital gain through the liquidation or sale of a company, or shareholding thereof, depending on the difference between the rate of CGT and PIT.

Incidence of the corporation tax

2.2.27 The statutory incidence of taxes on capital income generally falls on natural persons in the form of personal taxation, whether based on the accrual of income or realisation of gains, of income arising from property, income in the form of interest, business income in an unincorporated business, and on income or gains distributed to the individual by a fund. In contrast, the statutory incidence of a CIT falls on the income of incorporated businesses, as defined by relevant tax law, which will in turn be passed on to natural persons in the form of (i) owners of corporate equity capital or capital in general through lower post-tax returns on corporate equity or capital in general, (ii) labour through decreased wages, or (iii) on consumers or suppliers through increased output prices or decreased input prices (see Box 2.3).

Box 2.3 The incidence of corporate taxation

While the statutory incidence of a CIT falls on taxable incorporated entities, it is generally accepted that the effective incidence falls on one of a combination of owners of corporate equity capital through reductions in post-tax corporate capital income receipts, labour through decreased wages paid by corporations, or on consumers or suppliers through increased output prices or decreased input prices set by corporations, insofar as they are price setters. The degree to which the incidence of CIT is borne by capital or labour is important in determining the efficacy of CIT in redistributing income from recipients of capital income to recipients of labour income, insofar as that is a policy objective of the CIT. This has long been a contested matter given its importance in determining the efficacy of the corporation tax (Seligman, 1927; Edgeworth, 1897).

Economic theory may be a useful guide to establishing the effective incidence of the corporation tax. Public finance theory has utilised, since the 1960s, a competitive general equilibrium model - which describes a competitive market economy where the production, consumption, and exchange decisions of all economic participants leads to the setting of an optimal price across all markets such that the quantity of goods or services supplied equals the quantity of goods and services demanded - to attempt to capture the incidence of taxation (Atkinson & Stiglitz, 1987). The first application of this analysis to the incidence of CIT by Harberger (1962) assumed a closed economy, a fixed stock of capital and labour and factor mobility between sectors, competitive markets and constant returns to scale. Driven by a number of additional assumptions regarding the relative intensity of labour and capital, elasticity of factor substitution within sectors (i.e. a measure of the rate at which capital and labour can substitute for each other), and elasticity of product substitution (i.e. a measure of the rate at which sectors can substitute production between each other), Harberger concluded that all capital - corporate and non-corporate - would bear a large share of the corporate tax burden through a lower post-tax return to capital, with labour bearing a smaller share in lower wages, with consumers suffering no burden due to the capital absorbing or shifting the burden onto labour rather than increase prices (Clausing, 2012). Atkinson & Stiglitz (1987: 197) have noted the difficulties applying the Harberger model empirically, given the restrictive assumptions required.

Adjusting this model to account for, *inter alia*, an open economy, a closer approximation of most national economies since the 1980s, yields different results, depending on the relative international mobility of capital, relative elasticity of international product substitution, size of the country, elasticity of product substitution, and relative intensity of labour and capital. In particular the more mobile international capital and the higher elasticity of substitution between domestic and imported products are assumed to be, the higher the labour share of the incidence of the corporate income tax (Gravelle, 2013). It has been suggested that a modified general equilibrium Harberger model would imply that that a small open economy should not impose a source-based CIT, on the basis that, under conditions of international capital mobility and if the economy is a price-taker in capital markets, firms would only locate in that economy if the prices of the other factors of production were reduced enough to generate a sufficient post-tax rate of return on capital for firms (Gordon, 1986; Frenkel, Razin & Sadka, 1991). However, as Gravelle (2013) notes, a relaxation of an assumption of perfect capital mobility or relative factor substitution results in capital bearing the

larger incidence of corporate taxation. Auerbach (2006) has noted that where the CIT taxes economic rents then the incidence will fall on shareholders, as there will be no shifting of incidence.

Empirical econometric studies may also be used to attempt to capture the incidence of the corporate income tax. Desai, Foley & Hines (2007) used a Bureau of Economic Analysis (BEA) dataset on 52 US Multi-National Enterprises (MNEs) operating in 50 different jurisdictions between 1989 and 2004 from which measures of wage rates, interest rates, profits, and corporate tax rates were extracted, with explanatory variables used to account for wages and interest rates, namely workforce education and the strength of creditor rights. Desai, Foley & Hines found that, applying a number of regressions to the data, between 45 and 75 percent of the incidence of CIT fell on labour. An alternative starting point is to assume that firms and workers bargain to determine wage rates, which adds to the general equilibrium assumption that relative price movements of labour and capital are determined by change in supply and demand. Arulampalam, Devereux, & Maffini (2012) used a firm-level dataset of accounting information of 55,082 companies (the ORBIS dataset), assumed that the size of the labour force and wage rate are determined by bargaining, controlled for the difference in value added across their dataset, and found that in the long run an exogenous \$1 increase in the tax bill tends to reduce real wages at the median by 75 cents.

Gravelle (2011), in a review of the empirical literature, has highlighted the difficulty of using country-level data and controlling for the determinants of wages at an aggregate level, which make it challenging to isolate the impact of CIT changes on wage levels.

2.3 Tax expenditures

2.3.1 Provisions of a tax code may be analysed by reference to whether they form part of a ‘benchmark tax’, or whether they are tax expenditures, which reduce tax obligations of taxpayers with reference to a benchmark tax or, in certain cases, are provided as payable tax credits. Article 14(2) of Council Directive 2011/85/EU (‘the Budgetary Framework Directive’) provides that Member States shall publish detailed information on the impact of tax expenditures on revenues. Regulation 2 of the European Union (Requirements For Budgetary Frameworks of Member States) Regulations 2013 (S.I. No. 508 of 2013) provides for a statutory definition of tax expenditures:

“tax expenditures” means a transfer of public resources that is achieved by—
(a) reducing tax obligations with respect to a benchmark tax rather than by direct expenditure, or

(b) provisions of tax legislation that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to the tax base.

2.3.2 This definition followed that outlined by the OECD in 2010, as the Budgetary Framework Directive did not provide for a definition for tax expenditure (OECD, 2010b). In October 2014 the Department of Finance published *Guidelines for Tax Expenditure Evaluation*, which provides a framework and methodologies for *ex ante* and *ex post* analysis of tax expenditures (Department of Finance, 2014). The guidelines do not recommend a definition for ‘benchmark tax’, noting that it be could defined, at one extreme, as the entirety of the extant system and at the other, against a theoretical tax system so that all relieving provisions are in effect tax expenditures.

2.3.3 To meet the obligations laid down in Article 14(2) of Budgetary Framework Directive the Department of Finance publishes a list of tax expenditures at Budget time, relying on the definition provided for in Regulation 2 of S.I. No. 508 of 2013. This outlines four substantive corporation tax expenditures: (i) the KDB, (ii) R&D Tax Credit, (iii) corporation tax relief for new start-up companies, and (iv) relief for investment in film productions.

Knowledge Development Box

2.3.4 Section 32 of the Finance Act 2015 provided for the introduction of the KDB, a ‘Patent Box’ style tax incentive, which provides for a deduction of up to 50% of profits in respect of qualifying income arising from qualifying assets, namely patents, copyrighted software and, for small and medium-sized enterprises (SMEs), other intellectual property (IP) that is similar to an invention which could be patented. The profits which may avail of the KDB are calculated by reference to the ‘modified nexus’ approach agreed as part of BEPS Action 5. To avail of the deduction, a company must have carried out and incurred expenditure on the research and development, as defined by section 766 TCA 1997 (i.e. the same definition as for qualification for the R&D tax credit), which led to the creation of the qualifying assets. Given the KDB applies to accounting periods commencing on or after 1 January 2016 there is, at present, no detailed information available regarding the number of claims or Exchequer cost.

R&D Tax Credit

2.3.5 Sections 766, 766A and 766B TCA 1997 provide for a tax credit for expenditure, as defined by section 766, on R&D activities, plant and machinery and buildings. The tax credit is provided in addition to the ordinary deduction of R&D as a business expense. Credit is given at 25% of allowable expenditure. Prior to 2012, the qualifying R&D expenditure was reduced in full by the base-year (2003) expenditure in calculating the relief. Finance Act 2012 allowed the first €100,000 of qualifying R&D expenditure to qualify for the credit, regardless of the base year (2003) expenditure. This amount was increased to €200,000 for 2013. Following Budget 2013 and a review of the tax credit, this amount was increased to €300,000 for 2014 (Department of Finance, 2013).

2.3.6 Following Budget 2015, the requirement to subtract base year (2003) R&D expenditure was removed and all qualifying R&D expenditure for accounting periods beginning on or after 1 January 2015 is now eligible for the 25% tax credit. The Department of Finance analysed the effectiveness of the R&D tax credit in encouraging business expenditure on research & development in 2016 (Department of Finance, 2016). It was estimated that of the R&D conducted by firms since 2009, 60% would not have occurred in the absence of the R&D tax credit.

Table 2.3. Exchequer cost (€m) and number of claimants of the R&D tax credit, 2004 - 2015

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Cost (€m)	70.5	65.2	74.7	74.7	146	216.1	223.7	261.3	281.9	421.4	553.3	708
No. of claimants	73	135	141	141	582	900	1,172	1,409	1,543	1,576	1,570	1,532

Corporation Tax relief for new start-up companies

2.3.7 Section 486C TCA 1997 was introduced to provide support to new incorporated businesses in their early years of trading. The relief is granted by reducing the corporation tax payable on the profits of a new trade and gains on the disposal of any assets used for the purpose of that new trade. Prior to amendments made in Finance Act 2011, full relief was available where the corporation tax otherwise payable by the company was €40,000 or less. Marginal relief applied where the corporation tax liability was between €40,000 and €60,000.

2.3.8 Finance Act 2011 modified the relief by linking the quantum of corporation tax relief to the amount of Employers' PRSI paid by a company in an accounting period, subject to a maximum of €5,000 per employee and an overall limit of €40,000. Finance Act 2013 expanded the relief by allowing a carry-forward of any unused relief arising in the first three years of trading, due to losses or insufficient profits, for use in subsequent years. This tax expenditure was extended in 2014 for a further year to allow for a full review of the relief to be carried out. In Budget 2016, following a review of the relief by the Department of Finance it was extended for a further three years to 2019 (Department of Finance, 2015).

Table 2.4. Exchequer cost (€m) and number of claimants of section 486C, 2010 - 2015

Year	2010	2011	2012	2013	2014	2015
Cost (€m)	4.6	6.8	5.5	4.9	4.7	4.8
No. of claimants	872	1284	1270	1038	977	936

Film Relief

2.3.9 Section 481 TCA 1997 provides for relief from corporation tax in the form of a credit to producer companies, as defined by legislation, in respect of the cost of production of certain films. The credit is granted at a rate of 32% of the lowest of: (i) expenditure incurred by the qualifying company on the employment of eligible individuals or on goods, services or facilities within the State on the production of a qualifying film; (ii) 80% of the total cost of production of the film; (iii) or €70 million.

2.3.10 Between 1984 and 1993, film relief was provided as a deduction, at the marginal rate of corporation tax, against investment in the production of certain films. In 1993, film relief was extended to personal income tax. Following an economic impact assessment by the Department of Finance, it was decided to transform the film relief to a corporation tax credit (Department of Finance, 2012). The amended section 481 TCA 1997 came into effect in January 2015. Budget 2016 provided for an increase in the nominal cap from €50 million to €70 million. The Exchequer cost in 2015 was €69.7 million with 1,102 claimants. This includes an element of cost from investors under the previous scheme who had made an application on or before 14 December 2014.

2.4 International features of the corporation tax code

2.4.1 The decision on where to locate the corporate income tax base raises the question of how competing claims to taxable revenue are treated by jurisdictions where, for

example, a residence based tax jurisdiction and source based tax jurisdiction may both claim the same the same profit generated in the source based tax jurisdiction. The current international consensus regarding the appropriate allocation of taxing rights between states is currently contained in the ‘UN Model Double Taxation Convention Model between Developed and Developing Countries’ (‘the UN Model Convention’) and the ‘OECD Model Tax Convention on Income and on Capital’ (‘the OECD Model Convention’) Double Taxation Conventions, which classify types of income or gains and allocate primary taxing rights to that income or gains to one or other of the Contracting Parties to ensure the complete or partial elimination of juridical double taxation, namely where a taxpayer is subject to tax on the same income or capital in two jurisdictions. This consensus arose in the 1920s (see Box 2.4). The OECD and UN Model Conventions reflect the principle that business profits should be taxed at source where the value attributable to economic activity is generated. Ireland has signed 73 bilateral Double Taxation Agreements (DTA), which reflect the OECD and UN Model Conventions, depending on the treaty partner and when the DTA was negotiated.

Box 2.4 Origins of the international tax system

The current international consensus regarding the appropriate allocation of taxing rights between states is contained in the UN Model Convention and the OECD Model Convention. This consensus emerged in the 1920s under the aegis of the League of Nations, established in 1920 as a multilateral body to promote co-operation following the conclusion of World War I, following pressure from the International Chamber of Commerce (ICC), an international business lobby group founded in 1919 to promote trade and investment, open markets, and international capital mobility. The ICC was particularly concerned with juridical double taxation as World War I had necessitated the introduction of new taxes, the expansion of the tax base, and an increase in tax rates, including on forms of corporate income, by the combatant countries.

In 1923, the ICC contemplated that where a source and residence jurisdiction both claimed taxing rights to profits those profits should be taxed once, with taxing rights allocated in proportion to the profits realised in each jurisdiction, and where those jurisdictions could not agree, the profits should be apportioned by reference to sales (Wells & Lowell, 2014). This approach was partially inspired by the arrangements to eliminate juridical double taxation adopted by the successor states to the Austro-Hungarian Empire. However, this model was later eschewed by the League of Nations.

In 1921, the Fiscal Affairs Committee of the League of Nations commissioned four economists, Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp, to examine ‘general Principles which govern international competence in taxation’ (League of Nations, 1923). The report prepared by the four economists in 1923 drew heavily on concepts developed by Edwin Seligman, a strong advocate of a progressive income tax and the ability to pay principle in the field of personal taxation, and adopted the principle that the ‘economic allegiance’ of the taxpayer should form the basis for the allocation of taxing rights. A four-fold test to determine in which jurisdiction economic allegiance lay was proposed comprising of: (i) the origin, or source, of capital or income, (ii) the location of the capital or income, (iii) the place of enforcement of the rights to capital or income, and (iv) the place of residence of the recipient of the income. The report examined four possible methods to relieve juridical double taxation: (i) allocation of all taxing rights to the source jurisdiction, (ii) allocation of all taxing rights to the residence jurisdiction, (iii) a proportional allocation of taxing rights between both source and residence jurisdiction, and (iv) the classification-and-assignment approach, where taxing rights would be allocated between source and residence jurisdictions based on the type of income. On the basis that natural rather than legal persons ultimately bear the effective incidence of taxation, and on the basis of ability to pay principle, the report prepared by the economic experts expressed a preference that taxing rights should be allocated wholly to residence jurisdiction. However, in recognition that the global economy was divided between capital exporting and capital

importing jurisdictions, the report proposed the classification-and-assignment approach as an alternative, and suggested that wealth arising from commercial establishments should be taxed in the country of source.

On foot of the economists' report the legal and technical basis for the allocation of taxing rights between states was prepared by a 'Committee of Technical Experts on Double Taxation and Tax Evasion' appointed by the Fiscal Affairs Committee (League of Nations, 1927). Although the Committee favoured a multilateral convention, it was agreed that Member States' fiscal systems were of such differing designs that a number of model bilateral conventions should be provided for countries to utilise. The model conventions served a dual purpose: to facilitate cross-border trade and investment by relieving individuals and enterprises from double taxation, and to protect national public finances from the effects of double non-taxation. Four draft models were prepared:

- Convention for the Prevention of Double Taxation;
- Convention for the Prevention of Double Taxation in the special matter of Succession Duties;
- Convention on Administrative Assistance in Matters of Taxation; and,
- Convention on Judicial Assistance in the Collection of Taxes.

In October 1928, the League of Nations reached agreement on the draft models presented by the Committee, and the model Convention for the Prevention of Double Taxation ('League of Nations Model Convention') forms the basis of the current OECD, UN and US Model Conventions. The 1928 Model Convention adopted the classification and assignment approach, providing that the source country could retain taxing rights to business profits from any 'industrial, commercial or agricultural undertaking' attributable to economic activity within its jurisdiction. The concept of the permanent establishment (PE) of an enterprise was used to identify whether an enterprise had an economic presence in a jurisdiction and accordingly whether a jurisdiction was permitted, under the terms of a DTA, to exercise taxing rights to that business income.

The 1928 Model Convention was silent on the method used to attribute profit to the PE and affiliated companies. The Committee of Technical Experts had proposed that the PE should be treated as a separate entity for tax accounting purposes but contracting parties were free to provide for other methods, such as formulary apportionment. In 1933, the Draft Convention on the Allocation of Business Income between States for the Purposes of Taxation, approved by the Fiscal Affairs Committee, Articles 3 and 5 of which endorsed separate accounting for PEs and affiliate enterprises respectively, provided that transactions between a PE or affiliate enterprises and connected parties should be priced as if they occurred at arm's length between independent parties.

By the 1930s, the primary principles underlying the international tax system were in place: (i) the beginning of the, albeit slow, growth of bilateral tax treaties based on the classification and assignment of income to either source or resident jurisdictions to relieve juridical double taxation, (ii) the treatment of PE and affiliate enterprises as separate accounting units and the application of the arm's length principle to allocate profit within MNEs between jurisdictions, and (iii) the recognition that the exchange of information and mutual administrative assistance were important principles to ensure the correct allocation of taxing rights and attribution of profits between jurisdictions.

OECD Model Double Taxation Convention on Income and on Capital

- 2.4.2 The Organisation for European Economic Co-operation (OEEC) was established in 1948 to co-ordinate the dispersal of Marshall Plan funds. It was later re-formulated and extended beyond European states in 1961 as the OECD. In 1963, the OECD published an updated draft Model Convention, the Draft Double Taxation Convention on Income and Capital (OECD, 1963). This was later revised by the Committee on Fiscal Affairs of the OECD as the Model Double Taxation Convention on Income and on Capital (OECD, 1977). The 1977 OECD Model Convention has most recently been updated in 2014 (OECD, 2014a).

- 2.4.3 The most relevant articles of the OECD Model Convention for attributing taxing rights to company profits between contracting parties are:
- i. Article 3, which provides for a definition of company as ‘any body corporate or any entity that is treated as a body corporate for tax purposes’ and a definition of enterprise;
 - ii. Article 4, which provides for the assigning of tax residency of a taxpayer to one or other contracting state;
 - iii. Article 5 provides for the definition of ‘permanent establishment’, namely the conditions by reference to which an enterprise in one contracting state will be liable to tax in the other contracting state through its PE;
 - iv. Article 7 provides for the taxation of the business profits of a PE through the treatment of a PE as a separate and independent enterprise;
 - v. Article 9 provides for the adjustment of profits between related enterprises operating in both contracting states where arrangements between the related enterprises do not reflect the arm’s length principle;
 - vi. Articles 11, 12 and 13 provide for the default application of withholding taxes in a source state to dividends, interest and royalties respectively (the current default position is to apply no withholding taxes to royalties);
 - vii. Article 25 provides for the competent authorities in each contracting state to endeavour to resolve by mutual agreement disputes in which a taxpayer believes they have been subject to taxation not in accordance with the Convention that results in double taxation.

UN Model Double Taxation Convention Model between Developed and Developing Countries

2.4.4 Following decolonisation in the 1950s and 1960s, many of the newly independent nation states were largely capital importers and it was recognised that such nations would not sign up to DTAs unless the balance of taxing rights provided for a greater allocation of taxing rights to source countries in such DTAs. On foot of a resolution of the Economic and Social Council of the United Nations in 1967, the Secretary-General of the UN appointed an Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries. The United Nations published the first iteration of the United Nations Model Double Taxation Convention between Developed and Developing Countries in 1980 (UN, 1980).

- 2.4.5 The UN Model follows the classification-and-assignment method but, *inter alia*, provides for:
- i. higher withholding taxes on interest, royalties and dividends than the OECD Model (Articles 11, 12, 13);
 - ii. the deeming of a PE over a broader range of activities than the OECD model (Article 5);
 - iii. for the taxation of business profits in certain circumstances where there is no permanent establishment (Article 7);

- iv. that no correlative adjustment may be made to relieve double taxation in certain circumstances (Article 9);
- v. provides for greater taxing rights of capital gains on land situate in the state (Article 13) (Lennard, 2009).

In broad terms, for a number of types of income the UN model contains a preference for retaining more taxing rights to source countries than the OECD model. Many developing countries utilise the UN Model Convention as the basis for their DTA negotiations. The UN Model Convention was most recently updated in 2011 (UN, 2011).

Eliminating juridical double taxation and cross-border economic double taxation

- 2.4.6 The OECD Model Convention provides for two methods for eliminating juridical double taxation: (i) Article 23A provides for the exemption method, whereby a jurisdiction exempts from taxation certain income or capital where a treaty partner has already taxed such income or capital; (ii) Article 23B provides for the credit method, whereby a jurisdiction deducts from the taxable income or capital of a taxpayer an amount equal to the income or capital taxes paid by that taxpayer to a treaty partner. As Ireland operates a residence-based corporate income tax base the credit method is applied to relieve foreign source income from taxation. Where the Government have concluded a double taxation agreement (DTA) with a foreign jurisdiction relief from tax borne on foreign-source income by Irish resident companies is provided by way of a credit against any Irish tax payable on that income. The rules for computing the operation of the credit on foreign source income are set out in Schedule 24 of TCA 1997. Section 826(2) TCA 1997 provides such rules apply where a DTA is in force. Section 826A TCA 1997 provides that unilateral relief should be given in accordance with Schedule 24 TCA 1997 where no DTA is in place. In this manner juridical double taxation, where a taxpayer is subject to tax on the same income or capital in two jurisdictions, is partially or entirely eliminated.
- 2.4.7 The OECD Model Convention does not prescribe the elimination of cross-border economic double taxation (i.e. the taxation of two taxpayers, in this case the subsidiary entity and its parent entity, on the same income). However, the Commentary on the Model Convention suggests that, where states opt for the credit method under Article 23B, states may provide for a credit for the underlying tax paid by a subsidiary company on the profits distributed (OECD, 2014: 322). Accordingly, the typical Irish treaty provides for a credit on underlying tax, while Schedule 24 TCA 1997 provides for a credit for underlying tax for dividends paid to an Irish parent company from non-treaty jurisdictions.
- 2.4.8 In terms of intra-EU distributions between associated companies, Article 4 of the Directive 2011/96/EU (as amended) ('the Parent-Subsidiary Directive' or 'PSD'), given legal effect by section 831 TCA 1997, provides for the elimination of cross-border inter-associated company economic double taxation through either the credit

or exemption method.⁷ Accordingly, Ireland exempts intercompany distributions between resident companies from the charge to corporation tax, and provides relief via the credit method (including for underlying tax for the purposes of giving effect to the Parent-Subsidiary Directive, the relevant DTA, or unilateral credit) to the Irish resident recipient in the case of cross-border intercompany distributions which fall within the PSD.

2.4.9 In terms of intra-EU payments of interest and royalties between associated companies (defined by reference to a 25% direct holding requirement), Council Directive 2003/49/EC ('the Interest and Royalties Directive') applies to exempt such payments from withholding tax which would otherwise apply. Section 267G TCA 1997 gives effect to the Interest and Royalties Directive in Irish law. Where a Member State applies, under the transitional arrangements outlined in the Interest and Royalties Directive, a withholding tax on interest and royalties, section 267J TCA 1997 provides a credit for the withholding tax charged.

2.4.10 Council Directive 2009/113/EC ('the Mergers Directive'), a codification of previous Directives, is designed to remove fiscal obstacles to cross-border reorganisations involving companies situated in two or more Member States. It is transposed in Irish law in Part 21 TCA 1997 and applies to defer the amount of CGT arising on the disposal of an asset, relating to mergers, divisions, transfers of assets and exchange of shares within the scope of the Directive.

⁷Article 5 of the PSD requires relief to be given in the paying company's Member State by way of exemption – accordingly, the Dividend Withholding Tax does not apply to distributions under the PSD. The PSD was initially introduced as Directive 90/435/EEC and recast in 2011.

3. OVERVIEW OF BEPS ACTIONS

3.1 Context of the OECD/G20 BEPS Project

- 3.1.1 Since the 1920s, the principle of allocating taxing rights has generally been that trading (or ‘active’) income, such as business profits, should primarily be taxed at source (i.e. in the country in which the activity takes place) and that non-trading (or ‘passive’) income should primarily be taxed in the country of residence of the investor, with, in some circumstances, an element of residual taxing rights to passive income being held by the source country through the imposition of withholding taxes. This principle has been formalised through bilateral double taxation treaties, which allocate primary taxing rights between contracting parties to relieve double taxation. Since the 1930s, it has been a principle embedded in double taxation treaties that the pricing of internal transactions between associated enterprises should be subject to the arm’s length principle, which requires that such transactions should be priced as if the enterprises were independent, operating at arm’s length and engaging in comparable transactions under similar conditions and economic circumstances.
- 3.1.2 The internationalisation of capital, trade and financial flows has been facilitated by trade and capital market liberalisation at a global level through multi-lateral organisations such as the World Trade Organisation (WTO) and at a regional level through economic and political blocs such as the EU. These policy changes have been accompanied by reductions in the transport, information and communications costs, partly as a result of technological advances in transport and information and communication technology. As a consequence, MNEs now increasingly produce and supply intermediate goods and services across multiple jurisdictions through Global Value Chains (GVCs) in which value is added to goods and services by MNEs before the supply of the final good or service (OECD, 2013c; OECD, WTO and World Bank Group, 2014).
- 3.1.3 The United Nations Conference on Trade and Development has estimated that 80% of global trade now takes place within MNE GVC networks (UNCTAD, 2013: 135). The fragmentation of the processes involved in the supply of goods and services across borders has increased the complexity of applying corporate income tax to the activities of such MNEs. Moreover, MNEs are now no longer necessarily tied to a particular jurisdiction, with a national identity and corporate headquarters identified within a single country (Desai, 2009). This increasingly globalised business environment in which MNEs operate across multiple borders has challenged the coherence of the source-based corporate income taxation, as the interaction of national tax rules has given rise to opportunities for base erosion, whereby the taxable income of a company in a jurisdiction is reduced, and profit shifting, whereby taxable income is moved from a high-tax jurisdiction to a low-tax jurisdiction.

3.1.4 In light of the challenges to the international tax framework and public controversy regarding the taxation of the profits of MNEs, in September 2013 the leaders of the G20 endorsed the OECD Action Plan to address BEPS (G20, 2013; OECD, 2013b). In October 2015, following two years of work and the participation of more than 60 countries the OECD and G20 released 13 reports covering 15 actions to combat BEPS. The 15 actions aim to (i) restore the coherence of corporate income taxation at the international level by ensuring that the interaction of national rules does not lead to the double non-taxation of corporate income, or less than single taxation, (ii) align the right to tax with corresponding economic substance, and (iii) ensure transparency while promoting increased certainty and predictability.

3.2 Summary of BEPS Actions

3.2.1 The BEPS Actions fall into a number of categories and themes; Actions 2 to 5 aim to restore the coherence of corporate income taxation at the international level by ensuring that the interaction of national rules does not lead to the double non-taxation of corporate income, or less than single taxation, Actions 6 to 10 aim to align the right to tax with corresponding economic substance, Actions 11 to 13 aim to improve tax transparency, Action 14 aims to provide tax certainty for business, Action 1 comprises a report on the digital economy, while Action 15 explored the feasibility of developing a multilateral instrument to update the global network of bilateral tax treaties.

3.2.2 Certain BEPS actions have been agreed as setting new minimum standards which countries are committing to adhere to; other BEPS actions are considered to be best practices, which outline that tax rules that should be implemented in certain areas if countries choose to take action; and other actions are classified as common approaches, where it is expected that, over time, national practices will move towards the approach recommended in the relevant BEPS action.

3.2.3 On foot of the publication of the BEPS reports in October 2015, the European Commission published the Anti-Tax Avoidance Package, which included a number of legislative proposals to implement a number of BEPS actions (European Commission, 2016a). Accordingly, throughout 2016 EU Member States moved to implement a number of BEPS actions through European legislation, including Directive 2016/1164 ('the Anti-Tax Avoidance Directive'), which provides for Actions 2, 3 and 4 and which was further amended in February 2017, and Directive 2016/881 ('DAC4'), which provides for the country-by-country reporting component of Action 13.⁸

⁸ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, O.J. L 193/1; Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, O.J. L 146/8.

BEPS Action 1 – the Digital Economy

- 3.2.4 The BEPS Action 1 Report, *Addressing the Tax Challenges of the Digital Economy*, addressed the challenges posed to the application of international tax rules by the increasing digitisation of the economy, and in particular the difficulties of establishing a nexus with a jurisdiction for tax purposes, the attribution of value to data gathered by companies, and uncertainty regarding characterisation of payments in new business models (OECD, 2015a). The report concluded that no specific direct tax measures should be recommended as it is expected that the BEPS challenges in the digital economy should be addressed by the outcomes of the other BEPS actions. The report also noted that it is not possible to ring-fence the digital economy as the whole economy is beginning to share the characteristics of the digital economy.

BEPS Action 2 – Hybrid Mismatches

- 3.2.5 Part I of the BEPS Action 2 Report, *Neutralising the Effects of Hybrid Mismatch Arrangements*, set out a common set of principles to ensure a common approach to addressing hybrid mismatches (OECD, 2015b). Hybrid mismatch arrangements may occur where differing national tax rules give rise to multiple deductions on a single expense, deductions in one state without corresponding taxation in another, or the generation of multiple foreign tax credits for one amount of foreign tax paid. For example, a financial instrument may be viewed as a debt instrument by the tax law of one state, thus generating a deduction for interest paid, and an equity instrument by the tax law of another, thus generating an exemption for dividends paid (if that state operates a territorial system or exempts receipt of foreign dividends in the hands of a company). Part II examined the interaction of hybrid mismatches and double taxation treaties, including the issue of dual resident entities, namely entities treated as residents of two states for tax purposes, and hybrid entities, namely entities, such as partnerships, which may not be treated as a subject of taxation by one of the two states concerned. The BEPS Action 6 Report contained possible measures to address dual resident entities, such as updating the relevant residency article of DTAs to attribute residency to one or other of the Contracting Parties on a case-by-case basis.

- 3.2.6 Article 9 of the Anti-Tax Avoidance Directive applies to hybrid mismatches between EU Member States and applies in certain situations to prevent the occurrence of either a double deduction or a deduction without corresponding taxation in another Member State. Following the agreement of a proposal to amend the Anti-Tax Avoidance Directive in February 2017 the application of the provisions concerning hybrid mismatches was extended to third countries. This provision must be implemented by 1 January 2020. That element of the BEPS Action 2 Report relating to double taxation treaties is being applied through the Multilateral Instrument described in the BEPS Action 15 Report.

BEPS Action 3 – CFC Rules

- 3.2.7 The BEPS Action 3 Report, *Designing Effective Controlled Foreign Company Rules*, set out a number of recommendations in relation to Controlled Foreign Company (CFC) rules to better achieve international coherency in their application.

CFC rules attribute, under specified circumstances, some or all of the income of a foreign company controlled by shareholders in a parent jurisdiction to the parent jurisdiction and subjects that income to taxation in the parent jurisdiction (OECD, 2015c). CFC rules, first introduced by the US in 1962, are primarily designed as a deterrent to profit shifting.

- 3.2.8 Article 7 of the Anti-Tax Avoidance Directive provides that an entity not subject to tax in a Member State should be treated as a CFC if (i) a company resident in the (parent) Member State has a 50% control over the entity and (ii) if the amount of tax charged on the income of the entity is less than 50% of the tax which would have been charged if the income had been subject to tax in the parent Member State. In these situations, Member States should impose a tax on certain non-distributed passive income of the CFC, subject to a carve-out for substantive economic activity within the EU. Alternatively, a CFC rule based on non-genuine arrangements, as defined, may be chosen. This provision must be implemented by 1 January 2019.

BEPS Action 4 – Limitations on interest deductibility

- 3.2.9 Most states allow the deductibility of interest where it is a trading expense and in certain other cases in their corporation tax codes. The BEPS Action 4 Report, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments*, noted that the interaction of such rules created BEPS risks where MNE groups could (i) attribute higher levels of third party debt to subsidiaries in high tax countries, (ii) use intragroup loans to generate interest deductions in excess of the MNE group's third party interest expense, and (iii) use intragroup or third party financing to fund the generation of tax exempt income (OECD, 2015d). This action identified a common approach and recommended a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage (a range of 10% to 30%) of its earnings before interest, taxes, depreciation and amortisation (EBITDA).

- 3.2.10 Article 4 of the Anti-Tax Avoidance Directive provides, subject to other rules, that a deduction in respect of a net interest expense may not exceed 30% of EBITDA. Although this provision must be implemented by 1 January 2019, there is a possibility to defer it until 1 January 2024, at latest, if Member States have equally effective rules to combat BEPS risks in place already.

BEPS Action 5 – Countering Harmful Tax Practices

- 3.2.11 The Action 5 Report, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, builds on the framework established by the 1998 OECD report *Harmful Tax Competition: An Emerging Global Issue* ('Harmful Tax Competition'), which provided a framework for evaluating whether a feature of a state's corporation tax code constitutes a harmful tax practice (OECD, 2015e). One of the eight factors outlined in the *Harmful Tax Competition* report provides that a preferential regime may be harmful if 'the regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities'. Action 5 focused on the substantial activity requirement in the context of IP regimes, such as 'Patent Box' style tax incentives, and consensus was reached

on the ‘modified nexus’ approach, which uses expenditure incurred by a company as a proxy for substantive activity carried out by the company. As regards tax transparency, a framework for mandatory spontaneous exchange, covering a number of rulings that could give rise to BEPS concerns in the absence of such compulsory spontaneous exchange, has been agreed.

- 3.2.12 The OECD exchange of rulings initiative referred to above was implemented by the Revenue Commissioners with effect from 1 April 2016 and exchanges under this initiative have already commenced. In addition, ‘DAC 3’, which provides for exchange of broader categories of rulings between EU Member States, has been transposed into Irish law by way of the European Union (Administrative Cooperation in the Field of Taxation) (Amendment) Regulations 2016 (SI No. 619 of 2016) and by introducing a new section 891GA TCA 1997 in Finance Act 2016. The first exchanges under the Directive are due to take place by 30 September 2017.

BEPS Action 6 – Treaty Benefits

- 3.2.13 The BEPS Action 6 Report, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, proposed a number of minimum standard changes to the OECD Model Tax Convention, which is widely used as the basis to negotiate double taxation treaties, to prevent the use of double taxation treaties to avoid tax through treaty shopping (OECD, 2015f). Treaty shopping occurs where a person not tax resident in either Contracting State to the treaty attempts to obtain the benefits of the tax treaty. To prevent this, Action 6 proposed amendments to the international network of bilateral tax treaties to either (i) introduce a principle purpose test which denies the benefits of a double taxation treaty where one of the principal purposes of a transaction or arrangement is to obtain treaty benefits, unless granting those benefits would be in accordance with the purpose of the treaty, (ii) introduce a limitation-on-benefits rule which requires entities pass objective tests to avail of treaty benefits, or (iii) a combination of both. These will be given effect through the Multilateral Instrument proposed in Action 15.

BEPS Action 7 – Permanent Establishment

- 3.2.14 Double taxation treaties generally provide that the profits of a foreign enterprise are taxable in a state only to the extent that the enterprise has a PE within the state to which profits may be attributable. The BEPS Action 7 report, *Preventing the Artificial Avoidance of Permanent Establishment Status*, proposed changes to the definition of PE in the OECD Model Tax Convention to prevent the artificial avoidance of PE status (OECD, 2015g). These will be given effect through the Multilateral Instrument proposed in Action 15.

BEPS Actions 8, 9 and 10 – Aligning Transfer Pricing Outcomes with Value Creation

- 3.2.15 Transfer pricing rules are used to determine the conditions for transactions within an MNE group resulting in the allocation of profits to group companies in different jurisdictions for tax purposes. The internationally accepted principle is that such prices should be established as if they occurred at arm’s length such that, as provided for by Article 9 of the OECD and UN Model Tax Conventions, that ‘[when] conditions are made or imposed between... two [associated] enterprises in

their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly’.

3.2.16 Given the complexity of establishing appropriate transfer pricing, the OECD provides an interpretation of the arm’s length principle in its *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, first published in 1995, most recently updated, following Actions 8, 9 and 10, in May 2016 (OECD, 2010a). These Guidelines provide tax authorities and practitioners with a number of suggested methodologies to establish the appropriate pricing outcome dictated by the arm’s length principle.

3.2.17 The increasing importance of intangible assets has raised methodological challenges to correctly attribute profits using transfer pricing, posing BEPS risks, while there were also concerns that transfer pricing rules did not capture the substantive allocation of risk with associated MNE enterprises. The BEPS Actions 8, 9 and 10 Report, *Aligning Transfer Pricing Outcomes with Value Creation*, recommended a number of changes to the Transfer Pricing Guidelines in particular (8) to hard to value intangibles, (9) aligning allocation of risk to actual decision-making and (10) a number of pricing practices which may be used to divert profits (OECD, 2015h).

3.2.18 Ireland introduced transfer pricing rules, applicable to trading profits, gains and losses, based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in place for 2010, through Finance Act 2010. A legislative amendment is required to give effect to updates to the Transfer Pricing Guidelines.

BEPS Action 11 – Measuring and Monitoring BEPS

3.2.19 The BEPS Action 11 Report, *Measuring and Monitoring BEPS*, recommends a number of measures to improve the collection, compilation and analysis of data by OECD Member States.

BEPS Action 12 – Mandatory Disclosure Rules

3.2.20 Action 12 develops recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures. Such rules require the disclosure of potentially aggressive or abusive tax planning arrangements to tax authorities which fall under certain statutory headings, and are designed to (i) obtain early information about potentially aggressive or abusive tax avoidance schemes in order to inform risk assessment, (ii) identify schemes, and the users and promoters of schemes in a timely manner and, (iii) to act as a deterrent, to reduce the promotion and use of avoidance schemes.

3.2.21 Ireland introduced mandatory disclosure rules for national tax planning arrangements through the Finance Act 2010, which are outlined in Chapter 3 of Part

33 TCA 1997, with the Mandatory Disclosure of Certain Transactions Regulations 2011 (S.I. No.7 of 2011) (as amended) providing for procedures relating to the disclosure rules. On foot of a request from the European Council the European Commission prepared a legislative proposal to provide for mandatory disclosure rules which will bring certain international schemes within the scope of (European Commission, 2016b). The draft Directive proposes to amend the Directive on Administrative Co-operation to provide for an obligation for mandatory disclosure of potentially aggressive tax planning schemes with a cross-border element by intermediaries (broadly those designing and promoting such schemes) to national tax authorities, and to ensure that Member States automatically exchange such disclosures with other Member States through the Directive on Administrative Co-operation.

BEPS Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

3.2.22 The Action 13 Report, *Transfer Pricing Documentation and Country-by-Country Reporting*, contains revised standards for transfer pricing documentation and a template for country-by-country reporting of the amount of revenue, profits, taxes and other indicators of economic activities for each tax jurisdiction in which a part of an MNE group, should its group revenue exceed €750 million, is tax resident (OECD, 2015j).

3.2.23 It was recommended that countries introduce country-by-country reporting from 1 January 2016. Ireland introduced this requirement through Finance Act 2015. At EU level, Directive 2016/881 ('DAC4') was agreed to give effect to country-by-country reporting, and Ireland transposed the Directive by amending the already existing provisions for country-by-country reporting through Finance Act 2016.⁹

BEPS Action 14 – Dispute Resolution

3.2.24 Article 25 of the OECD Model Tax Convention provides for a mutual agreement procedure (MAP) through which the competent authorities of the Contracting States may resolve differences regarding the interpretation of the Convention on a mutually-agreed basis. This is important in providing certainty to taxpayers and ensuring the elimination of double taxation as provided for by the provisions of DTAs. The Action 14 Report, *Making Dispute Resolution Mechanisms More Effective*, contained a minimum standard relating to measures to remove obstacles to an effective and efficient MAP that results in timely resolution of disputes and a monitoring mechanism to ensure implementation of the minimum standard (OECD, 2015k). The Action 14 minimum standard has been given effect by the relevant articles of the Multilateral Instrument agreed as part of BEPS Action 15.

3.2.25 The European Commission has proposed a draft Directive on Double Taxation Dispute Resolution Mechanisms in the European Union to provide for a mandatory binding arbitration between Member States, beyond the already existing provisions

⁹ Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, O.J. L 146/8.

for transfer pricing disputes. Political agreement on this Directive was agreed at the ECOFIN Council in May 2017.

BEPS Action 15 – Develop a Multilateral Instrument

3.2.26 The BEPS Action 15 Report proposed that a multilateral instrument be used to implement the treaty-related BEPS actions through the international network of bilateral double taxation treaties (OECD, 2015). In November 2016 over 100 jurisdictions, including Ireland, agreed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, which will amend over 2,000 tax treaties. The Multilateral Instrument provides some flexibility in its application: jurisdictions may specify whether the Multilateral Instrument will not apply to a particularly DTA; jurisdictions may opt to provide for the articles implementing BEPS minimum standards by choosing alternative approaches where the Multilateral Instrument provides that optionality; and, jurisdictions may opt out of provisions which are not BEPS minimum standards. A DTA will only be amended by the Multilateral Instrument when both contracting parties have opted for the same article.

3.2.27 Articles 3 to 5 of the Multilateral Instrument provide for the measures to address hybrid mismatches identified by the BEPS Action 2 Report. Articles 6 to 11 contain the results of the work of the BEPS Action 6 Report, aimed at preventing the granting of treaty benefits in inappropriate circumstances. Articles 12 to 15 provide for the recommendations outlined in the BEPS Action 7 Report regarding measures to prevent the artificial avoidance of PE status. Articles 16 and 17 give effect to the minimum standards for dispute resolution contained in the BEPS Action 14 Report. Articles 18 to 26 provide for the mandatory binding arbitration of MAP cases in which the competent authorities are unable to reach agreement within a fixed period of time.

3.2.28 On 7 June 2017, 68 jurisdictions signed the Multilateral Instrument, with more jurisdictions indicating that they intended to sign. At that time, the OECD published a detailed list outlining the extant DTAs which they seek to cover in the Multilateral Instrument, the list of expected reservations jurisdictions may seek to apply, and the notification of which optional provisions, where they apply, have been chosen. The Department of Finance published a list of Ireland’s positions as of 7 June 2017 which is outlined below. Ratification of the Multilateral Instrument will be a matter for the Oireachtas.

Table 3.1. Ireland’s approach to the Multilateral Instrument as of 7 June 2017.

Tax Treaties covered		
Provision in the Convention	Ireland’s approach	Commentary
Article 2 – Covered Tax Agreements	Include 71 of Ireland’s existing tax treaties	Ireland will include 71 of our bilateral tax treaties which are in effect as being covered by the convention. It has been bilaterally agreed to exclude one existing treaty which is currently being renegotiated.

BEPS Action 2 – Hybrid Mismatch Arrangements		
Provision in the Convention	Ireland’s approach	Commentary
Article 3 - Transparent Entities	Adopt Article 3(1) and Reserve on Article 3(2)	Article 3(1) introduces a useful provision to ensure a consistent tax treaty treatment when countries classify entities differently, as being transparent or opaque. Ireland intends to reserve on Article 3(2) due to concerns about significant uncertainty as to how the provision in paragraph 2 would be applied in practice.
Article 4 – Dual Resident Entities	Adopt	Ireland intends to adopt the new best practice rule in Article 4 on determining tax residence for dual resident entities.
Article 5 – Application of Methods for Elimination of Double Taxation	Reserve	Article 5 relates to methods to address problems where a country uses the exemption method to relieve foreign tax. Ireland adopts the credit method for eliminating double taxation as opposed to the exemption method, and therefore intends to reserve on this article.

BEPS Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances		
Provision in the Convention	Ireland’s approach	Commentary
Article 6 – Purpose of a Covered Tax Agreement	Adopt	Article 6 introduces a new preamble into tax treaties to confirm that the intention of the treaties is to prevent double taxation while not facilitating double non-taxation. Ireland intends to adopt this article.
Article 7 – Prevention of Treaty Abuse (This is a minimum standard)	Adopt Principal Purpose Test	Ireland intends to adopt the Principal Purpose Test (PPT) provided for in Article 7. This will introduce this general anti-avoidance clause into any treaty where the treaty partner also chooses the PPT option.
Article 8 – Dividend Transfer Transactions	Adopt	Ireland intends to adopt the anti-avoidance rule in Article 8 requiring a minimum holding period to be met before certain reduced rates on dividends are available.
Article 9 – Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property	Adopt	Ireland intends to adopt the anti-avoidance rule in Article 9 which is designed to prevent the use of companies and other entities to artificially avoid capital gains tax on the sale of real property.
Article 10 – Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions	Reserve	Article 10 provides anti-avoidance rules to target certain arrangements where foreign branch profits are exempt from tax. Ireland does not exempt such profits and therefore intends to reserve on this article.
Article 11 – Application of Tax Agreements to Restrict a Party’s Right to Tax its Own Residents	Reserve	Ireland intends to reserve on the “savings clause” provided for in Article 11. Ireland does not believe such a clause is necessary and

		it is not a standard part of our tax treaty policy to seek such clauses.
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BEPS Action 7 – Artificial Avoidance of Permanent Establishment Status		
Provision in the Convention	Ireland’s approach	Commentary
Article 12 – Artificial Avoidance of Permanent Establishment Status through <i>Commissionnaire</i> Arrangements and Similar Strategies	Reserve	Article 12 introduces a new test for when an agent can constitute a permanent establishment (i.e. a taxable presence). Work is still underway at OECD level to determine what profits, if any, would be attributable to new permanent establishments created under this new test. Ireland intends to reserve on Article 12 due to continuing significant uncertainty as to how the test would be applied in practice.
Article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions	Adopt Option B and the Anti-fragmentation rule	Article 13 provides two options to clarify how certain exemptions from the permanent establishment test are to be interpreted. Option B is consistent with Ireland’s longstanding interpretation of the provisions and Ireland intends to adopt this option. Ireland intends to also adopt the anti-fragmentation rule in Article 13(4) which is designed to prevent corporate groups from fragmenting a cohesive operating business into several small operations in order to avail of these exemptions.
Article 14 – Splitting-up of Contracts	Adopt	Ireland intends to adopt the Article 14 anti-avoidance rule which is designed to prevent contractual arrangements being done in a manner which artificially prevents a long standing building site from being classified as a permanent establishment.
Article 15 – Definition of a Person Closely Related to an Enterprise	Adopt	Article 15 introduces a definition for the term “person closely related to an enterprise”. Ireland intends to adopt this article as the definition is relevant for the interpretation for Articles 13 and 14.

BEPS Action 14 – Improving Dispute Resolutions		
Provision in the Convention	Ireland’s approach	Commentary
Article 16 – Mutual Agreement Procedure	Adopt	Article 16 sets out standard time limits and procedural rules for how disputes under tax treaties should be dealt with. Ireland intends to adopt this article.
Article 17 – Corresponding Adjustments	Adopt	Article 17 provides for countries to unilaterally adjust the amount of tax paid by a taxpayer in certain cases. It is intended to provide a more efficient mechanism to resolve certain

		disputes, and Ireland intends to adopt this article.
Articles 18 – 26 (Part IV) - Arbitration	Adopt Part IV	<p>Part IV deals with mandatory binding arbitration. Countries must first decide whether to opt into Part IV and, if they do, they must adopt or reserve on a number of articles dealing with how arbitration would work.</p> <p>Ireland intends to opt into Part IV as mandatory binding arbitration provides an important mechanism for ensuring disputes are resolved and that double taxation does not arise. Within the various articles, Ireland is open on the type of arbitration that is used. Ireland generally supports arbitration being available wherever possible except where:</p> <ul style="list-style-type: none"> • the issue has been decided by a Court, • the case involves domestic anti-abuse rules, or • the taxpayer may be liable to penalties as a result of “deliberate behaviour”.

Source: Department of Finance.

Table 3.2 Current state of play on achievement of BEPS Actions, June 2017.

NO.	Action	OECD Recommendation	Classification of Recommendation	Steps taken	Timeline
1	Address the Tax Challenges of the Digital Economy	Given many of the issues raised went beyond BEPS issues it was agreed that OECD and G20 countries would continue to monitor developments.	Report	Options to be considered further	2020
2	Neutralise the Effects of Hybrid Mismatch Arrangements	To pursue a common approach through domestic and treaty changes to prevent double non-taxation by eliminating the tax benefits of mismatches and to put an end to costly multiple deductions for a single expense, deductions in one country without corresponding taxation in another, and the generation of multiple foreign tax credits for one amount of foreign tax paid.	Common Approach	Article 9 of Directive 2016/1164 (the 'Anti-Tax Avoidance Directive' or 'ATAD')	Must be transposed by 31 December 2019 (Finance Act 2019). For some elements by 1 January 2022 (Finance Act 2021).
3	Strengthen CFC Rules	Sets out a number of recommendations with the aim of attributing certain income earned by CFCs to the controlling company.	Common Approach	Article 7 of Directive 2016/1164 ('ATAD')	Must be transposed by 31 December 2018 (Finance Act 2018).
4	Limit Base Erosion via Interest Deductions and Other Financial Payments	Recommends a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage (a range of 10% to 30%) of its EBITDA.	Common Approach	Article 4 of Directive 2016/1164 ('ATAD') - limit of 30% of EBITDA	Must be transposed at the latest by 1 January 2024 (Finance Act 2023).
5	Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance	Sets out a minimum standard based on an agreed methodology to assess whether there is substantial activity in a preferential regime and in particular consensus was reached on a 'modified nexus' approach to better align tax benefits with the location of R&D expenditure. Provide for a framework for compulsory spontaneous exchange of certain tax rulings.	Minimum Standard	KDB prepared in line with 'modified nexus' approach; Ireland participates in the exchange of information under OECD framework; Directive (EU) 2015/2376 provides for exchange of rulings.	Completed.
6	Prevent Treaty Abuse	Changes have been made to OECD Model Tax Convention to prevent abuse through Treaty shopping and the inadvertent prevention of the application of domestic anti-avoidance rules amongst other changes.	Minimum Standard	Articles 6 to 11 of the Multilateral Convention will apply, where applicable, throughout Ireland's DTA network.	Multilateral Convention must be ratified by the Oireachtas through primary legislation.

7	Prevent the Artificial Avoidance of PE Status	Amendment to the definition of PE in the OECD Model Tax Convention to ensure firms are taxed where substantive economic activity takes place.	Updated international standard	Articles 12 to 15 of the Multilateral Convention will apply, where applicable, throughout Ireland's DTA network.	Multilateral Convention must be ratified by the Oireachtas through primary legislation.
8, 9, 10	Assure that Transfer Pricing Outcomes are in Line with Value Creation	Recommends a number of changes via Transfer Pricing Guidelines in particular to (8) hard to value intangibles, (9) aligning allocation of risk to actual decision-making and (10) a number of pricing practices which may be used to divert profits.	Updated international standard	Updated Transfer Pricing Guidelines were agreed by OECD Council on 23 May 2016.	Part 35A of TCA 1997 will need to be amended to provide for application of 2017 OECD Transfer Pricing Guidelines in domestic legislation.
11	Measuring and Monitoring BEPS	Recommends measures to improve collection, compilation and analysis of data by OECD Member States.	Report	A new publication by the OECD of 'Corporate Tax Statistics' is being prepared.	Ongoing engagement.
12	Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements	Provides a modular framework of guidance drawn from best practices for use by countries with and without mandatory disclosure rules.	Best practice recommendation	Chapter 3 of Part 33 TCA1997 applies to domestic aggressive tax planning arrangements; European Commission to bring forward proposal for a Directive.	European Commission has brought forward a draft Directive to provide for mandatory disclosure of certain cross-border arrangements.
13	Re-examine Transfer Pricing Documentation and implement Country-by-Country Reporting (CbCR)	Contains a three-tiered standardised approach to transfer pricing documentation, including a minimum standard on Country-by-Country Reporting.	Minimum Standard for Country by Country Reporting/Common approach for Transfer Pricing	Section 891H TCA 1997 introduced by section 33 of Finance Act 2015; EU are proposing public country-by-country reporting to include tax paid.	Additional amendments for Finance Bill 2016 to take account of DAC4; Transfer Pricing Documentation to be examined in light of Actions 8,9 and 10
14	Make Dispute Resolution Mechanisms More Effective	Introduces measures to reduce uncertainty for firms on double taxation and improve dispute resolution.	Minimum Standard	Articles 16 to 26 of the Multilateral Convention will apply, where applicable, throughout Ireland's DTA network.	Multilateral Convention must be ratified by the Oireachtas through primary legislation. Directive on mandatory binding arbitration agreed by ECOFIN Council May 2017.
15	Develop a Multilateral Instrument	Develop a multilateral instrument to implement the BEPS treaty-related measures and amend bilateral tax treaties.	Further work being carried out to implement tax treaty BEPS recommendations	Signed on 7 June 2017.	Multilateral Convention must be ratified by the Oireachtas through primary legislation.

4. ENSURING THAT THE CORPORATION TAX CODE DOES NOT PROVIDE PREFERENTIAL TREATMENT TO ANY TAXPAYER

4.1 Introduction

4.1.1 The terms of reference provide that the review should ensure that the corporation tax code does not provide preferential treatment to any taxpayer. A feature of the corporation tax code may be considered preferential if it offers a tax preference in comparison with the general principles of the code. Given the breadth of this definition there are any number of features within any tax code which may be considered as providing preferential treatment to a taxpayer. Specified computation rules may be applied to specified types of companies identified in statute or to specified trades. For example, Part 23 TCA 1997 provides that companies engaged in the trade of farming are subject to slightly different computational rules regarding, *inter alia*, losses and capital allowances, while Chapter 3 of Part 25 TCA 1997 provides that societies registered under the Industrial and Provident Societies Acts 1893 to 2014, such as cooperative societies, have specified rules applied for the deductions of certain expenses. Accordingly, it is important to ensure that such preferential treatment is justified from a policy perspective and is not actively harmful or constituting harmful tax competition.

4.1.2 The criteria applied by both the OECD Forum on Harmful Tax Practices (FHTP) and the EU Code of Conduct for Business Taxation to identify a potentially harmful tax regime provide the internationally accepted criteria for identifying whether features of the tax code constitute harmful tax competition.

4.2 OECD Forum on Harmful Tax Practices

4.2.1 The OECD FHTP was established on the instruction of the OECD Council following the publication of 'Harmful Tax Competition: An Emerging Global Issue' (hereafter '*Harmful Tax Competition*') by the OECD in 1998, which was prepared at the request of OECD and G7 Ministers (OECD, 1998). The 1998 Report established a number of measures to evaluate harmful tax practices and to identify tax havens. The work of the FHTP focuses on whether a tax regime constitutes a harmful preferential regime. Identifying whether a regime is potentially harmful involves three stages: (i) consideration of whether a regime is preferential and whether it falls within the scope of the FHTP; (ii) consideration of the four key factors and eight other factors identified by the *Harmful Tax Competition* report as determining whether a preferential regime is potentially harmful; and (iii) consideration of the economic effects of a preferential regime to determine whether it is actually harmful.

4.2.2 A tax regime is considered preferential if it offers a tax preference in comparison with the general principles of taxation of the relevant jurisdiction. The scope of FHTP extends to income from geographically mobile activities - such as, *inter alia*, shipping company regimes, banking regimes, insurance regimes, financing and

leasing regimes, fund management regimes, headquarters regimes, distribution centre regimes, service centre regimes, IP regimes, and holding company regimes - and so focuses on corporate income taxes in particular. The four key factors outlined in the *Harmful Tax Competition* report are: (i) the regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities; (ii) the regime is ring-fenced from the domestic economy; (iii) the regime lacks transparency (for example, the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure); and (iv) there is no effective exchange of information with respect to the regime. The eight other factors are (i) an artificial definition of the tax base; (ii) failure to adhere to international transfer pricing principles; (iii) foreign source income exempt from residence country taxation; (iv) a negotiable tax rate or tax base; (v) existence of secrecy provisions; (vi) access to a wide network of tax treaties; (vii) the regime is promoted as a tax minimisation vehicle; and (viii) the regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities.

- 4.2.3 In assessing whether a preferential tax regime within the scope of the FHTP is actually harmful regard is had to whether (i) a tax regime shifts activity from one country to the country providing the preferential tax regime, rather than generating significant new activity, (ii) the presence and level of activities in the host country are commensurate with the amount of investment or income, and (iii) the preferential tax regime is the primary motivation for the location of an activity.

4.3 The EU Code of Conduct

- 4.3.1 The EU Code of Conduct for Business Taxation ('the EU Code of Conduct') was agreed by the EU Council in December 1997, and represents a non-binding instrument designed to assist Member States in removing existing measures which constitute harmful tax competition and to refrain from introducing such measures in the future.¹⁰ The Code of Conduct Group (Business Taxation) assesses measures which may constitute harmful tax competition under the criteria outlined in the EU Code of Conduct. The EU Code of Conduct follows a similar process to the *Harmful Tax Competition* report in identifying whether a business tax measure is potentially harmful: (i) a business tax measure, whether legislative or administrative will fall within the scope of the EU Code of Conduct if it significantly affects the location of business activity within the EU; (ii) if the business tax measures provide for a significantly lower effective rate of tax than the levels which generally apply in a Member State then they are considered potentially harmful and fall within the scope of the EU Code of Conduct; and (iii) in assessing whether such measures are harmful the EU Code of Conduct provides that account should be taken of (a) whether tax advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, (b) whether tax advantages are ring-

¹⁰Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy - Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation - Taxation of saving, O.J. C 2.

fenced, (c) whether tax advantages are granted even without real economic activity or substantial economic presence within the Member States offering the tax advantage, (d) whether the rules for profit determination in respect of economic activities within an MNE group depart from internationally accepted principles, namely transfer pricing rules, and (e) whether the measures lack transparency.

4.4 History of preferential regimes in Ireland

- 4.4.1 Prior to 1997, for the purpose of attracting inward investment, Ireland operated what would be, and came to be, considered potentially harmful preferential tax regimes, namely, ESR, ‘Shannon Relief’, and manufacturing relief, which was subsequently extended beyond manufacturing activities. These regimes also came to be considered as State aid under the European Treaties, although as previously noted the manufacturing relief was initially considered by the European Commission not to constitute a State aid. State aid and potentially harmful preferential tax regimes are two different concepts: State aid is a matter of European Union law and the test for whether a measure constitutes State aid derives from the *acquis communautaire*, specifically originating in Articles 107 and 108 of the Treaty on the Functioning of the European Union (TFEU), which provides that an aid granted by a Member State to an undertaking or undertakings which represent a selective advantage and distorts competition shall be considered incompatible with the internal market, whereas the criteria for a potentially harmful preferential tax regime or a potentially harmful measure are outlined respectively by the *Harmful Tax Competition* report and the EU Code of Conduct.
- 4.4.2 The manufacturing relief, and manufacturing relief as it applied to the IFSC and the Shannon Airport area, were identified by the report presented by the Code of Conduct Group to the ECOFIN Council on 29 November 1999 (the ‘Primarolo Report’) as measures having potentially harmful features under the Code, and it was noted that the measures were being phased out.
- 4.4.3 A number of progress reports and guidance documents were prepared on foot of the *Harmful Tax Competition* report. The first progress report identified 47 potentially harmful regimes and 35 jurisdictions which met the criteria of tax haven (OECD, 2001). This report identified the application of manufacturing relief to the IFSC and Shannon Relief as potentially harmful preferential tax regimes. A second report focused on tax havens and the role of effective exchange of information and tax transparency. Additional reports issued in 2004 and 2006 focused on progress made in respect of the preferential regimes identified in the first progress report, and noted that the potentially harmful preferential regimes identified in the first progress report had been abolished (OECD, 2004 & 2006). The Centre for Tax Policy and Administration of the OECD provided additional guidance regarding the application of the *Harmful Tax Competition* report between 2000 and 2004, which is now contained in a Consolidation Application Note (OECD, 2004).

4.5 Current Preferential Regimes

4.5.1 Chapter 4 of the Report on BEPS Action 5 described the work carried out by the FHTP on preferential tax regimes for income arising from certain qualifying IP ('IP regimes' or 'Patent Boxes'). The last of the eight factors outlined in the *Harmful Tax Competition* report provides that a preferential regime may be harmful if 'the regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities'. Three approaches to ensure access to an IP regime met the substantive activity requirement were examined: (i) to require the taxpayer to undertake a specified number of development activities to access the IP regime; (ii) to allow access to the IP regime only to the extent that the taxpayer undertakes functions, assumes risks, and owns assets related to the income in question; or (iii) to use expenditure incurred by the taxpayer as a proxy for substantive activity carried out by the taxpayer and allow access to the IP regime on the basis of the expenditure actually carried out (the 'nexus' approach). Agreement was reached on the 'modified nexus' approach which set the appropriate formula to establish the income which may benefit from an IP regime (OECD, 2015n):

$$\frac{\text{Qualifying expenditure incurred to develop IP asset}}{\text{Overall expenditure incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

It was also agreed that qualifying expenditure could be subject to an uplift of up to 30% to take account of the acquisition costs (if any) of the IP or outsourcing costs.

4.5.2 The Irish IP Regime, the KDB, introduced through Finance Act 2015, is provided for in Chapter 5 of Part 29 TCA 1997 and follows the 'modified nexus' approach. The KDB provides for a 50% reduction of qualifying profits (the income receiving the KDB benefits) arising from specified trades relating to a specified IP asset. This results in an effective rate of corporation tax of 6.25% on such qualifying profits. To avail of the KDB a company must have incurred qualifying expenditure wholly and exclusively on the R&D which led to the development of the IP asset. Overall expenditure on the qualifying IP asset includes, in addition to qualifying expenditure, acquisition costs of the IP asset and group outsourcing costs. The KDB allows for an uplift on qualifying expenditure of the lower of 30% of qualifying expenditure or the total of acquisition costs and group outsourcing costs.

4.5.3 The FHTP evaluated the KDB to determine whether it was compliant with the *modified nexus* standard and, therefore, not a harmful preferential tax regime. The KDB was approved by the FHTP on 2 November 2016. The KDB was also evaluated by the EU Code of Conduct (Business Taxation) Group, to establish whether it was compliant with the *nexus* standard and not a potentially harmful tax regime. The Code of Conduct (Business Taxation) Group concluded that the KDB was not harmful, as confirmed in their report to the June 2017 ECOFIN Council meeting.

4.6 Recommendations

- 1) Any proposed measures should be carefully scrutinised to ensure that they do not (i) constitute a potentially harmful preferential tax regime, as identified by the OECD Forum on Harmful Tax Practices, or (ii) a potentially harmful tax regime, as identified by the EU Code of Conduct for Business Taxation.

5. ACHIEVING THE HIGHEST STANDARDS IN TAX TRANSPARENCY

5.1 Introduction

- 5.1.1 The ability of tax authorities to collect and share information is necessary to ensure the correct allocation of taxing rights and attribution of profits across borders, and concomitantly the collection of all taxes legally owed. The rise in fiscal deficits in 2008 and 2009 led states to become increasingly concerned with restoring fiscal capacity through, *inter alia*, exercising taxing rights which had been eroded by tax evasion or aggressive tax planning. Consequently, since 2008 there has been a step-change in international efforts by the G20 and OECD, and by the EU, to improve transparency in tax matters through the effective collection and exchange of information for tax purposes.
- 5.1.2 From 2009, concerted efforts were made to improve the effective sharing of financial account information, particularly by jurisdictions with bank secrecy laws, and to identify those jurisdictions which were non-cooperative. The US introduced the Foreign Account Tax Compliance Act (FATCA) in 2010, as part of the Hiring Incentives to Restore Employment (HIRE) Act, to require the provision by non-US financial institutions of information on financial accounts held by US citizens, residents, and certain US-resident legal persons. The automatic exchange of this information has been provided for by Inter-Governmental Agreements between the US and other jurisdictions which provided for the reciprocal exchange of the financial account information.
- 5.1.3 Since 2009, the re-named and re-purposed Global Forum on Transparency and Exchange of Information for Tax Purposes ('Global Forum') has become the key international body working to ensure the implementation of internationally agreed standards for the exchange of information on request. Following a request from the G20 in 2009 the Convention on Mutual Administrative Assistance in Tax Matters ('MAATM'), a multilateral agreement which facilitates, *inter alia*, the exchange of information on request, spontaneously, or automatically, has been expanded and now has 111 participating jurisdictions. In 2014, on the request of the G20, the OECD prepared a new Common Reporting Standard ('CRS') for the automatic exchange of financial account information. On foot of the preparation of the CRS, the EU amended the Council Directive 2011/16/EU (the 'Directive on Administrative Co-operation' or 'DAC1') to provide for the collection and automatic exchange of financial account information between Member States.¹¹ A Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS MCAA) has been developed to govern the automatic exchange of financial account information under MAATM.

¹¹ Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, O.J L 64/1.

- 5.1.4 To achieve an improvement in tax transparency, Action 5 of the BEPS Action Plan set out an agreed OECD framework for the compulsory spontaneous exchange of information on six types of taxpayer-specific rulings, Action 12 provided best practice recommendations regarding the design of mandatory disclosure rules, and Action 13 set out a minimum standard for the exchange of MNE CbC reports providing a set of indicators for economic activities for each country in which an MNE is active (OECD, 2015e; OECD, 2015i; OECD, 2015j). The EU has acted to implement BEPS Action 5 and the CbCR element of BEPS Action 13 on an EU-wide basis, through amendments to the Directive on Administrative Co-operation. On foot of BEPS Action 12, the European Commission have recently brought forward proposals for European legislation providing for mandatory disclosure rules to apply to cross-border schemes.
- 5.1.5 The terms of reference of the review provide for the following matter: ‘achieving the highest international standards in tax transparency, including in the automatic exchange of information on tax rulings with other relevant jurisdictions, having regard to benefits which may accrue to developing countries from enhancing global tax transparency’. This chapter identifies current methods to achieve transparency, the extant international standards in tax transparency established by the EU, OECD, G20, and the Global Forum, and identifies and evaluates the provisions of the Irish corporation tax code which relate to tax transparency and exchange of information.

5.2 Defining tax transparency

- 5.2.1 The definition of tax transparency used for the purpose of the review has been chosen to reflect the terms of reference of the review, recent efforts to improve transparency in tax matters by the EU, OECD, G20, and the Global Forum, and the internationally agreed objective of aligning taxing rights to corporate profits to economic substance: the purpose of transparency in tax matters is to ensure that taxpayers, citizens and state authorities have the appropriate information regarding the operation of legislative, legal or administrative provisions in a jurisdiction to (i) facilitate the collection of all tax owed by legal and natural persons in accordance with national and international law and the internationally agreed consensus regarding the appropriate allocation of taxing rights, and (ii) to ensure that harmful tax practices, as agreed by international norm-setting institutions such as the OECD, are not being facilitated by the operation of such provisions.
- 5.2.2 This definition is necessarily restrictive – it is acknowledged that there is disagreement amongst stakeholders regarding the purpose of tax transparency and consequently the methods used to achieve it. The restrictive definition reflects the current international consensus, as agreed at the OECD as part of the BEPS process and contained in extant European legislation, which more closely follows the terms of reference of the review. A more expansive view of the purpose of tax transparency regards it both as a good in itself and a way in which to influence taxpayer behaviour through enforcement of conformity to social norms regarding the appropriate structuring and payment of tax, and in particular by MNEs as

regards their appropriate liability to corporate income tax in developing countries. Advocates of this perspective propose the publication of certain categories of taxpayer information.

5.3 Methods to achieve tax transparency

Effective exchange of information for tax purposes

5.3.1 The methods used to facilitate tax transparency include the appropriate availability of, appropriate access to, and effective exchange of information between tax authorities for tax administration purposes, as provided for in national and international law. Exchange of information for tax purposes may be either of the following:

- i. **Exchange of information on request (EOIR):** The internationally agreed standards for EOIR are contained in the 2002 *OECD Model Agreement on Exchange of Information on Tax Matters* and its commentary, which provides a model for a bilateral or multilateral agreement providing for the effective EOIR (OECD, 2002b). Since 2005, the internationally agreed standard provides that parties to a bilateral or multilateral instrument to facilitate EOIR ‘provide assistance through exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the parties to the instrument, and that ‘such information shall include information that is foreseeably relevant to the determination, assessment and collection of such taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters’.
- ii. **Spontaneous exchange of information (SEOI):** An SEOI may occur where a party to a bilateral or multilateral agreement providing for the exchange of information provides information to the other party that is foreseeably relevant to that other party but which has not been previously requested. There may be a legal obligation to provide for SEOI: Article 9 of DAC provides that a Member State should undertake an SEOI where there are grounds to suppose that there may be tax loss to another Member State.
- iii. **Automatic exchange of information (AEOI):** AEOI occurs where information is exchanged periodically without a specific request. Internationally agreed standards for the automatic exchange of financial account information are contained in the *Standard for Automatic Exchange of Financial Account Information in Tax Matters* (OECD, 2017), which provides for a Common Reporting Standard (CRS) and a Model Competent Authority Agreement. AEOI also places obligations on private sector institutions, including financial institutions in the case of exchange of financial account information and MNEs in the case of CbCR, to collect and provide information to tax authorities for collation and automatic exchange.

Legal basis for information exchange

5.3.2 An exchange of information may only occur under the relevant legal instrument, which for an EU Member State such as Ireland, may be European legislation, the relevant exchange of information article of a (DTA, a multilateral convention, a Tax Information Exchange Agreement (TIEA), or another form of legal instrument. The following legal instruments facilitate the exchange of information:

- i. **Double Taxation Agreements:** Article 26 of the OECD and UN Model Double Taxation Conventions provides a model for exchange of information in DTAs. The 72 DTAs concluded between Ireland and other jurisdictions provide for a relevant exchange of information article, usually based on the extant model OECD or UN Model Convention of the day. DTAs are given effect in Irish law through section 826(1) TCA 1997;
- ii. **Council Directive 2011/16/EU:** Council Directive 2011/16/EU ('the Directive on Administrative Co-operation' or 'DAC1') (as amended by Council Directives, 2014/107/EU, (EU) 2015/2376, (EU) 2016/881) provides for AEOI regarding a broad range of categories of income and assets and also provides for the automatic exchange of financial account information based on the CRS; for SEOI where there are grounds to suppose that there may be tax loss to another Member State; for AEOI of cross-border tax rulings and advance pricing agreements (APA); and for AEOI of CbCR of MNEs. The Directive on Administrative Co-operation is binding on all Member States.
- iii. **Tax Information Exchange Agreements:** TIEA are based on the OECD Model Agreement on Exchange of Information in Tax Matters providing for EOIR. Ireland has signed 25 TIEAs.
- iv. **The Convention on Mutual Administrative Assistance in Tax Matters:** The MAATM provides for administrative assistance in tax matters between parties including the exchange of information, assistance in recovery and the service of documents. As regards the exchange of information MAATM provides for EOIR, SEOI, simultaneous tax examinations and, where parties agree, AEOI. MAATM is given effect in Irish law through the Mutual Assistance in Tax Matters Order 2013 (S.I. No. 34 of 2013).
- v. **Intergovernmental Agreement with the United States to implement the Foreign Account Tax Compliance Act (FATCA):** To implement FATCA, the US has signed a series of Inter-governmental Agreements with other jurisdictions to facilitate the exchange of financial account information.

Table 5.1. Number of exchanges of information on request, spontaneous exchanges of information, and automatic exchanges of information, 2012 – 2016

	EOIR		SEOI		AEOI (Treaty Only)*	
	Requests received	Requests sent	Received	Sent	Received	Sent
2012	164	94	47	12	25	21
2013	196	81	46	8	18	42
2014	226	98	53	8	21	0**
2015	267	98	46	7	13	38
2016	218	72	168	16	14	22

Source: Revenue Commissioners.

*The Automatic exchanges included above represent the number of times Ireland exchanged bulk information, such as details of refunds of taxes or exemptions granted to residents of other jurisdictions, and exchanged under the provisions of a DTA. ** Due to technical difficulties Ireland did not send automatic exchanges in 2014 (under a Treaty). These were subsequently sent in 2015 and are included in the 2015 figures above.

Double Taxation Agreements

- 5.3.3 Article 26 of the 1963 OECD Model Convention, which was to provide the basis for intra-OECD tax treaties, contained a limited provision, namely to provide for the exchange of information ‘necessary for the carrying out of the Convention and of the domestic laws of the Contracting States concerning taxes covered’ by the Convention (OECD, 1963). This was revised following the publication of the *OECD Model Agreement on Exchange of Information on Tax Matters* in 2002, and further revised in 2005. Article 26 now covers information that is ‘foreseeably relevant’ rather than ‘necessary’ and provides that when information is requested the other party shall use its information gathering measures to collect the information, notwithstanding that the other state may not need the information (OECD, 2002b; OECD, 2014). Article 26 of the UN Model Convention reflects the wording of the OECD Model Convention with a number of changes, and was updated in 2008 to reflect the *Agreement on Exchange of Information in Tax Matters* (UN, 2011).

Convention on Mutual Administrative Assistance in Tax Matters

- 5.3.4 The Convention on Mutual Administrative Assistance in Tax Matters (‘MAATM’), developed in 1988 by the OECD and Council of Europe, provides for exchange of information (automatic, spontaneous and on request) for all taxes – direct and indirect – including multilateral simultaneous tax examinations, and for assistance in collection of taxes. Following a request by the G20 in 2009, the MAATM was amended and open to signature for all countries from 1 June 2011. 111 jurisdictions currently participate in the MAATM, including all G20 members and all OECD members.

European Union: Directives on Administrative Co-operation

- 5.3.5 The EU first introduced legislative provisions to exchange tax information and facilitate co-operation in the recovery of outstanding tax between Member States in the 1970s through two Mutual Assistance Directives.¹² While the Mutual Assistance Directives provided for the automatic exchange of information from one Member State to another to ‘enable them to effect a correct assessment of taxes on income and on capital’, Article 8.1 excluded a Member State from an obligation to share information when the Member State was ‘prevented by its laws or administrative practices from carrying out these enquires or from collecting or using this information for its own purposes’. This limited the effectiveness of the Directives, particularly where Member States had stringent taxpayer confidentiality or bank secrecy laws. The Mutual Assistance Directives were amended over time to expand their scope of application to different taxes and provide for improved information exchange.

¹² Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the Field of Direct Taxation and Taxation of Insurance Premiums O.J L 336; Council Directive 76/308/EEC of 15 March 1976 on Mutual Assistance for the Recovery of Claims Resulting from Operations Forming Part of the System of Financing the European Agricultural Guidance and Guarantee Fund and of Agricultural Levies and Customs Duties and in Respect of Value Added Tax and Certain Excise Duties OJ L 73.

- 5.3.6 European policymakers recognised that the removal of domestic controls on cross-border capital movements in the late 1980s would give rise to a large increase in cross-border capital flows throughout the EU, and subsequently an increase in the risk of cross-border tax evasion. Article 6(5) of Directive 88/361/EEC (the ‘Capital Liberalisation Directive’) provided that the European Commission should submit a legislative proposal ‘eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national systems for the taxation of savings’.¹³ The Commission’s initial response focused on imposing a withholding tax on interest payments from a non-resident bank account in one Member State to the account-holder’s Member State of residence. However, following a failure to reach agreement regarding the first draft Savings Directive, European policymakers focused on the effective exchange of information as a more useful solution to combat tax evasion. In 2003, Directive 2003/48/EC (the ‘Savings Directive’) was agreed which provided for the automatic exchange of financial account information with a derogation for Member States who opted to introduce a withholding tax on cross-border interest payments.¹⁴
- 5.3.7 In 2006, the European Commission responded to concerns from Member States regarding tax fraud by indicating that it would seek further co-operation amongst Member States to combat tax fraud (European Commission, 2006). Accordingly, the Council Directive 2011/16/EU (the ‘Directive on Administrative Co-operation’ or ‘DAC1’) repealed and replaced Directive 77/799/EEC (as amended). DAC1 provides for: (i) the exchange of information ‘that is foreseeably relevant to the administration and enforcement of the domestic laws of the Member States’; (ii) spontaneous exchange of information where a Member State has information that may be useful for determining a loss, saving, or increase in tax for another Member State; (iii) automatic exchange of specific categories of information from one Member State to another relevant to income and capital taxation (namely ownership of and income from immovable property, employment income, directors’ fees, life insurance products, and pensions) from one Member State to another; and (iv) exchange of information on request where a request is made by one Member State to another Member State.
- 5.3.8 In 2012, the European Commission adopted a plan to strengthen action against tax fraud and tax evasion (European Commission, 2012). DAC was amended through Directive 2014/107/EU (‘DAC2’) to extend DAC to interest, dividends, and other income as well as account balances and sales proceeds from financial assets, thereby extending the specific categories encompassed by DAC and facilitating the repeal of the Savings Directive. Following DAC2 Member States could no longer exercise an option to apply a withholding tax.
- 5.3.9 In March 2015, the European Commission proposed a ‘Tax Transparency Package’, which comprised a further amendment to DAC in the form of Directive (EU)

¹³ Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty OJ L 178.

¹⁴ Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments O.J. L 157.

2015/2376 ('DAC3'), and which extended the automatic exchange of information provision to cross-border tax rulings and to APAs. The Commission at that time issued a discussion paper envisioning a number of additional measures, including CbCR along the lines recommended by BEPS Action 13 (European Commission, 2015). In January 2016, the European Commission launched the Anti-Tax Avoidance Package, which included a further revision of DAC, through Directive (EU) 2016/881 ('DAC4') to provide for CbCR (European Commission, 2016a).

Foreign Account Tax Compliance Act 2010

- 5.3.10 The US introduced FATCA 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act to require the provision by non-US financial institutions of information on financial accounts held by US citizens, residents, and certain US resident legal persons. If non-US financial institutions did not comply a 30% withholding tax on the US source income of the non-US financial institutions would apply. Since 1861, the US has taxed all US citizens, whether resident in the US or permanently resident overseas, so FATCA has global implications. While most US citizens living permanently abroad have no effective tax liability in the US due to the operation of the foreign tax credit and earned income inclusion their financial account information came under FATCA. Where extant US DTAs and TIEAs does not provide the legal authority for exchange of financial account information, the US approach is to negotiate an Intergovernmental Agreement (IGAs) to provide for the exchange of financial account information. This avoided a scenario whereby resident financial institutions of those countries would become subject to the 30% withholding tax due to the non-availability of a legal instrument to exchange financial account information. In some cases, these IGA provided for reciprocal exchange between the US and other party.

Mandatory Disclosure

- 5.3.11 Mandatory disclosure rules require the disclosure of potentially aggressive or abusive tax planning arrangements by promoters of such schemes to tax authorities. Mandatory disclosure rules have three purposes: first, to provide tax authorities with the necessary information to effectively deploy administrative resources; second, to enable appropriate legislative or regulatory changes in response to potentially aggressive or abusive arrangements to close off such arrangements; and third, to deter the promotion of such arrangements.

5.4 International standards in tax transparency

- 5.4.1 Due to the level of international co-operation required to give effect to greater tax transparency it has traditionally been driven by multilateral institutions, particularly the OECD through the setting of standards and norms, and the EU through its own norm-setting institutions and through European Directives agreed by the European Council.

OECD: Forum on Harmful Tax Practices

- 5.4.2 In the *Harmful Tax Competition* report, two of the four key factors are directly relevant to tax transparency, namely whether a regime lacks transparency or where there is no effective exchange of information with respect to the regime. The

Harmful Tax Competition report states that to be considered transparent a tax regime must satisfy the following conditions: (i) in terms of administrative practices, the conditions of applicability to taxpayers should be put forward in such a manner that they must be capable of being invoked against the tax authority; and (ii) details of the tax regime, including the application of the regime to any one taxpayer, must be available to the tax authorities of other countries concerned. Effective exchange of information may be hampered by domestic secrecy laws, for example bank secrecy, or where a tax authority fails to disclose certain information to another tax authority despite an obligation to do so. The additional guidance prepared by the OECD Centre for Tax Policy and Administration regarding the application of *Harmful Tax Competition* between 2000 and 2004 emphasises that transparency requires: (i) the existence of relevant and reliable information including the books and records of taxable companies, information on the identity of legal and beneficial owners, information on preferential regimes and their application to particular taxpayers, and (ii) access to relevant information (OECD, 2004).

BEPS Action 5 – Compulsory spontaneous exchange of information

- 5.4.3 As noted, one of the three pillars of the Action Plan on BEPS was to improve transparency, with certainty and predictability for business. The Report on BEPS Action 5, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, focused on the criteria outlined in *Harmful Tax Competition* and identified actions in two areas, including the development of an OECD framework for the compulsory spontaneous exchange of information on six categories of taxpayer specific rulings.

Box 5.1 Tax rulings

Many jurisdictions provide tax rulings, whereby a tax authority will provide a binding but time-limited ruling on a particular transaction or set of circumstances upon the request of a taxpayer. The advantages to the tax authority include greater knowledge of particular transactions, and the advantages to the taxpayer include greater certainty as to tax liability on the transaction or set of circumstances covered by the ruling. By their nature, larger and more complex firms such as MNEs will have greater recourse to tax rulings than other taxpayers, given the complexities of the transactions in which they engage, and the qualitative criteria which must be applied.

Since 2013, the Directorate General for Competition of the European Commission has been investigating the tax rulings of EU Member States. As a consequence, the Commission opened a series of State aid investigations into a number of tax rulings made by the tax authorities of Ireland, the Netherlands, Luxembourg, and Belgium, issuing final decisions in four cases.¹⁵ The investigations focus on the alleged provision of State aid by Member States' tax authorities. The *acquis communautaire*, and specifically Articles 107 and 108 of the Treaty on the Functioning of the European Union (TFEU), provides that an aid granted by a Member State to an undertaking or undertakings which grants a selective advantage and distorts competition shall be considered incompatible with the internal market. In each of the cases, the recipient(s) of the alleged State aid and the Member State alleged to have provided the aid have sought the annulment of the final decisions of the Commission.

There is no legislative provision for binding tax rulings in Irish legislation. The Revenue Commissioners may, in certain circumstances, provide opinions/confirmations 'to provide clarity and certainty in relation to the applicable tax/duty rules so that a taxpayer can file a correct tax return and comply fully with its tax/duty obligations' (Revenue Commissioners, 2017: 5).

5.4.4 The OECD framework applies to the following categories of taxpayer specific rulings which must be shared with the country of residence of all related parties with which the taxpayer enters into a transaction for which a tax ruling is granted: the country of residence of related parties that have made payments giving rise to income benefitting from a preferential tax regime and the country of residence of the ultimate parent company and the immediate parent company:

- i. **Cross-border rulings related to preferential regimes:** where a tax ruling given is within the scope of the FHTP, is preferential, and where no or a low effective tax rate applies such a ruling must be spontaneously exchanged with the relevant tax authorities in other jurisdictions;
- ii. **Cross-border unilateral Advance Pricing Agreements (APAs) and any other cross-border unilateral tax rulings covering transfer pricing or the application of transfer pricing principles;** where a tax authority agrees a unilateral APA or other form of cross-border tax ruling relevant to transfer pricing with a taxpayer resident in its jurisdiction it must spontaneously exchange the information with the relevant tax authorities in other jurisdictions.
- iii. **Cross-border rulings providing for a unilateral downward adjustment to the taxpayer's taxable profits that is not directly reflected in the taxpayer's financial/commercial accounts:** where a tax code allows for a downward

¹⁵Commission Decision of 30.8.2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple, C(2016) 5605 final; Commission Decision of 11.1.2016 on the Excess Profit Exemption State Aid Scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium, C(2015) 9837 final; Commission Decision of 21.10.2015 on State Aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, C(2015) 7143 final; Commission Decision of 21.10.2015 on State Aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat, C(2015) 7152 final.

transfer pricing adjustment of taxable profits there is a possibility such a regime may be considered preferential and lead to a low-tax or no-tax outcome. Accordingly, tax rulings providing for such an adjustment where it is not directly reflected in the taxpayer's accounts must be shared with other potentially affected tax authorities to allow for a potential corresponding upward adjustment.

- iv. **Permanent establishment (PE) rulings:** where a tax ruling is provided to establish whether or whether not a PE is established in any jurisdiction, or the level of profit attribution to the PE, that ruling must be exchanged with the relevant tax authorities in other jurisdictions.
- v. **Related party conduit rulings:** where a tax ruling is provided in respect of the tax treatment of cross-border flows of income or funds between related entities the ruling must be exchanged with the relevant tax authority.
- vi. **Any other type of ruling that in the absence of spontaneous information exchange gives rise to BEPS concerns:** a holding category of tax ruling has been put in place to allow the FHTP broaden the category of rulings to which an obligation to provide a spontaneous exchange of information should apply.

BEPS Action 12 – Mandatory Disclosure Rules

- 5.4.5 The Report on BEPS Action 12, *Mandatory Disclosure Rules*, develops recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures (OECD, 2015b). Such rules require the disclosure of potentially aggressive or abusive tax planning arrangements to tax authorities which fall under certain headings, and are designed to (i) obtain early information about potentially aggressive or abusive tax avoidance schemes in order to inform risk assessment, (ii) identify schemes, and the users and promoters of schemes in a timely manner to facilitate counteracting measures and, (iii) to act as a deterrent, to reduce the promotion and use of avoidance schemes. The key innovation in the Report on BEPS Action 12 was to explore the extension of mandatory disclosure rules to international schemes.

BEPS Action 13 – Country-by-Country Reporting

- 5.4.6 The Report on BEPS Action 13, *Transfer Pricing Documentation and Country-by-Country Reporting*, contains revised standards for transfer pricing documentation and a template for CbCR of the amount of revenue, profits, taxes and other indicators of economic activities for each tax jurisdiction in which part of an MNE group, with group revenue exceeding €750 million, is tax resident (OECD, 2015c). The Report requires country-by-country (CbC) reports to be filed in the jurisdiction of tax residence of the ultimate parent entity of the relevant MNE and shared through automatic exchange of information, whether through MAATM, DTAs, TIEAs, or other bilateral government-to-government instruments. The Report, which provided a model template for CbC reports, now incorporated into the OECD Transfer Pricing Guidelines, requires companies in MNE groups to report for each fiscal year of the reporting MNE and by each jurisdiction in which they operate: (i) revenues identifying whether from related or unrelated parties; (ii) profit or loss before corporate income tax; (iii) corporate income tax paid on a cash basis; (iv) corporate income tax accrued in the current year; (v) stated capital; (vi) accumulated

earnings; (vii) number of employees; (viii) tangible assets other than cash (or cash equivalents); and, (ix) a list of all constituent entities of the group by each tax jurisdiction itemising the main business activities of each entity.

- 5.4.7 A Multilateral Competent Authority Agreement on Country-by-Country Reporting (CbCR MCAA) has been developed to govern the exchange of CbC reports under the MAATM. Ireland signed the CbCR MCAA on 27 January 2016. Within the EU, the legal basis for the exchange of CbC reports between Member States is DAC4. For exchange of information outside the EU, Ireland relies on the CbCR MCAA.

Global Forum on Transparency and Exchange of Information for Tax Purposes

- 5.4.8 The Global Forum on Taxation (the ‘Global Forum’) was established in 2000 to provide a forum for dialogue between OECD members and non-OECD jurisdictions. Since 2009, when it was renamed the Global Forum on Transparency and Exchange of Information for Tax Purposes and restructured to expand its membership, the Global Forum has become the key international body working to ensure the implementation of exchange of information on request, and to build the capacity of members to ensure they can comply with the standards necessary to participate in the exchange of information. The standard for exchange of information on request is contained in the 2002 OECD Model Agreement on Exchange of Information on Tax Matters and its commentary (OECD, 2002b). Since 2009, the Global Forum has carried out peer reviews of the operation of exchange of information on request. The Global Forum now has 139 members with the EU and 15 international organisations participating as observers.

- 5.4.9 The current mandate of the Global Forum, in operation since 1 January 2016, provides that it ‘shall ensure a rapid and an effective global implementation of the standards of transparency and exchange of information for tax purposes, either on request or automatic’ and ‘achieve its aims by monitoring implementation of the standards, undertaking peer reviews, developing tools and assisting members to implement the standards effectively’ (OECD, 2015m). Revised guidance has been prepared to encompass those peer reviews carried out between 2016 and 2020 - the major change is to include, on foot of a request from the G20, the requirement for collection of information on the beneficial ownership (i.e. the natural person who ultimately owns or controls a legal entity or an asset) of certain legal persons and/or assets (OECD, 2016). Countries are evaluated under the terms of reference by reference to ten essential elements, divided under three headings:

A. Availability of information

1. Jurisdictions should ensure that ownership and identity information, including information on legal and beneficial owners, for all relevant entities and arrangements is available to their competent authorities;¹⁶
2. Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements; and,

¹⁶ The definition of beneficial ownership used in the terms of reference is taken from the Financial Action Task Force (FATF), an inter-governmental body which develops and promotes policies to combat money laundering and terrorist financing.

3. Banking information should be available for all account-holders.
- B. Access to bank, ownership, identity and accounting information
1. Competent authorities should have the power to obtain and provide information that is the subject of a request under an exchange of information arrangement from any person within their territorial jurisdiction who is in possession or control of such information (irrespective of any legal obligation on such person to maintain the secrecy of the information);
 2. The rights and safeguards (e.g. notification, appeal rights) that apply to persons in the requested jurisdiction should be compatible with effective exchange of information.
- C. Exchanging information
1. Exchange of information mechanisms should provide for effective exchange of information;
 2. The jurisdictions' network of information exchange mechanisms should cover all relevant partners, namely those partners willing to exchange information;
 3. The jurisdictions' mechanisms for exchange of information should have adequate provisions to ensure the confidentiality of information received;
 4. The exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties;
 5. The jurisdiction should request and provide information under its network of agreements in an effective manner.

Common Reporting Standard for the automatic exchange of financial account information

- 5.4.10 On foot of a report prepared for the G8 and following the endorsement in April 2013 of automatic exchange of information for tax purposes by G20 finance ministers and Central Bank Governors as the new global standard, the OECD prepared a new Common Reporting Standard ('CRS') on the automatic exchange of financial account information (OECD, 2013d; 2014b). This global standard is designed to ensure that jurisdictions may collect and exchange information, on an automatic basis, from resident financial institutions to share information with other jurisdictions to assist with the fight against tax evasion. The information identified by the CRS includes: (i) the name, address, jurisdiction of residence, Taxpayer Identification Number(s) (TIN) of the account holder(s), and if the account holder is a natural person, the date and place of birth; (ii) the account number (or equivalent); (iii) the name and identifying number of the financial institution; (iv) the account balance or value; and (v) gross interest paid and credited (OECD, 2014).
- 5.4.11 Within the EU, Directive 2014/107/EU ('DAC2') provides for, *inter alia*, the automatic exchange of financial account information and the use of CRS in such information exchange.

EU Code of Conduct

- 5.4.12 Under the EU Code of Conduct, where a measure provides for a significantly lower effective level of taxation than levels generally applying in other Member States, one of the criteria which is taken into account in determining whether the measure is harmful is ‘whether the tax measure... lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way’.

5.5 Achieving the highest international standards

Country-by-country reporting: BEPS Action 13

- 5.5.1 Ireland was an ‘early adopter’ of the BEPS Action 13 minimum standard for the automatic exchange of CbC reports, providing for CbCR through section 33 of the Finance Act 2015 which inserted section 891H TCA 1997. This section required that the first country-by-country report provided by an Irish-resident ultimate parent entity of a large MNE group to file a CbC report containing certain aggregate information relating to the global allocation of the MNE group’s income and taxes as well as certain indicators of the location of economic activity within the MNE group. Irish CbCR provisions, which apply for the fiscal years commencing on or after 1 January 2016, utilise the definitions provided by the OECD model legislation contained in the BEPS Action 13 Report. The Taxes (Country-By-Country Reporting) Regulations 2015 (S.I. 629 of 2015) (‘the 2015 Regulations’) provided that where the ultimate parent entity of an Irish resident MNE subsidiary/affiliate was not required to file a CbC report in its jurisdiction of residence or that jurisdiction does not have an agreement with Ireland to exchange CbC reports then the Irish resident MNE subsidiary/affiliate should file a secondary CbC report (referred to as an equivalent CbC report) in Ireland. These provisions were amended through Finance Act 2016, and the 2015 Regulations were replaced with the Taxes (Country-By-County Reporting) Regulations 2016 (S.I. 653 of 2016), following the adoption of DAC4.

Mandatory disclosure rules: BEPS Action 12

- 5.5.2 Ireland introduced mandatory disclosure rules in the Finance Act 2010, and they are now contained in Chapter 3 of Part 33 TCA1997, with the Mandatory Disclosure of Certain Transactions Regulations 2011 (S.I. No.7 of 2011) (as amended) providing for procedures relating to the disclosure rules. The rules provide that a ‘promoter’ or, in certain circumstances, a ‘user’, of arrangements which fall within one of four classes of ‘specified descriptions’ which may give rise to an Irish tax advantage and which are designed primarily to gain access to such an advantage, must disclose certain specified information to the Revenue Commissioners. Three of the four ‘specified descriptions’ are generic hallmarks designed to capture indicative features of tax avoidance, namely whether a promoter seeks to keep an arrangement confidential from other promoters or the Revenue Commissioners, whether it may reasonably be expected a premium fee would be charged by a promoter in respect of the arrangement, or whether standardised documentation is involved in implementing the arrangement. The fourth specified description identifies relevant tax advantages which include the artificial creation of losses,

employment schemes which may lead to a deferral or reduction in tax liability, the substitution of a capital gains liability for an income tax liability, and the reduction of an income tax liability by way of the taking of a gift.

- 5.5.3 The BEPS Action 12 Report contained a number of best practice recommendations regarding the design of mandatory disclosure schemes, many of which are currently provided for under the Irish mandatory disclosure regime. However, the Irish mandatory disclosure regime does not currently extend to cross-border schemes. The BEPS Action 12 Report made a number of recommendations in relation to design of a disclosure regime for international tax schemes (OECD, 2015j: 61 - 69). The European Commission's proposed Directive for mandatory disclosure rules provides for the disclosure of international schemes.

Exchange of taxpayer-specific rulings: BEPS Action 5

- 5.5.4 Ireland currently complies with the OECD Framework developed under Action 5, and an exchange of the categories of tax rulings covered by the Framework may be carried out under Ireland's DTAs, TIEAs, the Directive on Administrative Co-operation, or the MAATM. The Action 5 Report also contained a retrospective element, whereby relevant countries were required to exchange information on rulings issued on or after 1 January 2010 and still in effect on or after 1 January 2014. All rulings issued on or after 1 January 2014 must be exchanged, whether in effect or not. Ireland has complied with the deadline of 31 December 2016 for the exchange of such rulings.

Global Forum on Transparency and Exchange of Information for Tax Purposes

- 5.5.5 Ireland was subject to a Global Forum peer review in 2010 (OECD, 2011). Ireland was one of 16 jurisdictions to receive a rating of *compliant* - the highest rating achievable. A peer review of Ireland, under the revised terms of reference, is currently underway.

Convention on Mutual Administrative Assistance in Tax Matters

- 5.5.6 Ireland make the necessary legislative changes to ratify the MAATM by section 826(1C) TCA 1997 (inserted by the Finance Act 2010). The Mutual Assistance in Tax Matters Order 2013 (S.I. No. 34 of 2013) provides the Convention has force of law as of 1 September 2013. In 2010, the MAATM was amended by the *Protocol amending the Convention on Mutual Administrative Assistance in Tax Matters*, and the amended Convention came into effect on 1 June 2011. Article 30 of the MAATM recognised that a state may be limited in its ability to provide assistance under MAATM for practical, constitutional or political reasons, and provided that a contracting party may therefore enter a reservation to part of MAATM, such that it will not apply to that contracting party. Ireland currently has three reservations in place with regard to the amended Convention:
- i. Ireland does not provide assistance with the recovery of any tax claim, or in the recovery of an administrative fine;
 - ii. Ireland does not provide assistance in the service of documents for all taxes;

- iii. Ireland does not provide assistance in relation to taxes imposed by or on behalf of political subdivisions or local authorities and social security contributions.

5.5.7 The Taxation and Certain Other Matters (International Mutual Assistance) Bill, when enacted, will facilitate the withdrawal of Ireland's reservations regarding the recovery of tax and service of documents, except in respect of taxes imposed by or on behalf of political subdivisions or local authorities and social security contributions. The Bill cleared pre-legislative scrutiny in March 2017. The MAATM is particularly important as a legal instrument in facilitating information exchange with jurisdictions with which Ireland does not have a DTA, which includes many developing countries.

5.6 Recommendations

- 2) Ireland should take account of any recommendations of the peer review being undertaken by the Global Forum on Transparency and Exchange of Information for Tax Purposes.
- 3) Ireland should continue its commitment to support proposals for a Directive providing for mandatory disclosure rules in line with the recommendations outlined in the G20/OECD BEPS Action 12 Report.
- 4) The passage of the Taxation and Certain Other Matters (International Mutual Assistance) Bill through Dáil and Seanad Éireann should be facilitated.
- 5) Following the enactment of the Taxation and Certain Other Matters (International Mutual Assistance) Bill, Ireland will be able to, and should, withdraw its reservations regarding Sections II and III of the Convention on Mutual Administrative Assistance in Tax Matters, namely those sections encompassing the recovery of tax and service of documents. However, the reservation on Article 12, which allows one state to request another state take measures of conservancy, for example through the seizure of assets of a taxpayer before final judgement is given, should be retained.

6. FURTHER IMPLEMENTING IRELAND'S COMMITMENTS UNDER BEPS: ACTIONS, 8, 9, 10 AND 13

6.1 Introduction

6.1.1 Transfer pricing refers to the practice by which MNEs set intra-group pricing arrangements between associated business entities. The internationally accepted principle is that such prices be established as if they occurred at arm's length such that, as provided for by Article 9(1) of the OECD and UN Model Tax Conventions and the Associated Enterprises article of Ireland's DTAs, '[when] conditions are made or imposed between... two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly'. This reflects the consensus that taxing rights to business profits should rest in the jurisdiction in which the activity contributing to those profits took place. As MNEs have grown more important in global trade through GVCs, a greater proportion of global trade occurs between associated enterprises within an MNE group, highlighting the importance of transfer pricing in correctly attributing profit with an MNE group. The United Nations Conference on Trade and Development estimates that a third of gross global trade in 2010 (€6.3 trillion) was undertaken within MNE groups (UNCTAD, 2013: 135).

6.1.2 Given the volume of transfer pricing transactions, it is necessary to ensure that MNE profits should be taxed in the jurisdiction with primary taxing rights to those profits, so that both double taxation and double non-taxation is prevented, and to establish common methodologies to establish correct transfer prices under the Associated Enterprises article of the relevant DTA. Accordingly, in 1979, the Council of the OECD approved the publication of the report *Transfer Pricing and Multinational Enterprises*, which provided methodologies to assist MNEs and tax authorities to interpret Article 9(1) of the OECD Model Convention, and establish transfer prices at arm's length and ensure the correct attribution of profit between jurisdictions, and recommended that tax authorities take the report into account if adjusting prices under relevant associated enterprises article of DTAs. In 1995, the Council of the OECD recommended the use of the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* ('the OECD Transfer Pricing Guidelines'), which replaced the 1979 report, and which have been updated from time to time. The latest iteration of the OECD Transfer Pricing Guidelines prepared before the BEPS initiative was updated in 2010.

6.1.3 In applying the arm's length principle each member of an MNE group is treated as an independent separate entity rather than as part of single unitary group (see Box 6.1). Transactions between associated enterprises should be priced as if the

enterprises were independent, operating at arm's length and engaging in comparable transactions under similar conditions and economic circumstances. However, many MNE transactions are specific to that group, particularly given the increasing importance of intangible assets such as company-specific knowledge, IP, marketing and trademarks and accordingly prices for comparable transactions between independent parties are difficult to obtain. The increasing complexity of internal MNE transactions, in particular the difficulties in attributing value to intangible assets, has given rise to an increased incidence of potential transfer mispricing by MNEs, which facilitates profit shifting through the attribution of profit to jurisdictions with no or very low rates of corporate income tax.

Box 6.1 Origins of separate accounting and the arm's length principle

In October 1928, when the League of Nations reached agreement on the Model Convention for the Prevention of Double Taxation, it was silent on the method used to attribute profit to PEs and affiliated companies. The Committee of Technical Experts appointed to prepare the Model Convention had proposed that the PE should be treated as a separate entity for tax accounting purposes. However, no agreement was reached and contracting parties were free to provide for other methods.

In 1933, the Fiscal Committee of the League of Nations published a comparative analysis of the taxation of business income across 35 jurisdictions, undertaken by the tax lawyer Mitchell B. Carroll (Carroll, 1933). Of the three methods of allocating business profits – separate accounting, the empirical method, and formulary apportionment – the report recommended separate accounting as the primary method and the empirical approach as the secondary method. The empirical method was used where accounts were considered to be improperly prepared and income was attributed by tax administrators to the relevant company on the basis of the income of a similar company. Formulary apportionment allocates profit to a jurisdiction by reference to a formula weighted by reference to specified factors such as sales or number of employees.

The conclusions of Carroll's report informed the 1933 Draft Convention on the Allocation of Business Income between States for the Purposes of Taxation, approved by the Fiscal Affairs Committee, Articles 3 and 5 of which endorsed separate accounting for PEs and affiliate enterprises respectively, provided that transactions between a PE or affiliate enterprises and connected parties should be priced as if they occurred at arm's length between independent parties. If not, the Draft Convention provided that, subject to appeal, the tax authorities of either contracting state could adjust the accounts for tax purposes to give effect to the arm's length principle.

Both the arm's length principle and separate entity principle have been subject to frequent critiques (cf. Avi-Jonah et. al, 2009). The most fundamental critique rests on the view that MNEs are in fact single economic operators: MNE firms are established to take advantage of efficiencies associated with organising production within a single firm relative to the advantages of co-ordinating production through the price mechanism such that a certain proportion of the profit generated by an MNE firm can be attributed to firm-specific factors. Accordingly, treating the constituent parts of an MNE firm as separate entities and establishing inter-related party transfer prices is said to be less effective than other methodologies in accounting for profits arising from firm-specific factors, particularly as such factors, such as firm-specific knowledge, have grown in importance in generating value added in MNE production processes. A number of additional critiques follow: first, that MNEs use transfer pricing, particularly arrangements relating to intangible assets, to shift profit to low-tax jurisdictions; second, that the documentation requirements in place to justify transfer prices place a large burden on MNEs; and finally, that the system is extremely cumbersome.

In light of these critiques a number of alternatives have been proposed. A unitary system treats an MNE group as a single economic operator, determining taxable profits by reference to the consolidated income of the group, with profits allocated to jurisdictions through formulary apportionment. In October 2016, the European Commission re-launched its legislative proposal for a Common Consolidated Corporate Tax Base (CCCTB), which comprises two discrete legislative proposals: first, a proposed Council Directive on a Common Corporate Tax Base, which would

replace the extant corporate income tax base of all EU Member States for all companies in groups with a turnover greater than €750 million with a common corporate income tax base to apply to all such companies; and consequent to the adoption of a common base, a proposed Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), which would apportion taxable profits of companies between Member States by reference to a formula based on the location of sales, employees and fixed capital assets of a taxable company.

Alternatively, formulary apportionment may be applied to specified sources of MNE income rather than consolidated income (Avi-Jonah et. al, 2011). More fundamental alternatives have been proposed: it has been suggested that corporate income should be taxed on the basis of destination rather than source, such that a jurisdiction would exercise taxing rights to income from sales within its jurisdiction. Auerbach et. al (2010) have suggested a destination-based cash-flow tax (DBCFT), which would allow deductions from taxable income for all real costs incurred, as an efficiency-enhancing alternative to source-based taxation. Under a DBCFT, business expenses, such as the cost of labour, would be deductible if incurred in the country of origin, creating the possibility of a negative tax liability where a company exports most of its goods (i.e. it may deduct costs relating to exports but income relating to such exports will not come into the charge to tax in the country of origin as it would not claim taxing rights under the destination basis).

- 6.1.4 At the outset of the BEPS initiative, the OECD identified ‘[t]ransfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents’ as constituting a BEPS risk (OECD, 2013a: 48). Accordingly, Action 8 of the BEPS Action Plan aimed to ‘develop rules to prevent BEPS by moving intangibles among group members’, Action 9 aimed to ‘develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members’, Action 10 aimed to ‘develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties, and Action 13 aimed to ‘develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business’ (OECD, 2013b: 20). To achieve these aims, the Final Report on Actions 8-10, *Aligning Transfer Pricing Outcomes with Value Creation*, and the Final Report on Action 13, *Transfer Pricing Documentation and Country-by-Country Reporting*, set out a number of changes to the OECD Transfer Pricing Guidelines.
- 6.1.5 On 23 May 2016, the OECD Council approved the amendments to the OECD Transfer Pricing Guidelines set out in the BEPS Action 8, 9 and 10 Report and the BEPS Action 13 Report. These amendments will shortly be incorporated into the 2017 edition of the OECD Transfer Pricing Guidelines to reflect the approved amendments. Where Ireland’s tax treaty partners have given effect to the Actions 8, 9, and 10 they may seek to adjust a taxpayer’s profits under the Associated Enterprises article of the relevant DTA having regard to the 2017 OECD Transfer Pricing Guidelines. An amendment to the TCA 1997 will be required to give effect to the 2017 OECD Transfer Pricing Guidelines, as domestic legislation currently references the 2010 OECD Transfer Pricing Guidelines.

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

- i. the current domestic transfer pricing regime in Ireland;
- ii. the changes to the Transfer Pricing Guidelines outlined in BEPS Actions 8 – 10 and their potential effect on enterprises operating in Ireland; and also sets out the potential to,
- iii. apply domestic transfer pricing legislation to trading transactions entered into before 1 July 2010;
- iv. extend transfer pricing legislation to non-trading transactions, including capital transactions;
- v. extend transfer pricing legislation to SMEs;
- vi. strengthen transfer pricing documentation requirements; and,
- vii. to introduce two-way transfer pricing adjustments.

6.2 Domestic transfer pricing legislation

6.2.1 Section 42(1) of the Finance Act 2010 provided for the insertion of Part 35A TCA 1997, which provides for the application of the arm’s length principle, as consistent with the OECD Transfer Pricing Guidelines, to trading transactions between associated persons. Where trading transactions between associated persons, as defined by section 835B TCA 1997, are not carried out at arm’s length, section 835C TCA 1997 provides that the profits or losses are to be computed as if they were carried out at arm’s length. A company is considered as associated with another company if that other company is directly or indirectly participating in the management, control (as defined in section 10 TCA 1997) or capital of the company or if a person is directly or indirectly participating in the management, control or capital of both. The main features of the domestic transfer pricing rules set out in Part 35A TCA 1997 are that they:

- i. do not apply to SMEs;
- ii. apply to trading transactions;
- iii. do not apply to any intra-company transactions agreed before 1 July 2010;
- iv. provide for either an upward adjustment of receipts – ‘consideration receivable’ – or a downward adjustment of expenses – ‘consideration payable’ – for tax purposes; and,
- v. provide for transfer pricing documentation to be made available by taxpayers.

6.3 BEPS Actions 8 - 10

6.3.1 The changes to the Transfer Pricing Guidelines resulting from Actions 8-10 are primarily to Section D of Chapter I (‘Guidance for applying the arm’s length principles’), Chapter VI (‘Special Considerations for Intangible Property’), and Chapter VIII (‘Cost Contribution Arrangements’) of the OECD Transfer Pricing Guidelines. Following their adoption by the OECD Council in June 2016, the 2017

OECD Transfer Pricing Guidelines are now the appropriate reference point for transfer pricing rules.

- 6.3.2 The combined effect of the amendments to the OECD Transfer Pricing Guidelines apply in particular to: (i) transactions relating to intangible assets such as legally protected rights or company-specific knowledge; (ii) the relationship between the contractual and economic allocation of risk between members of an MNE group; (iii) the return on funding on capital contributions to internally generated assets by members of an MNE group; (iv) the valuation that may be applied by tax authorities to hard to value intangible assets, particularly those at an early stage of development; (v) cost contribution arrangements, and (vi) the transfer pricing of low value-added intra-group goods and services. A number of these changes may have a particular effect on MNEs operating in Ireland.

Intangible Assets

- 6.3.3 Action 8 examined transfer pricing transactions involving intangible assets, following the identification of the misallocation of profits as a key contributor to base erosion and profit shifting. The change of most consequence arising from Action 8 is that the return generating by an intangible asset will be attributed to the entity or entities that are performing some or all of the functions related to the development, enhancement, maintenance, protection and exploitation of an intangible asset (the ‘DEMPE functions’), and performing the control functions with respect to the associated risk. Accordingly, if the legal owner of an intangible asset outsources some of the DEMPE functions to another member of the MNE group, and/or does not control the associated risks, they should remunerate the other members of the MNE group who perform the DEMPE functions and control the risks.

Allocation of risk

- 6.3.4 Action 9 considered the contractual allocation of risk and consequent allocation of profits to those risks and provided guidance to analyse whether the contractual allocation of risk matched the actual control over risk exercised by an MNE group member. Control over risk is comprised of: (i) the capability to make decisions to take on, lay off, or decline a risk-bearing opportunity, together with the actual performance of that decision-making function, and (ii) the capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with the actual performance of that decision-making function. The net effect of the new guidance is that the contractual assumption of risk is no longer sufficient to justify the allocation of the upside benefit and downside cost associated with the risk.

Return on funding of capital contributions

- 6.3.5 Action 9 addressed the level of return to funding provided by a capital-rich MNE group member where those returns do not correspond to the level of activity undertaken by the funding company. MNE group members may provide funding

for the DEMPE of an intangible asset while other group members may perform the DEMPE functions. Accordingly, a comparability analysis may be carried out to assess the level of return that a third party would expect to receive where they do not control the risk or undertake the DEMPE functions. For example, where an MNE group member exercises control over only the financial risk associated with the provision of funding, they may expect only a risk-adjusted return, rather than a full return, resulting in a much lower attribution of profits to the MNE group member funding the DEMPE functions.

Hard to value intangibles

- 6.3.6 Hard to value intangibles ('HTVI') describe intangible assets whose value is extremely uncertain when transferred between members of an MNE group. For example, intangible assets in the early stages of development are difficult to value as they may not be commercially exploited until years after the transfer. Given such HTVI may be highly company-specific there is considerable asymmetry of information between the MNE and tax authorities. Accordingly, Action 8 provided for changes to the Transfer Pricing Guidelines which permit tax authorities to use *ex post* outcomes to examine whether *ex ante* pricing arrangements were made at arm's length. Given the imposition of a tax liability would take place years after the transfer of the HTVI takes place the application of the HTVI provisions will be subject to statutory time limits applying to tax authorities in making enquiries or amended assessments.

Cost contribution arrangements

- 6.3.7 Action 8 provided for revisions to the Transfer Pricing Guidelines relating to cost contribution arrangements (CCAs), which are contractual arrangements between companies to share the contributions made and risks assumed in joint acquisition or development of assets or services on the basis that the assets or services developed or acquired will provide benefits for each of the participants. Under the revisions, the framework applying to allocation of risk and the valuation of intangible assets applies to CCAs.

Low value-added intra-group services

- 6.3.8 Guidance has been provided on a simplified approach to low-value-added intra-group services to reduce the compliance burden for MNEs and provide certainty that the intra-group pricing of services will be accepted by tax authorities. Where the simplified approach is applied, MNEs may apply a mark-up of 5% to the cost base for all low value-adding services without the need to demonstrate that this reflects an arm's length price.

Applying BEPS Actions 8 – 10 to Irish legislation

- 6.3.9 Provision for the implementation of BEPS Actions 8 – 10 can be made by way of an amendment to section 835D TCA 1997 to update to the reference to the 2010 Transfer Pricing Guidelines to take account of the updates approved by the Council of the OECD in May 2016. The application of the 2017 OECD Transfer Pricing

Guidelines may impact a number of MNE activities in Ireland, depending on the facts and circumstances of each case.

- 6.3.10 At present, Ireland's position in the GVC of MNEs in sectors which rely heavily on IP is such that large amounts of royalties are paid out of Ireland by MNE affiliates to members of the same MNE group in other jurisdictions, reflecting the large amount of value added in either those jurisdictions, or other jurisdictions further down the GVC.. In certain circumstances the IP may be developed through R&D activity by the MNE group parent. The recipient of the royalty payments may be a capital-rich subsidiary which funds the acquisition of the IP from the group parent, owning it outright, or contributes to the development of the IP through a CCA. At present, in this scenario, the recipient of the royalty payments receives a significant return relating to the ownership of the IP (including through a CCA) and the contractual assumption of the associated risk. For Irish corporation tax purposes, such royalties are deductible by the Irish royalty importer as either an ordinary business expense under section 81 TCA 1997 or, in the case of patent royalties, as a 'charge on income' under section 243 TCA 1997 on a paid basis.
- 6.3.11 Where the recipient of the royalty payments does not perform the requisite DEMPE functions or control economically significant risks the application of the OECD 2017 Transfer Pricing Guidelines may result in the recipient of the royalty payments being attributed a return which reflects the risk-free or risk-adjusted return with respect to the recipient's funding activity. Assuming transfer pricing rules apply to all trading transactions, the introduction of the 2017 OECD Transfer Pricing Guidelines may have the impact that section 835C(2)(a) TCA 1997 may apply, depending on the facts and circumstances, to adjust the 'consideration payable' (the royalty) downwards, having regard to the DEMPE functions and control of the associated risks by the recipient of the royalty payments. Where a royalty expense is adjusted downwards there may be an excess profit attributed to the Irish trading company, insofar as the Irish trading company will not perform the appropriate DEMPE functions or control the requisite risks. This outcome, if it occurred, would result in Ireland exercising taxing rights in respect of business profits that may appropriately be allocated to another jurisdiction in which the initial R&D was carried out. This outcome would not be in line with the key objective of BEPS Actions 8 – 10 to align transfer prices with economic substance.

6.4 Extending transfer pricing rules to non-trading transactions

- 6.4.1 Section 835C(1)(c) TCA1997 provides that Part 35A TCA 1997 only applies to profits or gains or losses arising from income within the charge to tax under Case I or II of Schedule D. Accordingly, transfer pricing rules only apply to trading income and not to non-trading income chargeable to tax under Case III (interest, discounts, foreign income), Case IV (royalties that do not arise in the course of a trade, misc. income) and Case V (rental income) of Schedule D. Extending domestic transfer pricing rules to non-trading transactions may have a particular impact on group

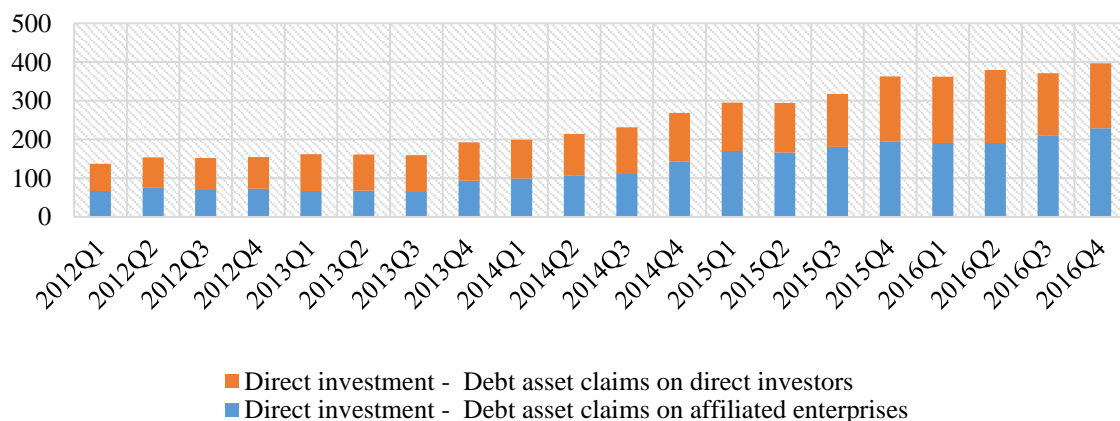
financing structures, transactions relating to loans the interest on which is treated as a ‘charge on income’ by an ‘investing company’ under section 247 TCA 1997, the letting of land and buildings, and types of companies to which specified computational rules apply regarding non-trading income. Domestic transfer pricing rules do not currently extend to chargeable gains or capital allowances, as both provide for equivalent concepts to the arm’s length principle and allow for the adjustment of capital values to reflect those equivalent concepts.

Group financing structures

6.4.2 A report carried out by Ramboll Management Consulting and Corit Advisory for the European Commission, *Study on Structures of Aggressive Tax Planning and Indicators*, identified the non-application of transfer pricing rules to intra-group non-trading interest-free loans as rendering Ireland vulnerable to aggressive tax planning in the context of intra-group financing (Ramboll Management Consulting and Corit Advisory, 2016). The extension of a non-trading interest-free loan by an Irish MNE affiliate to a foreign affiliate in a jurisdiction which grants a notional interest deduction creates opportunities for base erosion in the context of (i) a third tax base, where the foreign affiliate on-lends to an affiliate in the third country at an arm’s length interest rate, thus generating an interest deduction in the third country, and (ii) the Irish tax base, by way of a further on-lending back to the Irish affiliate or another Irish affiliate at arm’s length interest.

6.4.3 Irish resident members of MNE groups hold large debt asset claims against (i) direct investors (i.e. a parent company) and (ii) affiliated enterprises (i.e. to a company with whom the Irish entity shares a common parent). Chart 6.1 indicates an extract from series BPQ25 collected by the CSO as part of the compilation of the Balance of Payments data. External debt assets held by Irish resident non-IFSC entities against other MNE group members now stand at nearly €396 billion (equivalent IFSC debt assets stand at €218 billion). The stock of debt that is not related to the trade of Irish resident companies is unclear, but it does reflect the large quantum of debt assets on which interest payments to Irish affiliates may be subject to adjustment (the quantum of transactions is unknown).

Chart 6.1 Non-IFSC Debt asset claims on direct investors and affiliated enterprises (€bn), 2012Q1 – 2016Q4



Source: CSO Series BPQ25

6.4.4 Any change in this area may impact on *bona fide* intra-group financing, such as intra-group treasury operations. Groups may use cash pools to manage the liquidity requirements of the group by using the surplus cash available to some group affiliates to fund the cash requirements of other group affiliates through intra-company loans. This allows groups to avoid recourse to external credit markets and associated costs. Depending on the facts and circumstances of existing intra-group cash pooling structures, the group company designated as the ‘cash-pool leader’ may not be considered as engaging in a trade when engaging in intra-company lending associated with cash pooling. As a consequence, where the cash-pool leader extends a loan to another affiliate, the interest associated with the loan may be chargeable to tax at 25% in respect of non-trading income but the other group affiliate will only receive a deduction at 12.5%.

Extending transfer pricing rules to capital transactions

6.4.5 At present transfer pricing rules do not apply to capital transactions consisting of the acquisition and disposal of assets that are within the charge to CGT, or gains subject to corporation tax on chargeable gains. CGT already relies on the concept of ‘market value’, which is defined, per section 548 TCA 1997, as ‘the price which those assets might reasonably be expected to fetch on a sale in the open market’. Section 547 TCA 1997 provides that, where an asset is acquired otherwise than by means of a bargain at arm’s length it will be deemed to have been acquired at market value. Section 549 TCA 1997 applies to impose market value in relation to acquisitions and disposals of chargeable assets between connected persons, as defined by section 10 TCA 1997. While CGT legislation contains similar concepts to Part 35A TCA 1997 there are a number of differences including: (i) documentation requirements under transfer pricing rules to establish that transactions took place at arm’s length may differ to those required to establish market value; (ii) the definition of ‘associated person’ in Part 35A TCA 1997 is different to that of ‘connected person’, which is used for CGT purposes, so that the deeming of market value may apply in slightly different circumstances to the adjustment of transfer prices to reflect the arm’s length principle; and (iii) there is no equivalent to the OECD Transfer Pricing Guidelines specifically required to determine the ‘market value’ of assets for CGT purposes.

6.4.6 Section 835H TCA 1997 provides that transfer pricing rules do not apply when computing allowances or charges made in respect of capital expenditure, and so do not apply in the computation of capital allowances or balancing charges. Section 312 TCA 1997 applies to adjust the value of a capital allowance to reflect the open market price of the property on which the capital allowance is claimed in transactions between controlled persons. The definition of control in the section follows that applied in section 11 TCA 1997, which is also used when determining control for the purposes of transfer pricing provisions. This prevents the overvaluation of capital expenditure by related parties to avail of deductions for capital allowances. Section 291A(7) TCA 1997 applies to disallow capital

allowances in respect of expenditure on intangible assets to the extent that that expenditure exceeds ‘the amount which would have been paid or payable for the asset in a transaction between independent persons acting at arm’s length’. Section 291A(8) TCA 1997 allows the Revenue Commissioners to consult with an independent expert to ascertain the arm’s length price of the intangible asset. However, as with CGT, there is no explicit requirements that the OECD Transfer Pricing Guidelines apply for these purposes.

6.4.7 The UK applies a market value rule to certain transactions within the scope of chargeable gains, and does not apply transfer pricing rules to capital gains. UK transfer pricing rules do not apply to the computation of capital allowances and balancing charges.

6.4.8 There are a number of policy options regarding the extension of transfer pricing rules to capital transactions:

- i. Continue to keep capital transactions outside the scope of transfer pricing rules on the basis that existing legislation applies comparable concepts to the arm’s length principle with the effect that intercompany transactions should be carried out at arm’s length;
- ii. Bring all capital transactions within the scope of transfer pricing rules. As those provisions imposing a ‘market value’ or similar concept between related persons for both CGT and capital allowances apply to both legal and natural persons a specific provision would be required to apply transfer pricing rules to associated companies within the meaning of transfer pricing legislation;
- iii. Continue to keep capital transactions outside the scope of transfer pricing rules but supplement the existing market value rules that apply in respect of CGT and capital allowances by providing for the application of the OECD Transfer Pricing Guidelines where appropriate.

Given the already existing provisions to impose equivalents to the arm’s length value to the chargeable gains of companies, capital allowances or balancing charges in respect of related party transactions, any extension of transfer pricing rules in this area should be commensurate to the risk of mispricing occurring.

6.5 Extending transfer pricing rules to pre-1 July 2010 transactions

6.5.1 Section 42(2) of the Finance Act 2010 provides that Part 35A TCA 1997 applies to accounting periods beginning on or after 1 January 2011 and does not apply to any transactions the terms of which were agreed before 1 July 2010. In determining whether an intra-company arrangement was agreed before 1 July 2010 the Revenue Commissioners require that (i) the relevant agreement envisaged the arrangement or transaction concerned; (ii) the relevant agreement provides the price; and (iii) the relevant agreement is not merely an agreement for future agreements.

6.5.2 Given that the volume and value of pre-1 July 2010 arrangements outstanding are unknown, it is not possible to quantify the effects of extending Part 35A TCA 1997

to such transactions. If Part 35A TCA 1997 is not extended to pre-1 July 2010 arrangements, then *no* specific transfer pricing provisions – whether including or excluding the 2017 OECD Transfer Pricing Guidelines incorporating BEPS Actions 8 – 10 nor any other potential extension of transfer pricing rules - will apply to such arrangements. To the extent that such pre-1 July 2010 arrangements remain in place, it is appropriate to bring such arrangements within the scope of domestic transfer pricing legislation. In doing so, consideration will have to be given to the announcement and commencement date of any such changes.

6.6 BEPS Action 13: Strengthening transfer pricing documentation requirements

6.6.1 Section 835F TCA 1997 requires companies in an arrangement to which Part 35A TCA 1997 applies to ‘have available such records as may reasonably be required’ for the purposes of determining whether the trading income of the company has been computed in accordance with domestic transfer pricing legislation. Both the EU and the OECD have published guidance on transfer pricing documentation. The code of conduct on transfer pricing documentation for associated enterprises in the European Union (‘EU TPD’) was adopted by the EU Council in 2006.¹⁷ The OECD guidance on transfer pricing documentation is contained in Chapter V of the OECD Transfer Pricing Guidelines. At present, there is no explicit legislative requirement to furnish transfer pricing documentation in accordance with the EU TPD or OECD Transfer Pricing Guidelines. The Revenue Commissioners guidance on transfer pricing documentation, as set out in Tax Briefing 07/2010, indicates that the EU TPD and OECD Transfer Pricing Guidelines are accepted as representing good practice.¹⁸

6.6.2 BEPS Action 13 aimed to develop rules regarding transfer pricing documentation to enhance transparency for tax administration. The guidance on transfer pricing documentation provides that MNEs should provide all tax administrations in which they operate with (i) a high-level ‘master file’ detailing global business operations and transfer pricing policies, (ii) a detailed ‘local file’ specific to MNE operations in the jurisdiction concerned, detailing material related party transactions, the value of those transactions, and the MNE’s analysis of the transfer prices used for those transactions, and (iii) CbCR of the amount of revenue, profits, taxes and other indicators of economic activities for each tax jurisdiction in which part of an MNE group, should its group revenue exceed €750 million, is tax resident. Since May 2016, Annex I and II of Chapter V of the OECD Transfer Pricing Guidelines now contain a list of the information which should be included on the master file and local file respectively.

¹⁷ Resolution of the Council and of the representatives of the governments of the Member States, meeting within the Council, of 27 June 2006 on a code of conduct on transfer pricing documentation for associated enterprises in the European Union (EU TPD) (2006/C176/01)

¹⁸ Tax Briefing 07/2010.

6.6.3 The requirement for specified taxpayers to furnish a CbC report is already provided by Section 891H TCA 1997 and the Taxes (Country-By-Country Reporting) Regulations 2016 (S.I. 653 of 2016). At present, section 835F TCA1997 may not create an unqualified requirement for taxpayers to furnish transfer pricing documentation in line with the OECD 2017 Transfer Pricing Guidelines and BEPS Action 13. There is a strong case to specify a positive statutory obligation on taxpayers to provide the transfer pricing documentation outlined in Chapter V of the 2017 OECD Transfer Pricing Guidelines.

6.7 Extending transfer pricing rules to SMEs

6.7.1 Section 835E TCA1997 provides that Part 35A TCA 1997 does not apply to small and medium-sized enterprises (SMEs) as defined in the Annex to Commission recommendation 2003/361/EC of 6 May 2003.¹⁹ An SME is defined as an enterprise with less than 250 employees and either a turnover of less than €50 million or assets of less than €43 million on a global consolidation basis.

Table 6.1. European Commission definition of SMEs

	Employees	Turnover	Assets
Micro enterprise	Less than 10	Equal or less than €2m	Equal or less than €2m
Small enterprise	10 to 49	Equal or less than €10m	Equal or less than €10m
Medium enterprise	50 to 249	Equal or less than €50m	Equal or less than €43m

Source: European Commission.

6.7.2 The rationale for not applying transfer pricing rules to SMEs is to avoid an undue administrative burden, particularly in the area of documentation requirements. The OECD Transfer Pricing Guidelines do not recognise any specific exemption for SMEs but do emphasise, in paragraph 3.83 of the 2010 Transfer Pricing Guidelines, that:

‘small to medium sized enterprises are entering into the area of transfer pricing and the number of cross-border transactions is ever increasing. Although the arm’s length principle applies equally to small and medium sized enterprises and transactions, pragmatic solutions may be appropriate in order to make it possible to find a reasonable response to each transfer pricing case’.

The EU TPD provides that ‘Member States undertake not to require smaller and less complex enterprises (including small and medium-sized enterprises) to produce the amount or complexity of documentation that might be expected from larger and more complex enterprises’.

6.7.3 Jurisdictions with transfer pricing rules generally apply such rules to SMEs, with the exceptions being Ireland and the UK. Since 2004, the UK has generally exempted SMEs, as defined by the Commission Recommendation of 6 May 2003, from transfer pricing rules except (i) where an SME has a transaction with an affiliate in a jurisdiction without a non-discrimination clause in its DTA with the

¹⁹ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC).

UK, (ii) where an SME elects to be subject to transfer pricing rules, and (iii) where HMRC issues a notice requiring the application of transfer pricing rules (which HMRC may issue to medium-sized enterprises or to an SME party to a transaction relevant to a patent box claim).

6.7.4 In line with the OECD Transfer Pricing Guidelines and, if they are EU Member States, the EU TPD, jurisdictions often apply less onerous documentation requirements for SMEs, completely exempt SMEs from documentation requirements subject to specific conditions, or publish tailored guidance for SMEs.

6.7.5 There are a number of policy options regarding the extension of transfer pricing rules to SMEs:

- i. Retain the exemption for SMEs as currently provided for in Part 35A TCA 1997;
- ii. Align the approach with the UK by bringing certain high-risk intercompany transactions between SMEs within the scope of transfer pricing rules;
- iii. Remove the SME exemption completely;
- iv. Reduce the size threshold to bring more enterprises within the scope of domestic transfer pricing provisions; or
- v. Remove the SME exemption for all enterprises but, in line with other EU Member States, reduce the transfer pricing documentation required for either all SMEs or small and micro enterprises to reduce the compliance burden for such enterprises.

6.7.6 The Revenue Commissioners have provided an indication of the number of groups operating in Ireland which may be within the scope of transfer pricing rules if the SME exemption for enterprises was reduced below certain thresholds. This data is prepared on the basis of annual CT1 forms returned by companies for 2013. This data is merely indicative and a number of caveats apply: (i) CT1 forms are prepared on an individual company basis and companies are identified as a member of a group by the addition of a group marker in the Revenue database; (ii) the thresholds only reflect companies in Ireland, whereas for the purposes of determining whether a company is an SME, thresholds should be applied on a global consolidated basis, and (iii) no data is available on the basis of assets.

Table 6.2 Potential number of companies impacted by reduced thresholds, 2013

Minimum number of employees	Minimum turnover (€m)	No. of foreign owned groups	No. of domestic groups
200	40	44	42
200	30	45	44
150	30	48	47
150	25	48	51
100	30	51	57
50	10	68	84

6.8 Providing for two-way transfer pricing

- 6.8.1 At present, transfer pricing rules may apply only to adjust profits of an Irish company upwards, rather than downwards. Section 835C(2)(a) TCA 1997 applies to adjust the ‘consideration payable’ to reduce the arm’s length principle which has the effect of reducing tax-deductible expenses. Section 835C(2)(b) TCA 1997 only applies to increase the ‘consideration receivable’ to reflect the arm’s length principle which has the effect of adjusting income upwards.
- 6.8.2 A number of submissions suggested the introduction of two-way transfer pricing to adjust the amount of income attributed to an Irish company downwards, on the basis that transfer mispricing may lead to an overstatement of profits in Ireland. Transfer pricing occurs, in this scenario, where transfer prices between an Irish MNE affiliate and a foreign affiliate are not established according to the arm’s length principle as outlined in the OECD Transfer Pricing Guidelines with the effect that ‘excess’ profit is attributed to Ireland either through the charging of excessive prices by the Irish affiliate which generates a deduction in the foreign jurisdiction or through the charging of reduced prices by the foreign affiliate which leads to higher income being declared in Ireland.
- 6.8.3 At present, if transfer mispricing occurs, a foreign tax authority may adjust the transfer prices charged or taken by a foreign affiliate resident in their territory to reflect the arm’s length principle, and attribute a higher quantum of taxable profit to the foreign affiliate. To relieve double taxation, the Irish affiliate may (i) receive, if the Revenue Commissioners concur that the transfer pricing adjustment by the foreign tax authority represents an appropriate allocation of taxing rights, correlative relief under the Associated Enterprise Article of the relevant DTA between Ireland and the foreign jurisdiction with the effect that the quantum of profit attributed to the Irish affiliate is reduced, (ii) seek a Mutual Agreement Procedure under a relevant DTA which may result in the re-allocation of profit between the two jurisdictions depending on the facts and circumstances of the dispute, or (iii) seek to avoid double taxation through the application of the ‘EU Arbitration Convention’, which provides a framework for relieving double taxation amongst EU Member States in the area of transfer pricing disputes.²⁰
- 6.8.4 A number of submissions noted that the tax authorities of developing countries may not have the institutional capacity to carry out an audit of potential transfer mispricing. It was suggested that Ireland should provide that the Revenue Commissioners may adjust tax-deductible expenses attributed to an Irish entity upwards or income attributed to an Irish entity downwards. If two-way transfer pricing adjustments were introduced a legal instrument would need to be in place to ensure the sharing of the appropriate information to ensure that the profits

²⁰ Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) O.J. L 225/10.

attributed to the other jurisdiction could be adjusted and taxing rights exercised by that jurisdiction.

- 6.8.5 Of greater concern is the reversal of the balance of risk associated with two-way transfer pricing. Where domestic transfer pricing rules provide for an adjustment of income upwards only business profits are taxed at least once in one jurisdiction. If domestic transfer pricing rules allow for a downwards adjustment of business profits there is a risk of a double non-taxation outcome where, for example, the foreign jurisdiction chooses not to exercise their taxing rights. It is rare for jurisdictions to provide for two-way transfer pricing in their domestic legislation, and legal instruments are currently constructed with an assumption that a jurisdiction will only seek to adjust profit attributed to resident entities upwards. For example, the EU Arbitration Convention only addresses disputes arising from an upward adjustment of profit in one Member State.

6.9 Recommendations

Recommendations 6, 7, 8, 9, and 10 are made in concert with Recommendation 16, which suggests that further consultation should be undertaken on certain matters with a view to improving tax certainty:

- 6) Ireland should provide for the application of the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8, 9 and 10 in Irish legislation.
- 7) Domestic transfer pricing legislation should be applied to arrangements the terms of which were agreed before 1 July 2010.
- 8) Consideration should be given to extending transfer pricing rules to SMEs, having regard to whether the concomitant imposition of the administrative burden associated with keeping transfer pricing documentation on SMEs would be proportional to the risks of transfer mispricing occurring.
- 9) Consideration should be given to extending domestic transfer pricing rules to non-trading income. There is a strong rationale to extend domestic transfer pricing rules to non-trading income where it would reduce the risk of aggressive tax planning. Consideration should also be given to extending transfer pricing rules to capital transactions, having regard to whether such an extension would improve the existing provisions which already apply arm's length values to companies' transactions relevant to chargeable gains and capital allowances.
- 10) There should be a specific obligation on Irish taxpayers who are subject to domestic transfer pricing legislation to have available the transfer pricing documentation outlined in Annex I and II of Chapter V of the OECD 2017 Transfer Pricing Guidelines to ensure implementation of BEPS Action 13.

11) If it is decided to implement any or all of Recommendations 6 – 10, this should take place no later than end 2020, which is the year to which the OECD and G20 have agreed to extend their co-operation on BEPS to complete the current work.

7. FURTHER IMPLEMENTING IRELAND'S COMMITMENTS UNDER BEPS: ACTIONS, 2, 3 AND 4

7.1 Introduction

- 7.1.1 A number of the BEPS actions which were not agreed to be binding 'minimum standards' were agreed to be 'best practices' or 'common approaches'. Therefore, while countries did not formally commit to taking action it was recognised that consistent global standards in these areas would be beneficial to preventing aggressive tax planning. In this context, three of the BEPS actions – Actions 2, 3 and 4 – were agreed as best practice or common approach recommendations to targeting certain types of aggressive tax planning. These aimed at targeting the abusive use of hybrid mismatch arrangements, controlled foreign companies and interest deductions.
- 7.1.2 In January 2016, the European Commission presented an 'Anti-Tax Avoidance Package', one of the constituent elements of which was a proposed Directive to provide for common anti-tax avoidance measures (European Commission, 2016a). In July 2016, the EU Council agreed Directive (EU) 2016/1164 ('the Anti-Tax Avoidance Directive' or 'ATAD'), which provided for five separate anti-avoidance measures applying to corporate income taxes which must be transposed into law by Member States within the timelines outlined by the Directive. The Directive outlines a 'minimum level of protection' in each of the five areas, which provides Member States with the scope to go beyond the Directive by legislating for additional anti-avoidance measures in domestic law or introducing anti-avoidance measures through their DTAs.
- 7.1.3 The Directive provides for five measures, three of which stem from the BEPS Reports, namely: (i) the BEPS Action 2 Report, *Neutralising the Effects of Hybrid Mismatch Arrangements*, which set out a set of principles to ensure a common approach to addressing hybrid mismatches; (ii) the BEPS Action 3 Report, *Designing Effective Controlled Foreign Company Rules*, which set out a number of recommendations in relation to CFC rules to better achieve international coherency in their application; and (iii) the BEPS Action 4 Report, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments*, which recommended a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage (in a range of 10% to 30%) of its earnings before interest, taxes, depreciation and amortisation (EBITDA). The additional measures are (i) a requirement to apply, in four specified scenarios, an 'Exit Tax' on the value of assets being transferred outside of a Member State and (ii) the requirement to provide for a General Anti-Abuse Rule (GAAR) in domestic legislation to disregard non-genuine arrangements for tax purposes.

7.1.4 In February 2017, the ECOFIN Council agreed an amendment to ATAD to apply the provisions concerning hybrid mismatches to non-EU Member States. Each individual provision of ATAD must be transposed into Irish law by the date prescribed by the Directive. However, there are a number of policy options regarding the transposition, which are outlined below.

7.2 Interest Limitation rule

7.2.1 Article 4 of ATAD requires Member States to introduce a fixed ratio rule which limits an entity's deductions in respect of all 'exceeding borrowing costs' to 30% of its EBITDA, as defined by the Directive. 'Exceeding borrowing costs' are defined as the amount by which deductible borrowing costs exceed taxable interest revenues and economically equivalent taxable revenues. Article 4 of ATAD provides for a number of options for Member States in transposing the Directive, including whether to provide for a lower fixed ratio. Article 11(6) provides that Member States 'which have national targeted rules for preventing BEPS risks... which are equally effective' to Article 4 may apply national rules until 1 January 2024 at the latest.

7.2.2 The Directive prescribes a minimum fixed ratio of 30%, and Member States may opt for anything between 0% and 30%. The BEPS Action 4 Report recommends anywhere between 10% and 30%. The Report outlines a series of factors to consider in determining the appropriate ratio for a jurisdiction, including that 'a country may apply a higher benchmark fixed ratio, where for constitutional or [EU law requirements] it has to apply the same treatment to different types of entities which are viewed as legally comparable, even if these entities pose different levels of risk'.

7.2.3 Article 4(1) of the Directive provides scope for Member States to allow entities calculate the ratio at the 'level of the group', with 'group' defined by domestic law. Accordingly, the definition of 'group' will need to be clarified when the interest limitation is transposed into domestic law.

7.2.4 Article 4(3) allows two derogations from the general application of the interest limitation. First, Article 4(3)(a) has the effect that Member States may give a taxpayer or group the right to deduct the first €3 million of exceeding borrowing costs/net interest expenses regardless of the company's or group's EBITDA. Assuming a fixed ratio of 30%, the benefit of this would only be available to entities or groups with an EBITDA of less than €10 million. Paragraphs 54 to 56 of the BEPS Action 4 Report recommended the inclusion of such a *de minimis* threshold on the basis 'that certain entities may pose a sufficiently low risk that excluding them from a fixed ratio rule and group ratio rule would be appropriate'. Second, Article 4(3)(b) allows the exemption of 'standalone entit[ies]' from applying the ratio. A 'standalone entity' is defined as 'a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment', while 'associated enterprise', as defined by Article 2 of ATAD, would broadly be two entities that share 25% common ownership.

- 7.2.5 Article 4(4) provides for the option for a Member State to exclude the exceeding borrowing in two circumstances. First, Article 4(4)(a) allows Member States to exclude any loans entered into prior to 17 June 2016 from the scope of the fixed ratio rule. This exclusion does not extend to any subsequent modification of such loans. If Ireland opts to exclude pre 17 June 2016 loans, only borrowing costs in respect of loans entered into or modified after 17 June 2016 would be considered in the calculation of borrowing costs when applying the ratio. Paragraph 195 of the BEPS Action 4 Report noted that: *‘a country may also apply transitional rules which exclude interest on certain existing loans from the scope of the rules, either for a fixed period or indefinitely. In this case it is recommended that these transitional rules are primarily restricted to interest on third party loans entered into before the rules were announced’*. Second, Article 4(4)(b) allows the Member States to exempt borrowing costs on loans which are used to fund long-term public infrastructure from the application of the ratio, provide certain conditions are met.
- 7.2.6 Article 4(5) allows Member States to introduce one of two types of group ratio rules which would limit the application of the fixed ratio where an entity has (i) a higher equity to assets ratio than the group ratio or (ii) has a lower interest to EBITDA ratio than the overall consolidated group of which it is a member. A decision will be needed by Ireland as to which approach, if any, is preferable.
- 7.2.7 Under Article 4(6) of ATAD, Member States may provide one of three options in terms of the manner in which a company may carry forward or backward exceeding borrowing costs which may not be deducted in the current year: (i) the first option provides for the indefinite carry forward of excess borrowing costs; (ii) the second option is the same as the first but allows companies to carry back exceeding borrowing costs for the three prior years; and (iii) the third option is the same as the first but allows the carry forward of ‘unused interest capacity’ (where an entity’s actual net interest deductions are below the maximum permitted) for a period of up to five years. Paragraph 160 of the BEPS Action 4 Report noted that providing for a carry forward or back of interest expenses or unused interest capacity may ‘reduc[e] the risk of a permanent disallowance of interest expense where interest expense and EBITDA arise in different periods’.
- 7.2.8 Article 4(7) allows Member States to exclude financial undertakings, defined widely by reference to a number of EU Directives, from the scope of the Directive. The Update to the BEPS Action 4 Report noted that there may be scope for taking a different approach to certain financial undertakings in addressing BEPS risks as: (i) banks and insurance companies rely on interest income and, in the case of banks, interest is also usually the largest operating expense; (ii) banking and insurance groups are subject to regulatory capital rules which limit the ability to shift debt; and (iii) banks and insurance companies provide debt finance, whether as providers of credit, investors, or purchasers of corporate bonds, and as such usually have a net interest income (rather than net interest expense) (OECD, 2017).

- 7.2.9 Article 4(8) allows Member States to use consolidated financial statements prepared under accounting standards other than International Financial Reporting Standards (IFRS) or local generally accepted accounting principles (GAAP).
- 7.2.10 Finally, as a consequence of the implementation of the fixed ratio rule the question arises whether to replace or remove existing anti-avoidance rules aimed at preventing the generation of excessive interest deductions. At present, section 247 TCA1997 provides for the conditions under which interest from certain qualifying loans including, *inter alia*, loans used to acquire share capital in a trading company, a Case V (rental) company or of a company that holds shares in such companies, may be treated as a deductible ‘charge on income’ by an ‘investing company’. This section contains a number of anti-avoidance provisions to prevent or restrict relief in circumstances where interest is payable on related-party borrowings which are used in connection with an acquisition of shares and assets intra-group. Ireland’s anti-avoidance rules are designed to prevent an erosion of the Irish tax base and are considered both relatively stringent, and in terms of the operation of section 247 TCA 1997, complex. Furthermore, section 249 TCA 1997 restricts relief for interest where the investing company is regarded as having, or is deemed to have, recovered capital without using it to repay the loan in respect of which interest is claimed under section 247 TCA 1997. In considering whether to remove any existing protections, consideration should be given to the recommendations of the BEPS Action 4 Report regarding the use of targeted rules to compliment a fixed ratio rule.
- 7.2.11 If it is determined that Ireland’s current interest limitation rules are equally effective then Article 4 must be transposed by 1 January 2024. Accordingly, the options outlined above will only become germane closer to that time.

7.3 Hybrid Mismatch Arrangements

- 7.3.1 The recommendations set out in the BEPS Action 2 Report, *Neutralising the Effects of Hybrid Mismatch Arrangements*, to address hybrid mismatches through domestic legislation were complex. The recommendations addressed payments made under a hybrid financial instrument, where, for example, the distribution from an instrument is treated as a dividend distribution in one jurisdiction and an interest payment in another, or payments made to or by a hybrid entity, such as a legal entity which may be treated as tax transparent in one jurisdiction and as a taxable entity in another jurisdiction. The recommendations take the form of linking rules that align the tax treatment of an instrument or entity with the tax treatment in the counterparty jurisdiction. The recommended rule is that countries deny a deduction for a payment to the extent that it is not included in the taxable income of the recipient in the counterparty jurisdiction or to the extent that it is also deductible in the counterparty jurisdiction. If this primary rule is not applied, then the counterparty jurisdiction can generally apply a defensive rule, requiring the deductible payment to be included in income or denying the duplicate deduction

depending on the nature of the mismatch. In this manner, a double non-taxation or double deduction outcome may be avoided.

- 7.3.2 Article 9 of ATAD, as initially introduced, laid down short, concise anti-hybrid rules which sought to impose an obligation on Member States to apply the BEPS primary and secondary rules. Article 9 initially applied to intra-EU payments and requires that a deduction is denied by one Member State where there is a double deduction (i.e. a tax deduction granted in two Member States for the same payment) or a deduction without inclusion (i.e. a tax deduction in one Member State but no tax charge in the Member State where the income is received). These rules were due to be implemented by Member States by 1 January 2019.
- 7.3.3 By limiting itself to intra-EU situations, the anti-hybrids element of the Directive was considered less ambitious in scope than the BEPS Action 2 report. In February 2017, the ECOFIN Council agreed an amendment to ATAD. This amendment ('ATAD 2') is intended 'to provide for a framework that is consistent with and no less effective than the OECD BEPS report on hybrid mismatch arrangements'. ATAD 2 extends the general anti-hybrid rules to target mismatches with third countries, includes rules on hybrid transfers and imported mismatches, and seeks to address the full range of double deduction outcomes. The rules are limited to intra-group scenarios where the risks of aggressive tax planning are greatest. Broadly, ATAD 2 seeks to address four broad types of hybrid mismatch situations: (i) hybrid mismatches that result from payments under a financial instrument; (ii) hybrid mismatches that are the consequence of differences in the allocation of payments made to a hybrid entity or permanent establishment; (iii) hybrid mismatches that result from payments made by a hybrid entity to its owner or deemed payments between the head office and permanent establishment or between two or more permanent establishments; and (iv) double deduction outcomes resulting from payments made by a hybrid entity or permanent establishment.
- 7.3.4 ATAD2 delays the implementation date for the introduction of any anti-hybrid rules to 1 January 2020 and allows a longer period, until 1 January 2022, to implement the elements of the rules which target so-called 'reverse hybrids', a type of hybrid entity that is treated as transparent for tax purposes in the payor jurisdiction and a taxable entity in the payee jurisdiction. There is limited optionality within the Directive for Member States. Article 9(4) of the Directive (as amended by ATAD2) does allow Member States to exclude certain hybrid mismatches from the scope of the secondary inclusion rule even where a deduction is not denied by the payor jurisdiction. Additionally, Article 9(4)(b) allows Member States to exempt hybrid instruments that are issued by banks for the sole purpose of satisfying loss absorbing capacity requirements until 2023. More generally, detailed technical consideration will be needed by Ireland to identify how anti-hybrid rules can best be implemented into Irish domestic law. The proposal is complex and transposition is likely to be challenging.

7.4 Controlled Foreign Company rules

- 7.4.1 The BEPS Action 3 Report, *Designing Effective Controlled Foreign Company Rules*, set out a number of recommendations in relation to CFC rules to better achieve international coherency in their application. The Report outlined a number of building blocks necessary for effective CFC rules including: (i) rules for considering what type of legal entity should be considered a CFC and whether the parent company has sufficient control over the foreign entity for the foreign entity to be a CFC; (ii) what kind of CFC exemptions and threshold requirements should apply, namely whether there should be a *de minimis* amount below which CFC rules should not apply, an anti-avoidance requirement to activate CFC rules, or a tax rate exemption to only apply CFC rules to CFCs in jurisdictions with lower tax rates; (iii) what type of income of a CFC should be attributable to the parent company; (iv) rules for computing income, namely which jurisdiction's computation rules should apply and whether specific rules for computing CFC income are required; (v) rules for attributing income to the shareholders of the CFC; and (vi) rules to prevent or eliminate double taxation.
- 7.4.2 The Report also notes that recommendations for CFC rules need to provide sufficient flexibility so that jurisdictions can design CFC rules that combat BEPS in a way that is consistent with both their international legal obligations and the policy objectives of their domestic tax systems. Ireland has historically not introduced CFC rules given that Irish resident companies are taxed on a worldwide basis.
- 7.4.3 Articles 7 and 8 of ATAD outline a minimum requirement for Member States to implement CFC rules and utilise a number of options suggested in the BEPS Action 3 Report. In terms of defining CFC, Article 7(1) provides broadly that a company is considered a CFC if it is subject to more than 50% control by a taxpayer or the associated enterprise of the taxpayer, and the corporate income tax paid on its profits is less than half the tax it would have paid had the income been taxed in the hands of its parent company.
- 7.4.4 Article 7(2) provides that Member States may utilise one of two approaches to determine whether the income of a CFC should be attributed to a parent company: (i) to attribute specified undistributed passive income of a CFC to the parent company or (ii) to attribute undistributed income arising from non-genuine arrangements to the parent company. The first approach provides that certain forms of specified, primarily passive, income (interest, royalties, dividends, leasing income, income from banking and insurance, income from certain intra-company services) should be attributed to the parent company except where the CFC 'carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances'. In addition, a Member State may opt to apply a *de minimis* exception, not to apply CFC rules to an entity where less than a third of its income accrues from specified passive income. If Ireland chooses to adopt the first option, consideration will be needed as to whether

Ireland adopts the substantive economic activity test for all third countries or only for CFCs in EU Member States.

7.4.5 The second approach to attributing income of a CFC to a parent company applies to ‘non-distributed income arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage’. To identify whether an arrangement is non-genuine, the Directive requires an analysis of the extent to which the CFC would not own the assets or assume the risks that it does if it were not for the parent company undertaking the people functions relevant to those assets and risks. Member States choosing this option may exclude from the scope of CFC rules an entity with accounting profits of less than €750,000 and non-trading income of less than €75,000. However, it should be noted that trading income is not defined in the Directive. Additionally, a Member State can exclude from CFC rules an entity whose accounting profits are less than 10% of its operating costs for the relevant period.

7.4.6 Articles 7 and 8 must be transposed by 1 January 2019.

7.5 Exit Tax

7.5.1 While the BEPS recommendations provided the momentum behind ATAD, two of the five anti-avoidance measures included in the Directive are not BEPS recommendations. Instead, the requirement to impose a GAAR is based on Article 80 of the first iteration of the Proposal for a Directive for a Common Consolidated Corporate Tax Base (CCCTB), as brought forward by the European Commission in 2011 (European Commission, 2011). The Exit Tax was proposed to provide that Member States are in a position to tax the economic value of any capital gain created in their territory where the gain has not been realised at the time of the transfer out of the Member State.

7.5.2 Article 5 of ATAD provides that Member States must impose an exit tax on the transfer of an asset out of its territory, the chargeable basis of the tax being the market value of the transferred assets less their value for tax purposes. The exit tax must be imposed on four types of transfer: (i) the transfer of assets from the head office to a permanent establishment in another jurisdiction; (ii) the transfer of assets from a permanent establishment to the head office or permanent establishment in another jurisdiction; (iii) the transfer of residence of a taxpayer to another jurisdiction; and (iv) the transfer of a business carried on by a permanent establishment in a Member State to another jurisdiction with the effect that the Member State relinquishes taxing rights over the transferred assets. Article 5(2) allows a taxpayer to defer the payment of the exit tax over a period of five years where the destination of any of the types of transfer is another European Economic Area (EEA) Member State. ATAD does not specify the (i) calculation of the value of the assets for tax purposes or the (ii) rate of the exit tax, which leaves discretion in these areas to Member States.

7.5.3 Ireland already imposes an exit tax: section 627 TCA 1997 operates by deeming the disposal of an asset and its reacquisition at market value for CGT purposes where a company, within the meaning of the legislation, ceases to be resident in the State. Section 628 TCA 1997 provides for a postponement of the exit tax where an Irish resident parent company is prepared to assume responsibility for the contingent liability of its subsidiary, subject to an election being made by both parties and certain conditions being met. Section 628A TCA 1997 provides for an equivalent to the deferral of payment of the exit tax as outlined in the previous paragraph. The scope of the charge in this section is not wide enough to encompass all the transactions covered by the Directive. Accordingly, the transposition of the exit tax will require legislative amendments.

7.5.4 Article 5 is required to be transposed by 1 January 2020.

7.6 General Anti-Abuse Rule

7.6.1 Article 6 of the Directive requires Member States to introduce a GAAR. The rule requires Member States to ignore arrangements ‘which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances’. An arrangement will be treated as ‘non-genuine’ to the extent that it is not entered into for valid commercial reasons that reflect economic reality. The language of the GAAR in ATAD is based on Directive (EU) 2015/121, which amended the Parent-Subsidiary Directive by adding a targeted anti-avoidance rule.

7.6.2 The Irish GAAR, as initially contained in section 86 of the Finance Act 1989 (consolidated in section 811 TCA 1997), applies to income tax, corporation tax, VAT, CGT, capital acquisitions tax, stamp duty and the USC. The GAAR provides for a definition of ‘tax advantage’, of ‘transaction’, for the Revenue Commissioners to form an opinion that a ‘tax avoidance transaction’ gives rise to a ‘tax advantage’, and for the Revenue Commissioners to make such adjustments that are just and reasonable to deny the tax advantage resulting from the tax avoidance transaction. Section 811 TCA 1997 also provides for the manner by which Revenue shall notify the taxpayer, and also provides for an appeal to the Appeal Commissioners, and thereafter to the High Court on a point of law. Section 811 TCA 1997 applies to transactions commenced on or before 23 October 2014. Section 811C TCA 1997, introduced in Finance Act 2014, applies the GAAR to transactions commenced after 23 October 2014 and dis-applies the requirement for the Revenue Commissioners to form an opinion that a transaction is a tax avoidance transaction. A person is not entitled to any tax advantage arising out of or by reason of a tax avoidance transaction to which section 811C TCA 1997 applies.

7.6.3 Article 6 provides for a minimum standard which Member States must adhere to but Member States may provide for stronger requirements. It is possible that the Irish GAAR may require no or small amendments. Article 6 is required to be transposed by 1 January 2019.

7.7 Recommendations

Recommendation 12 is made in concert with Recommendation 15, which suggests that further consultation should be undertaken on certain matters with a view to improving tax certainty:

- 12) In transposing the Anti-Tax Avoidance Directive, Ireland should have regard to the recommendations of the Reports on BEPS Actions 2, 3 and 4.

8. DELIVERING TAX CERTAINTY FOR BUSINESS AND MAINTAINING THE COMPETITIVENESS OF IRELAND'S CORPORATION TAX OFFERING

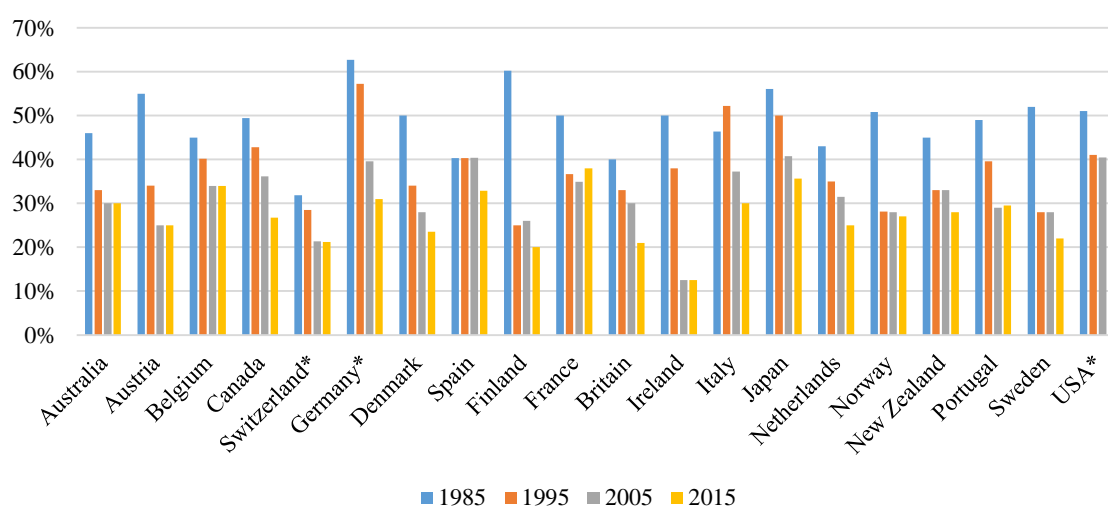
8.1 Introduction

8.1.1 The concepts of ‘competitiveness’ and ‘certainty’ in tax policy are often applied broadly. For the purposes of the review ‘competitiveness’ was considered by reference to the effectiveness of the corporation tax code in encouraging additional economic activity, increasing employment, and expanding output in Ireland, while further implementing the actions agreed under the OECD initiative to combat BEPS. Tax certainty was considered by reference to the impact of uncertainty regarding the effect of the corporation tax code on the investment decision of firms.

8.2 Tax competition

8.2.1 There is a wide empirical literature on the phenomenon of corporate tax competition, which Deveureux & Loretz (2012) have defined as ‘the uncooperative setting of source-based taxes on corporate income where the country is constrained by the tax setting behaviour of other countries’, emphasising that states compete over flows of capital, investments and profit in strategic interaction with other states while being affected by cross-border spill-overs. Cross-border spill-overs may occur where the reduction in CIT in one jurisdiction causes capital, investments or profit to flow from other jurisdictions with an increase in the capital stock, investment or tax base of the first jurisdiction. Strategic interaction between jurisdictions occurs where reductions or increases in CIT in one jurisdiction impels other jurisdictions to raise or lower their CIT rates. Statutory rates of CIT across the OECD have fallen over the past thirty years, and this behaviour has often been attributed to tax competition between states, particularly for internationally mobile capital (see chart 8.1).

Chart 8.1 Rate of CIT in selected OECD members in years 1985, 1995, 2005, & 2015.



Source: Oxford University Centre for Business Taxation Tax Database.

- 8.2.2 States may compete for three types of capital: the location of new firms; the investment of existing firms; and for accounting profits, which may be generated, according to the arm's length principle, in one country but shifted to another through transfer mispricing (Leibricht & Hochgatter, 2012). Alternative benchmarks may be used to measure competition for the three types of capital: the statutory CIT rate is often used as a measure of the incentive for profit shifting; forward looking effective average tax rates (EATR), which measure the present value of the expected tax burden of a discrete investment, are used to measure tax competition for discrete investment projects; and forward-looking effective marginal tax rates (EMTR), which measure the wedge between pre-tax and after-tax returns on capital where the final euro invested just covers the cost of capital, are used to measure the tax rate on new investments by existing firms.
- 8.2.3 Devereux & Griffith (1999, 2003) have outlined a methodology to calculate a forward-looking EMTR and EATR. The methodology examines a hypothetical investment taking place in one period and generating a return in the next period. The EMTR and EATR takes account of a number of features of the tax code, including the statutory rate of CIT, capital allowances, deductibility of interest or equity, and treatment of foreign source income. ZEW (2015) prepare an analysis of the EATR of each EU Member State, based on the Devereux/Griffith methodology, in respect of investment in five types of asset and three sources of financing on an ongoing basis. The average EATR of EU Member States, calculated using the Devereux/Griffith methodology, fell gradually between 1998 and 2007, though notably Ireland's gradually increased for certain investments due to the ending of the manufacturing relief (Elschner & Vanborren, 2009).
- 8.2.4 Statutory CIT rates fell from the early 1980s through to the late 1990s, a process accompanied, in the EU-15 and G7 states, by the broadening of the CIT tax base with the effect that the EMTR remained broadly stable and EATR for projects earning economic rents fell, indicating competition for mobile highly profitable capital (Devereux, Griffith, Klemm, Thum & Ottaviani, 2002). Statutory rates within the EU-28 and EU-15 have continued to fall through the 2000s. It is particularly notable that the United Kingdom has, since 2008, embarked on a gradual reduction in its main statutory rate of corporation tax from 28% in 2010 to 19% in 2017 combined with reducing the main rate of capital allowances, continuing a policy of tax cutting and base broadening initiated in 1984, the thrust of which has been carried through by successive British administrations (Miller & Pope, 2015).
- 8.2.5 Tax competition may take the form of one or all of (i) reductions in the statutory CIT rate, (ii) narrowing the CIT base (captured by the AETR and METR), (ii) relaxed enforcement of national tax law towards MNEs, and (iv) non-transparent

tax law or administrative practice (Genschel & Schwarz, 2011). International tax co-ordination has circumscribed corporate tax competition in a number of these areas. The OECD FHTP and EU Code of Conduct have, over time, reduced the scope for the introduction of targeted preferential tax regimes to attract more mobile capital, and BEPS Action 5 will have the effect of restricting ‘Patent Boxes’ to the ‘modified nexus’ approach. Transparency initiatives including revisions to the EU Directive on Administrative Co-operation and the BEPS Actions relating to transparency, which have reduced the scope for non-transparent tax law or practices and the relaxed enforcement of tax law regarding MNEs. One of the main vectors for BEPS activities is the potential for transfer mispricing, and the combination of BEPS Actions 8-10 and 13 should reduce the potential in this area. Accordingly, the main areas for potential CIT competition will increasingly be the statutory rate of CIT, AETR and METR, and the limited number of tax expenditures compatible with international norms regarding fair tax competition utilised by jurisdictions. It can be expected that smaller states, such as Ireland, with limited initial factor endowments, lower capacity for economies of scale than larger markets, and availability of agglomeration rents, will continue to levy lower rates of CIT to attract mobile international capital.

Box 8.1 Tax harmonisation

The most comprehensive proposals for CIT harmonisation at a supranational level have emanated from the EU. Initially, such proposals were designed to facilitate the objectives of the Treaty Establishing the European Economic Community (TEEC), namely the removal of restrictions on the movement of capital (Article 67 TEEC) and the freedom of establishment of firms (Article 52 TEEC), issuing laws regarding the establishment or functioning of the common market (Article 100 TEEC) or create distortions to the common market (Article 101 TEEC).

The 1962 Neumark Report recommended the harmonisation of the CIT codes of the six EEC Member States on the basis of a partial integration of PIT and CIT using the split-rate methodology (European Commission, 1963). In 1967, the European Commission proposed measures to eliminate double juridical and economic taxation with the EU, and, more ambitiously, ‘a uniform definition and method of calculation of taxable corporate profits’ and approximation of common rates (European Commission, 1967). The Commission believed such proposals would ensure neutrality between sources of finance (i.e. retained earnings versus new equity) and in choice of business formation (i.e. whether to incorporate). In 1970, the van den Temple Report carried out for the Commission recommended harmonisation on the basis of the classical system of corporate taxation, on the grounds that it was most effective in facilitating the relief of international juridical double taxation. In 1975, the Commission published a draft Directive providing for the harmonisation of company taxation on the basis of imputation, with statutory rates permitted within a band of 45% and 55%, and the removal of withholding taxes on dividends and interest. This proposal took into account Directives already proposed in the field of relieving taxation regarding cross-border intra-group distributions and the removal on fiscal obstacles to cross-border mergers (European Commission, 1975). However, the draft Directive did not include provisions for a common tax base. A 1980 report by the Commission recognised that harmonisation would require a common scope of application (i.e. definition of the taxable person), a common tax system, similar rates of tax, and a common basis of assessment (European Commission, 1980). However, a 1988 proposal to harmonise the CIT base was never presented, given opposition from Member States.

During the late 1980s, in light of the Single European Act and efforts to complete the Internal Market, legislative proposals were focused on relieving cross-border juridical and economic double taxation within the EU and resolving disputes which might lead to double taxation of enterprises (European Commission, 1990). In 1990, the Parent-Subsidiary Directive, Mergers Directive and

Arbitration Convention were adopted into EU law, and Directives providing for cross-border loss relief and the removal of withholding taxes on interest and royalties were proposed. At the same time, the Commission indicated that it was withdrawing its 1975 draft Directive and formed an expert committee to examine the issue of (i) whether different systems of company taxation distort the common market, (ii) if so, whether such distortions would be eliminated by tax competition or require a legislative proposal, and (iii) what specific measures were required to eliminate such distortions. The subsequent 1992 Ruding Report did not suggest full harmonisation but suggested that the Commission should focus on removing obstacles to cross-border investment and shareholding, restrict tax competition through a common minimum CIT base and common minimum statutory CIT rate, and encouraging transparency as regards tax incentives (European Commission, 1992).

Notwithstanding the Ruding Report, in general EU policy in the 1990s accepted the existence of CIT competition, and sought to restrict the use of harmful preferential tax regimes designed to attract mobile capital through the EU Code of Conduct. In 2001, the European Commission suggested a common CIT base with companies assessed on a consolidated EU-wide basis, profit attributed between Member States on the basis of formulary apportionment, and no harmonisation of national tax rates (European Commission, 2001a;2001b). While a number of options were discussed, including, in one variant a single EU CIT code administered by a single EU authority with a single EU-wide tax rate to fund the EU institutions, by 2004 the ECOFIN Council began work on a Common Consolidated Corporate Tax Base, a common tax base to which companies headquartered in an EU Member State could opt in. In 2011, the Commission proposed a draft Directive for a Common Consolidated Corporate Tax Base (CCCTB) (European Commission, 2011). Member States could not agree on the CCCTB proposal and it was withdrawn.

In June 2015, the European Commission indicated it would seek to relaunch the CCCTB. In October 2016, the European Commission brought forward two discrete legislative proposals: first, a proposed Council Directive on a Common Corporate Tax Base, which would replace the extant corporate income tax bases of all EU members applying to with a common corporate income tax base to apply to all company groups with a turnover greater than €750 million; and consequent to the adoption of a common base, a proposed Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), which would apportion taxable profits of companies between Member States by reference to a formula based on the location of sales, employees and fixed capital assets of a taxable company (European Commission, 2016c; 2016d).

8.3 Taxation of foreign income of companies

Moving to a territorial tax base

- 8.3.1 Of the 34 members of the OECD, six, including Ireland, impose CIT on a worldwide basis, with relief from double taxation provided via the credit method. The other 28 OECD member states operate a territorial corporate income tax base, although the types and share of foreign income taxed vary from state to state depending on national policy choices. In general, the territorial CIT base applies to exempt the dividends remitted from companies resident in another jurisdiction controlled, by reference to a holding requirement, by companies resident in the parent jurisdiction and also exempts the foreign branch profits of the latter companies. This practice, as respects the dividend exemption, is often referred to as a ‘participation exemption’. A number of OECD member states have moved in recent years towards a participation exemption for foreign dividends and/or exemption of branch profits including Germany since 2001, and Australia, New Zealand, Japan and the UK since 2009.
- 8.3.2 During the public consultation a number of stakeholders suggested moving to a territorial CIT base. The difficulty of computing the credit for foreign income,

particularly when income arises from multiple jurisdictions, was highlighted as a competitive disadvantage. Schedule 24 TCA1997, which gives effect to the computation of the foreign credit, has been amended multiple times since 1997 in light of policy changes and to take account of judicial decisions. Accordingly, the operation of the relief for foreign credit has become more complex, which is seen as a burden on business. Entitlements to credit, deduction, pooling and carry-forward as they apply to foreign income in the form of royalties, branch profits, interest, dividends and leasing income in respect of both DTAs and unilateral relief are set out in Schedule 24 TCA 1997.

Historical participation exemption regimes

- 8.3.3 There were previously limited participation exemption provisions for foreign income in operation: the first, provided through section 847 TCA 1997, related to profits from specified foreign trading activities of IFSC companies and was discontinued for accounting periods ending after 31 December 2010; the second, provided through section 222 TCA 1997, was an exemption for specified foreign dividends certified by the Minister for Finance paid to an Irish parent company aimed at encouraging repatriation of foreign dividends.²¹ However, the general policy stance has been to reject any move to a participation exemption for foreign branch profits and for foreign dividends without corresponding anti-avoidance measures such as CFC rules, or thin capitalisation rules which prevent the creation of interest expenses above a certain limit. Given Articles 7 and 8 of the ATAD now provide for CFC rules it may, depending on the nature of the CFC rules introduced, be timely to consider whether it is appropriate to consider: (i) moving towards an exemption methodology in respect of providing double taxation relief for intercompany distributions and/or branch profits; or as an alternative, (ii) redrafting Schedule 24 TCA 1997 to provide for a simplification of the operation of computation of the foreign credit.

Achieving neutrality in international taxation

- 8.3.4 The choice of opting for either the exemption or credit method is sometimes characterised as a choice between alternative forms of tax neutrality, in this case alternative methods to ensure that the allocation of capital is not distorted. Richman (1963, 1969) pioneered the concept of neutralities in international tax policy in the context of debates about the taxation of the foreign income of US corporations in the early 1960s, highlighting the trade-off between capital export neutrality, treating investment the same for tax purposes regardless of the country of destination, and capital import neutrality, treating investment the same for tax purposes regardless of the country of origin. A third concept, introduced in light of the increasing importance of highly company-specific productive intangible assets, is that a tax system should achieve capital ownership neutrality such that a company will acquire assets to maximise their pre-tax returns.

²¹ The withdrawal of both measures followed a Commission Decision that the measure constituted unlawful State aid - 2003/601/EC: Commission Decision of 17 February 2003 on aid scheme C54/2001 (ex NN55/2000) Ireland — Foreign Income (Text with EEA relevance) (notified under document number C(2003) 569) OJ L 204

- 8.3.5 Capital export neutrality can be achieved through a worldwide residence based tax base with no provision for taxation on a remittance basis (i.e. no deferral of tax liability on foreign income) and the provision of an unlimited credit for the payment of foreign tax (i.e. the credit could be used to offset domestic liabilities). Capital export neutrality enhances global economic efficiency, under certain assumptions, by ensuring that outbound investors' capital allocation decisions are determined by the pre-tax rate of return on capital. To achieve pure capital export neutrality would require that all jurisdictions adopt a worldwide system of taxation, with no deferral of tax and foreign tax paid offset by a full credit for foreign tax. This would eventually equalise the marginal productivity of capital across all countries, maximising global income. In practice, residence-based jurisdictions limit the foreign tax credit to foreign income and tax certain types of corporate income on a remittance or deferred basis (Kofler, 2012). This practice has been referred to as 'defensive neutrality', as the limitation on foreign tax credit provides a dis-incentive to invest in higher tax jurisdictions, although capital export neutrality may still apply to lower-tax jurisdictions. The commitment to capital export neutrality as a policy goal was strongest in the US during the 1960s, given global outbound foreign direct investment was dominated by the US. However, even then the US did not move to provide an unlimited foreign tax credit .
- 8.3.6 National neutrality implies that it is optimal, from a national perspective, to operate a worldwide CIT base with no deferral and to allow foreign tax paid as a tax deduction in the same manner as business expenses or labour costs (i.e. taxing after-tax foreign income) (Feldstein & Hartman, 1979). Investors will be neutral between the pre-tax return on domestic investments and the return on foreign investment after payment of foreign taxes. This effectively imposes a higher tax rate on outbound investments and as such favours domestic investments. It has been argued this approach would raise national welfare by maximising the sum of tax revenue and after-tax profits of home-country companies, as opposed to the objective of capital export neutrality, which would raise global welfare by ensuring optimal global economic efficiency. The feasibility of the policy mix required for national neutrality is greater in a large capital-exporting country, and as such has been suggested in the US. Though considered, it has been dismissed due to fears that other jurisdictions would retaliate (Graetz & O'Hear, 1997). In addition, the assumption underlying national neutrality is that there is a fixed supply of domestic saving, ensuring a direct trade-off between outbound investment and domestic investment.
- 8.3.7 Capital import neutrality can be satisfied through a territorial tax base operationalised through an exemption for active business income earned by subsidiaries or branches of a domestic corporate taxpayer. Capital import neutrality and capital export neutrality cannot be satisfied by jurisdiction unless all jurisdictions impose the same CIT rate.²² Capital import neutrality is often linked

²² Capital import neutrality and capital export neutrality cannot be satisfied by jurisdiction unless all jurisdictions impose the same CIT rate. If jurisdiction A imposes a CIT rate of 40% on a territorial basis, and jurisdiction B

to international competitiveness, as it ensures that domestic firms seeking to invest abroad can achieve the same post-tax return as their competitors.

- 8.3.8 Given the growth in cross-border investment since the 1980s, a larger proportion of the domestic capital stock in OECD states is owned by foreign corporations or shareholders. Desai and Hines (2003, 2004) have noted that the productivity of assets, particularly intangible assets used by MNEs, are dependent on the identity of the entity which owns and controls the assets. They proposed that international tax policy should ensure capital ownership neutrality, a condition which is satisfied if the tax code does not distort cross-country ownership patterns, such that the tax system is neutral regarding the ownership of assets, which ensures that those companies willing to pay the greatest pre-tax price for an asset (that is, the company capable of ensuring the greatest productivity of assets) acquire, manage and control those assets (Griffith, Hines, & Sorensen, 2010). It is argued that a territorial CIT base is closer than a worldwide CIT base to optimising ownership of assets from a national perspective (i.e. ensuring the highest productive use) as MNEs headquartered in a territorial jurisdiction will earn a higher post-tax return on operations in a low-tax foreign jurisdiction, which increases the reservation price such MNEs are willing to pay to acquire the asset (Desai & Hines, 2003). Accordingly, it has been argued that a jurisdiction operating a territorial CIT base may be said to satisfy national ownership neutrality (Hines, 2003).
- 8.3.9 Devereux (2008) introduced the concept of market neutrality, which is satisfied if no company can gain a tax-induced advantage over another. In other words, if two firms, resident in any jurisdiction, compete in the same market, in any jurisdiction, they should face the same effective tax rate on their investment. This would require complete harmonisation of CIT rates and bases with the effect that effective tax rates in third countries are the same.
- 8.3.10 The theoretical discussions above play a greater role in countries with (i) a relatively high rate of corporate income tax, and (ii) significant outbound investment. Ireland's statutory rate of CIT on trading income is the lowest in the OECD, and foreign tax credits are not provided against domestic income as the cost of doing so would be prohibitive. Accordingly, the Irish worldwide CIT base does not satisfy capital export neutrality. In any case, given the relatively small 'domestic' pool of capital (i.e. that available to domestic firms and MNEs headquartered in Ireland) available for outbound investment any possible increase in the allocative efficiency of capital globally, if that were a public policy objective, would be minimal.
- 8.3.11 The low rate of trading CIT and provisions for pooling of dividends ensure that Ireland achieves capital import neutrality insofar as Irish outbound investors will usually not be subject to Irish CIT on returns from investment abroad as provided

imposes a CIT rate of 30% on a worldwide basis with provision of an unlimited foreign tax credit then investment from jurisdiction B into jurisdiction A would satisfy capital export neutrality as investments in both A and B by an A-based company are subject to tax rate of 40%. However, capital import neutrality cannot be satisfied as an investment in B by a B-based company would be subject to a global tax rate of 30%, while an investment by an A-based company would be subject to global tax rate of 40%.

for by the relevant DTA or, in the case of unilateral relief, subject to the relevant rules outlined in Schedule 24 TCA 1997. Accordingly, there is a very high probability that outbound investors will be subject to tax *only* in the source country. This also ensures national ownership neutrality in most cases. Changing the location of the Irish corporate income tax base will have little impact on the satisfaction of neutralities in international taxation nor, given Ireland's small pool of domestic outbound investors, should it form the main basis of policy consideration.

Current participation exemption

- 8.3.12 At present, a participation exemption is provided for the disposal of shareholdings in a foreign company in certain circumstances. Section 626B TCA1997 was introduced through section 42 of the Finance Act 2004 to provide for exemption from corporation tax on gains from the disposal of shares in an investee country where the investor is the parent company of the investee company. The conditions for the relief are: (i) the investor company must have held at least 5% of the ordinary shares in the investee company (including the rights to profits and assets on a winding-up) for a continuous period of 12 months at the time of the disposal or ending within two years of the disposal; (ii) the investee company must be resident for tax purposes in an EU/treaty country; and (iii) the investee company must carry on a trade; or the business of the investor company, its investee company and their "5%" investee companies, taken as a whole, must consist wholly or mainly (considered to mean greater than 50% by the Revenue Commissioners) of the carrying on of a trade or trades.

Taxation of foreign dividends

- 8.3.13 Paragraphs 8 and 9 of Schedule 24 TCA 1997 provide for a credit to be given to relieve underlying tax in respect of foreign dividends received by a company, subject to conditions regarding minimum shareholdings or voting power as dictated by the relevant DTA. This mitigates economic double taxation in relation to an inter-associated company dividend distribution. The underlying foreign tax is considered the foreign tax attributable to the proportion of the profits out of which the dividend is paid.
- 8.3.14 The Parent-Subsidiary Directive provides that inter-company distributions from subsidiary to parent, subject to a minimum holding percentage or a holding period as outlined in Article 3, should be relieved of economic and juridical double taxation by either the credit or exemption method. Ireland has opted to apply the credit method. The jurisprudence of the Court of Justice of the European Union (CJEU) also influences the structure of taxation of cross-border inter-company dividends within the European Union. In the broadest terms, where a Member State relieves economic double taxation of distributed profits for resident taxpayers it must extend this relief to non-residents such that any economic double taxation must apply to resident and non-resident taxpayers.
- 8.3.15 The CJEU's interpretation of the compatibility of diverging treatment of domestic-source and foreign-source dividends with Articles 49 & 56 TFEU (the freedom of

establishment and freedom to provide services respectively), in two successive CJEU cases (‘FII1’ and ‘FII2’) – in effect resulting from two references to the CJEU in respect of the same UK legal matter - has necessitated legislative changes in Ireland and the UK, and substantive changes to the treatment of foreign-source dividends.²³ On foot of the FII1, section 21B TCA 1997 was introduced to allow taxpayers elect to have foreign dividends paid out of trading income taxed at the 12.5% rate and pool excess foreign credits in respect of dividends to reduce the tax liability on receipt of other foreign dividends. Excess credits on dividends chargeable at 12.5% cannot be credited against tax on dividends chargeable at 25% (although excess credits in respect of ‘25% dividends’ *can* be set off against 12.5% tax of foreign dividends). On foot of FII2, provision was made for an additional foreign tax credit (AFTC). The AFTC acts as a top-up foreign tax credit where Schedule 24 does not provide full relief from Irish corporation tax on EU-sourced dividends – this is provided for by computing the AFTC by reference to the statutory rate of corporation tax that applies in the jurisdiction of the company making the distribution.

Table 8.1 Quantum of foreign dividend income at 12.5% and 25% rate on the CT1 form, 2010 – 2015 (€m)

Year	2011	2012	2013	2014	2015
section 21B claim (foreign dividends 12.5%)					
Claimants	298	345	368	393	434
Amount (€m)	2,157	3,521	2,690	4,213	7,607
Other Foreign Dividend (25%)					
Claimants	484	463	512	511	526
Amount (€m)	100	23	41	217	213
Credit for all foreign tax claimed					
DTA Relief*	567	673	552.3	949.5	947.5
AFTC***	0	0	0.5	70.4	237.5

*Refers to the aggregate of all creditable foreign tax claimed

**AFTA introduced Finance Act 2013.

Source: Revenue Commissioners.

8.3.16 Over 95% of the total amount of foreign dividends reported by corporate taxpayers for accounting periods ending in 2015 were claimed by taxpayers to be receivable at 12.5%.

8.3.17 ‘Credit pooling’ was introduced in the Finance Act of 2004. To utilise pooling arrangements, the receiving company must have 5% or more of the voting power within the paying company. Unused credits may be carried forward indefinitely for use in future periods.

8.3.18 In practice, Irish resident companies with foreign subsidiaries will not pay tax on the profits of such subsidiaries as companies will utilise the pooling of dividends and timing of dividends payments to ‘mix’ credits from high tax and low tax

²³ Case C-446/04, *Test Claimants in the FII Group Litigation*, ECLI:EU:C:2006:774; Case C-35/11, *Test Claimants in the FII Group Litigation*, ECLI:EU:C:2012:707.

jurisdictions, retain earnings overseas for reinvestment rather than face a potential Irish tax liability, or realise profits as a chargeable gain through the disposal of shares in, or liquidation of, a foreign subsidiary to avail of the s. 626B TCA 1997 exemption. Stakeholders have noted that the application of foreign credit is complex to apply in practice, particularly where an Irish resident company owns companies in multiple jurisdictions.

Taxation of foreign branch profits

- 8.3.19 Given the worldwide basis of Irish corporation tax, where an Irish resident company operates a foreign branch or agency/permanent establishment (PE) in another jurisdiction the profits of the foreign branch/PE are generally subject to Irish tax. Irish corporation tax principles are applied to computing the profits and allowable expenses of a foreign branch. The losses attributable to a foreign branch/PE will be taken into account in computing the profits of the Irish resident company. The pooling of branch profits is provided for under Paragraph 9FA of Schedule 24 TCA 1997 (inserted in the Finance Act 2007) and applies to branch profits from both treaty and non-treaty jurisdictions. Accordingly, unrelieved foreign tax (i.e. excess credits in respect of a foreign branch, reduced by relief for deduction) may be set against corporation tax payable in respect of other foreign branch income for the period. Excess credits may also be carried forward.

Other territorial systems

- 8.3.20 In 1999, the then Inland Revenue issued a document on double taxation relief for companies, which noted that the historic aim of the UK's credit system was to achieve capital export neutrality. Despite the commitment to achieve capital export neutrality, it was not decided at that time to extend the foreign tax credit for utilisation against UK-source income given the Exchequer implications, nor was it decided to subject the worldwide income of UK corporate residents (including their subsidiaries) to immediate taxation. In 2006, the CJEU found that CFC rules must respect the freedom of establishment and refrain from creating an unjustified difference in treatment between domestic and foreign investment, which had the effect of limiting CFC rules to wholly artificial transactions.²⁴ In that context, in 2007 HM Treasury published a discussion document regarding the possibility of introducing participation exemption system for the foreign income of British companies in concert with targeted interest limitation rules and revised controlled company rules which would tax certain categories of passive income at the parent company level, with a view to 'improve the competitiveness and attractiveness of the UK as a location for multinational business' (HM Treasury, 2007). The paper noted that the necessary corollary of the benefits of an exemption system in terms of simplification and reductions in administrative cost was anti-avoidance rules to prevent profit shifting out of the UK. The participation exemption for branch profits introduced by the UK in 2009 allowed companies to elect irrevocably for an exemption from UK corporation tax of foreign branch profits rather than using the credit method. Early analysis based on micro-level data from company level databases suggests that the move to a participation exemption in respect of

²⁴ C-196/04 - Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue.

dividends increased the quantum of profits repatriated to Britain in the short-run (Eggers, 2015).

- 8.3.21 In 1988 New Zealand moved to a worldwide tax base for their corporate income tax base, introducing CFC rules and providing for taxation of foreign dividends with relief provided via the credit method. In 2009 New Zealand reintroduced a territorial tax base to remove impediments to outbound investment for New Zealand resident companies and minimise compliance costs (NZ Treasury, 2007). However, the New Zealand Treasury noted that dividends that gave rise to a deduction in the subsidiary's jurisdiction should be denied (i.e. hybrid instruments) to (i) prevent a double non-taxation result, and (ii) to prevent tax-based incentives for New Zealand resident companies to move formerly New Zealand based economic activities to other jurisdictions. New Zealand also retained its CFC rules. Australia moved to a territorial tax base in 1991, although the participation exemption was restricted to dividends flowing from those jurisdictions with a similar tax base to Australia (Canada, France, Japan, New Zealand, the UK, and the US). In 2004, Australia extended its participation to exemption to all jurisdictions to encourage outbound investment (Australian Department of the Treasury, 2002).
- 8.3.22 Article 8(d) of the Draft Directive 2016/0337 (the 'Common Corporate Tax Base' or 'CCTB'), proposed by the European Commission in October 2016, provides for an exemption for corporate taxpayers for 'received profit distributions, provided that the taxpayer has maintained a minimum holding of 10 % in the capital or 10 % of the voting rights of the distributing company for 12 consecutive months' (European Commission, 2016c). This exempt distribution is subject to a 'switch-over clause' provided by Article 53 – this has the effect of a 'switch over' from exemption to taxation with a deduction for foreign tax paid where the profit distribution is received from an otherwise qualifying distributing company in a third country (i.e. non-Member State) where the distributing company would be subject to a statutory CIT rate 50% lower than the CIT rate in the Member State.

Design of a participation exemption for dividends and branch profits

- 8.3.23 Common features of participation exemption regimes include a number of anti-avoidance measures such as, *inter alia*, (i) CFC rules to prevent the diversion of profits to subsidiary companies in other jurisdictions, (ii) limits to interest deductibility to prevent the erosion of the home jurisdiction's tax base through deductible interest costs of funding foreign investments that yield only tax-exempt income, (iii) the maintenance of residual tax on foreign income (i.e. a 95% exemption rather than a 100% exemption) and (iv) provisions to limit access to tax treaty benefits that would otherwise effectively accrue to exempt foreign branches of resident companies. In the case of CFC rules, should a decision be made to introduce a participation exemption for branch profits and dividends, consideration would have to be given as to whether such rules should be more extensive than the minimum prescribed by ATAD. As regards limits to interest deductibility, consideration will have to be given to the effectiveness of both existing interest limitation provisions, which restrict the deductibility of interest on a loan advanced

to foreign subsidiary in certain circumstances, and the prospective interest limitation rules under Article 4 of ATAD.

8.3.24 The *Harmful Tax Competition* report identified the exemption of foreign income as a factor in identifying a harmful preferential tax regime, as such an exemption may encourage the location of entities for tax rather than business purposes, and may be used for treaty shopping (OECD, 1998: 32). Articles 6 to 11 of the Multilateral Instrument may mitigate some of these risks. The *Harmful Tax Competition* report noted provisions which may artificially define the tax base may include unconditional rules for the avoidance of double taxation (built in to the exemption or the credit method) that go beyond the ordinary scope of the instruments to avoid double taxation - economic as well as judicial (OECD, 1998: 30). Accordingly, the *Harmful Tax Competition* report recommended that ‘that countries that apply the exemption method to eliminate double taxation of foreign source income consider adopting rules that would ensure that foreign income that has benefited from tax practices deemed as constituting harmful tax competition do not qualify for the application of the exemption method’ (OECD, 1998: 43). These recommendations should be taken into account when considering whether, and how, to introduce participation exemption.

8.3.25 Other design features to be considered include: (i) whether a participation exemption should be restricted to a certain set of countries, whether countries with which Ireland has a DTA or by reference to another set of criteria; (ii) whether to provide that Irish companies should hold some minimum ownership in a foreign subsidiary to qualify for an exemption for foreign dividend income; (iii) whether to limit an exemption for branch profits to the trading income of branches; (iv) and the basis on which profits attributable to the foreign branch should be determined (the default option should be to base any such determination on the relevant Business Profits article of the DTA); and (v) whether to permit taxpayers to elect for relief of foreign tax by exemption or credit. Of particular importance will be the interaction of an exemption for foreign branches with the existing allocation of taxing rights within Ireland’s DTA network.

Rationale for moving to territorial tax base

8.3.26 The rationale for introducing a participation exemption regime in recent years has primarily been to enhance the competitiveness of domestic tax regimes. The transmission channel for improving competitiveness includes: (i) improving the position of domestic firms vis-à-vis the taxation of outbound foreign direct investment, (ii) improving the attractiveness of the CIT code vis-à-vis the location of holding companies and, (iii) reducing what may be a non-trivial compliance burden on domestic outbound investors. Given the combination of pooling and carry-forward provisions for foreign dividends and branch profits and a low CIT rate ensures that domestic firms do not generally face an Irish CIT charge on foreign income, the second and third channels are the most germane in the Irish case.

Redrafting Schedule 24

8.3.27 As an alternative to moving to a territorial CIT base, which would involve a narrowing of the Irish corporation tax base and a move away from the long-standing presentation – and defence – of our corporate tax system as *low rate/broad base*, there may be scope for a comprehensive redrafting of Schedule 24 with a view to a policy and revenue neutral simplification of the computation of the foreign credit for all forms of foreign income: dividends, branch profits, interest, royalties and leasing income. This would achieve the competitiveness advantages associated with moving to territorial CIT base, whilst avoiding the introduction of additional complexity to the corporation tax code in the design of a participation exemption. Any simplification of the foreign tax credit should have particular regard for the contribution of foreign royalty income to corporation tax receipts.

8.4 Tax certainty

8.4.1 Certainty for an individual regarding their tax liability, including the timing, manner and quantity of taxation, was one of the four maxims of taxation identified by Adam Smith. This principle of taxation has been applied in modern frameworks. The BEPS Action 1 Report utilised the ‘The Ottawa Taxation Framework Conditions’ agreed as part of the 1998 report on the Taxation of Electronic Commerce which were the basis of the Ottawa Ministerial Conference (OECD, 2001; OECD, 2015). The principles identified by the Framework Conditions included certainty and simplicity, namely that ‘tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted’ (OECD, 2015: 17). Tax uncertainty may be considered a departure from the principle of certainty in tax matters such that it is difficult for a taxpayer to manage the risk associated with a particular activity or investment due to the difficulty of ascertaining the location, quantum, or timing of the prospective tax liability on that activity or investment. Achieving tax certainty must also be considered with the other objectives of a tax system, namely to collect, in a context where a state faces a budget constraint imposed by fiscal rules or by the normal operation of sovereign debt markets, a desired quantum of tax revenue to finance a desired quantum of public goods and services, to redistribute income in a manner consistent with societal preferences, and to achieve the wider macroeconomic and microeconomic objectives of government policy.

Increasing perception of tax uncertainty

8.4.2 The current international environment has been perceived as one of increasing tax uncertainty regarding the taxation of profits of companies, particularly as regards cross-border investment. A number of international and domestic drivers of tax uncertainty in recent years include: (i) the introduction of adjustments to the CIT rate or base designed to enhance economic growth and/or assist in fiscal consolidation in response to the global financial crisis; (ii) the increasing participation in, and formation of, GVCs by MNEs with the consequence that production, distribution and exchange increasingly takes place across borders and within MNEs; (iii) the increasing importance of intangible assets in MNEs GVCs and attendant difficulties in correctly attributing profits to MNE affiliates; (iv) the

introduction of unilateral policy measures by states to assert taxing rights to profits; and (v) the implementation of the BEPS Actions, although in the medium term the BEPS Actions, both in terms of Action 14 and in totality, may reduce uncertainty.

Sources of tax uncertainty

- 8.4.3 In response to a request by the G20 in September 2016, the International Monetary Fund (IMF) and OECD prepared a report on tax certainty for the G20 Finance Ministers (OECD/IMF, 2016).²⁵ The Report classified the sources of uncertainty into six categories: (i) tax policy design and legislative uncertainty; (ii) policy implementation and administrative uncertainty; (iii) uncertainty around dispute resolution mechanisms; (iv) uncertainty arising from changes in business and technology; (v) taxpayer conduct; and (vi) international aspects of uncertainty. The Report discussed the results of two major surveys, conducted by the OECD, of sources of tax uncertainty and tools for reducing tax uncertainty. The first surveyed businesses and the second surveyed Forum on Tax Administration (FTA) member tax administrations.
- 8.4.4 The Report extracted the top ten sources of tax uncertainty from the business survey: (i) considerable bureaucracy to comply with tax legislation, including documentation requirements; (ii) unpredictable or inconsistent treatment by the tax authority; (iii) inconsistencies or conflicts between tax authorities on their interpretations of international tax standards; (iv) lengthy decision making of the courts, tribunals or other relevant bodies; (v) complexity in tax legislation; (vi) tax legislation not in line with the evolution of new business models; (vii) unpredictable and inconsistent treatment by the courts; (viii) unclear, poorly drafted tax legislation; (ix) lack of expertise in tax administration on aspects of international taxation; and (x) inability to achieve early certainty proactively. While only two of the top ten sources of tax uncertainty related to tax policy design and legislation, seven of the top ten tools for fostering tax certainty were related to legislation, including: (i) reduced frequency of changes in the tax legislation; (ii) reduction of bureaucracy to comply with tax legislation; (iii) detailed guidance in tax regulations; (iv) changes in statutory tax rates announced in advance; (v) reduced length and complexity of tax legislation; (vi) domestic tax legislation in line with international taxation standards; and (vii) timely consultation with taxpayers when changes are introduced. The availability of effective domestic dispute resolution regimes was also highlighted.
- 8.4.5 The Report also included a narrative analysis undertaken by the IMF quantifying the frequency of policy changes to the CIT rate and base and lag in implementation of policy changes across twelve advanced countries (not including Ireland) between 1983 and 2014. This indicated that the frequency of changes in CIT policy varied widely, with an average of 17 significant policy changes per country over the period, with 40 being the greatest and nine being the least, with a spike in changes during the financial crisis. The implementation periods for most changes were at

²⁵ The report was prepared by the staff of the OECD and IMF. The institutions note that it reflects a broad consensus amongst staff but should not be regarded as officially endorsed views of the organisations or their member countries.

least 150 days after announcement, 20% of changes were implemented in less than 30 days. Of the 12 countries surveyed, only one showed an average implementation period of less than 100 days, while the average implementation period increased towards the end of the observed period.

Effects of tax uncertainty

- 8.4.6 Uncertainty regarding the taxation of profit is widely perceived as negatively affecting the location and quantity of investment by business (Devereux, 2016). Given the range of sources of tax uncertainty, it is difficult to quantify the effects of tax uncertainty. For example, although it is possible to explore the impact of uncertainty regarding a change in the CIT rate or base, it is more difficult to examine the impact of administrative practices which by their nature incorporate a discretionary element on the part of tax administrators. Intuitively, where a business investment entails sunk (i.e. irreversible) costs businesses may postpone or change investment decisions should the post-tax return on investment be sufficiently uncertain. This intuition applies whether the uncertainty in question is the kind of radical uncertainty described by Knight (1921/1957), where it is not possible to assign a probability of an outcome occurring, or whether there are a number of outcomes to which probabilities can be assigned.

Reducing tax uncertainty: tax policy design and legislative uncertainty

- 8.4.7 Tax uncertainty can result from frequent and unexpected changes to tax legislation as economic operators may require time to adapt to changes, such as additional administration requirements. The OECD/IMF Report suggests that proactive consultation, announcing changes in advance and timely issuance of guidance can reduce uncertainty regarding tax measures. It is also important that the implementation period for tax changes is predictable, and clearly signalled to taxpayers to ensure they can prepare for changes. However, it may be appropriate to provide shorter or minimal implementation periods in a number of circumstances: first, to provide for a shorter implementation period to avoid forestalling by taxpayers, whereby an opportunity is created to shift income or gains between tax periods; and second, to prevent or induce changes in economic decision-making by taxpayers.
- 8.4.8 In Ireland, the implementation period for corporation tax changes has usually been between the announcement of a change by the Minister for Finance in the Financial Statement (i.e. the Budget Speech) to Dáil Éireann and the enactment of the Finance Bill giving effect to the Minister's announcements. Following the alignment of the fiscal year with the calendar year Budgets were presented in early December and the Finance Bill enacted in late March, giving an implementation period of 120 days. Following the coming into force of Regulation (EU) No 473/2013, Article 4(2) of which provided that the draft budget for the forthcoming year for the central government of EU Member States should be made public not later than 15 October, the annual Budget has been presented in mid-October, and the Finance Bill enacted

in mid-December.²⁶ This has reduced the normal implementation period to between 65 to 70 days. Particular corporation tax measures have had longer implementation periods, characterised by consultation with key stakeholders. For example, an intention to introduce the KDB was announced in October 2014 as part of Budget 2015, a public consultation was published in January 2015, a feedback statement was published in July 2015, the KDB was announced in October 2015 as part of Budget 2016, and Finance Act 2015 provided for the introduction of the KDB in legislation, which, in total, was an implementation period of over 400 days.

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

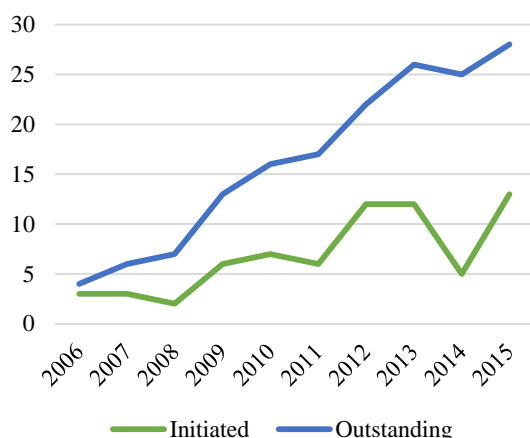
8.4.10 In terms of substantive rate changes, Ireland's reduction in the rate of corporation tax on trading income to 12.5% was announced in May 1997 following a Government Decision, and policy regarding corporation tax rates has not changed since that time. Successive Irish Governments have maintained the 12.5% rate, including during the recent fiscal crisis, to the extent that it may have become considered, over time, as a 'credible commitment', notwithstanding that there are no formal institutional arrangements to bind any future Government or Oireachtas to maintain the rate. To the extent that corporate investors consider the commitment to continuing the 12.5% rate as credible, this may reduce uncertainty regarding the future tax rate on a prospective investment.

Reducing tax uncertainty: international aspects

8.4.11 A number of consultees foresaw potential for increased uncertainty regarding the application of international tax standards as BEPS actions continue to be implemented, particularly in the area of transfer pricing disputes. In recent years the quantity of new and outstanding MAP initiated under the relevant MAP article of extant DTAs has increased (see Charts 8.1a and 8.1b). The MAP is important to ensuring the correct application and interpretation of the relevant DTA. From the perspective of the taxpayer it is important in ensuring the prevention of double or more than single taxation, and from the perspective of the contracting party it assists in ensuring that the correct amount of tax is allocated to each contracting party. Both the risk of uncertainty and double taxation may deter cross-border investment where the relevant DTA is subject to inconsistent interpretation or application by one or both of the contracting parties.

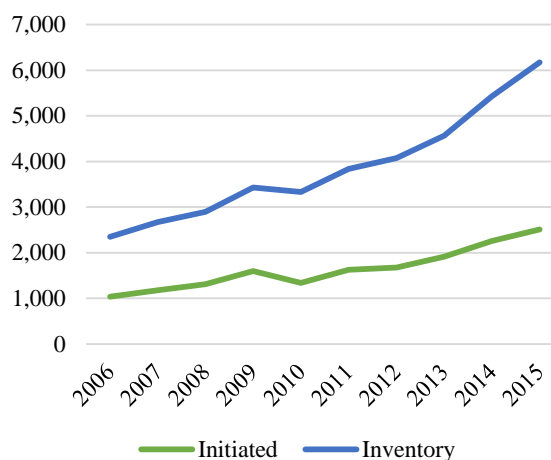
²⁶ Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area OJ L 140.

Chart 8.1a. Number of new and outstanding MAP cases by year, Ireland, 2006 to 2015



Source: OECD.

Chart 8.1b. Number of new and outstanding MAP cases by year, OECD, 2006 to 2015



Source: OECD.

8.4.12 Action 14 of BEPS outlined a number of minimum standards to improve tax certainty regarding the MAP which were operationalised through amendments to Article 25 of the OECD Model Convention and the associated Commentary on Article 25, which provides guidance as to the interpretation of the Article. These changes are in turn contained in Article 16 of the Multilateral Instrument. In brief, paragraph 1 of Article 25 provides for an obligation on competent authorities to provide access to the MAP to a taxpayer, paragraph 2 provides for an obligation on competent authorities to endeavour to resolve the case if access is granted, and paragraph 3 provides that the competent authorities shall endeavour to resolve any disagreements regarding the interpretation or application of the relevant tax treaty. The BEPS Action 14 minimum standards aimed to ensure that treaty obligations related to the MAP are fully implemented in good faith and MAP cases are resolved in a timely manner, that administrative processes promote the prevention and timely resolution of treaty-related disputes, and ensure taxpayers that meet the requirements of paragraph 1 of Article 25 can access the MAP.

8.4.13 While the minimum standards agreed under BEPS Action 14 will improve tax certainty, there is still a risk that competent authorities will not come to agreement regarding the resolution of a MAP case. This raises the risk of MAP cases remaining outstanding for a lengthy period of time, notwithstanding the commitment arising from BEPS Action 14 to carry out peer reviews of national MAP arrangements within the context of the Forum on Tax Administration MAP forum. One mechanism to incentivise resolution of a MAP case is providing a mandatory binding MAP arbitration procedure should competent authorities fail to reach agreement after a period of time. While no consensus was reached as part of the BEPS process that mandatory binding MAP arbitration should apply, Ireland was one of 20 jurisdictions to commit to such a mechanism, which has now been provided for through Articles 18 to 26 of the Multilateral Instrument. Broadly

speaking, where contracting parties are unable to resolve a MAP case within a period of two years, unresolved issues of the case, at the request of the taxpayer concerned may be submitted for arbitration. Subject to the relevant articles and unless the contracting parties agree another approach, an arbitration panel of three individuals with expertise in international tax matters consider proposed resolutions from both competent authorities and choose either in their entirety (the ‘last best offer’ approach) or, alternatively (depending on the MLI option applicable), may set out their own independent view of the appropriate resolution.

8.4.14 The EU Arbitration Convention, in force since 1990, currently provides a facility for mandatory binding arbitration to eliminate double taxation arising from transfer pricing disputes or permanent establishment issues. Article 7 of the Convention provides that where the competent authorities fail to agree a resolution to a transfer pricing dispute after two years, they should establish an advisory commission and take a decision to eliminate the double taxation six months after the delivery of the opinion of the advisory commission. In 2016, the European Commission proposed a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union, which applies to all double taxation of business profits, provided for mandatory resolution of double taxation disputes on the basis of the ‘last best offer approach’ (unless the competent authorities agree otherwise), and provides for, in certain circumstances, access for taxpayers to national courts to argue for access to a MAP. On 23 May 2017, the ECOFIN Council agreed the Directive, subject to a number of amendments agreed by members of the Council. It is anticipated that this will lead to swifter resolution of MAP cases between EU Member States.

8.5 Recommendations

- 13) In the context of the introduction of the Controlled Foreign Company rule provided by the Anti-Tax Avoidance Directive, consideration should be given to whether it is appropriate to move to a territorial corporation tax base in respect of the income of the foreign branches of Irish-resident companies and, in respect of connected companies, the payment of foreign-source dividends. In doing so, regard should be had to whether moving to a territorial corporation tax base would require additional anti-avoidance measures. In deciding whether to move to a territorial corporation tax base, a balance must be struck between the prospective reduction in compliance burdens for Irish-resident outbound investors through an exemption of foreign income, the prospective increase in compliance burden necessitated by the introduction of any additional anti-avoidance measures required, and any potential revenue impact.
- 14) An alternative to a territorial corporation tax base is to review Schedule 24 of the Taxes Consolidation Act 1997 with a view to effecting a policy and revenue neutral simplification of the computation of the foreign tax credit for all forms of foreign income. This would achieve the competitiveness advantages associated with moving to a territorial corporation tax base, whilst avoiding the introduction of additional complexity to the corporation tax code by new anti-avoidance measures.

- 15) To reduce uncertainty and ensure that Ireland protects its corporation tax base, Ireland should ensure an adequately resourced Competent Authority.
- 16) A key element of reducing uncertainty in tax matters is pro-active consultation regarding proposed measures. It is recommended that a number of proposed changes suggested in this review are carried out subject to consultation to reduce uncertainty regarding the proposed changes and to better inform policy-making. In particular, it is recommended that consultation be carried out on:
- v. the implementation of the Anti-Tax Avoidance Directive, with a view to better understanding the effect of the proposed technical changes to the Irish corporation tax code;
 - vi. the implementation of Actions 8, 9 and 10 of the G20/OECD BEPS initiative;
 - vii. additional considerations regarding Ireland's domestic transfer pricing rules; and,
 - viii. the effects of moving to a territorial corporation tax base and of reviewing Schedule 24 of the Taxes Consolidation Act 1997 to effect a policy and revenue neutral simplification of the computation of the foreign tax credit.

9. THE SUSTAINABILITY OF CORPORATION TAX RECEIPTS

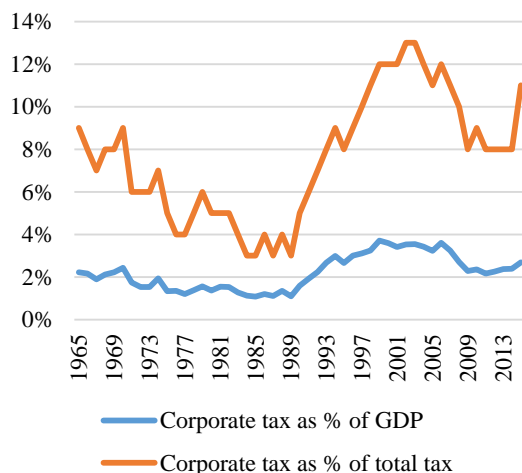
9.1 Introduction

9.1.1 In 2014, the corporation tax yield was €4,614 million, representing the fifth largest tax in terms of total tax receipts, and the fourth largest contributor to the Exchequer. In 2015, the corporation tax yield rose by 49% to €6,872m, representing the fourth largest tax in terms of total tax receipts, and the third largest contributor to the Exchequer. In 2016, corporation tax yield rose to €7,351 million. This increase in corporation tax receipts has raised questions as to the sustainability of corporation tax receipts as part of total tax receipts, and as to whether this increase represents a step change or series of once-offs.

Historic contribution of corporation tax yields

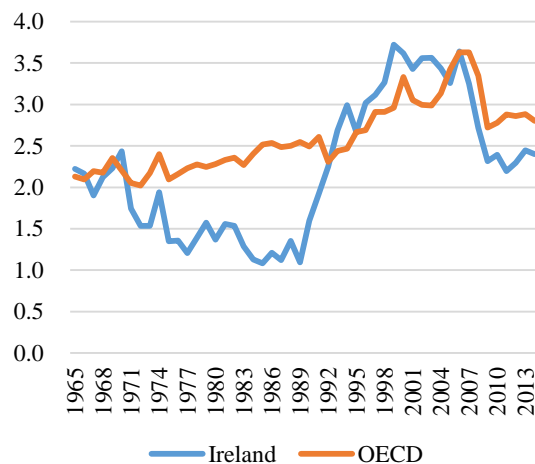
9.1.2 Tax arising from the profits of corporations gradually declined in importance as a percentage of total tax receipts and GDP in Ireland throughout the 1960s and 1970s, before gradually increasing again from 1990. These changes were largely policy driven through the narrowing of the corporation tax base through the operation of the ESR and Shannon relief, the expansion of accelerated capital allowances to all corporate taxpayers and evolution of tax-based financing and leasing outlined in section 2.1. An increase in receipts followed the decision in Budget 1988 to restrict accelerated capital allowances over a period of four years and the conclusion of ESR in 1990. The decision to reduce the rate of corporation tax on trading income to 12.5% was accompanied by additional base broadening measures, as outlined in paragraph 2.1.16.

Chart 9.1a Taxes on income, profits and capital gains as a % of GDP & as % of total tax, 1965-2015



Source: OECD Revenue Statistics

Chart 9.1b. Taxes on income, profits and capital gains of corporates as % of GDP, 1965 - 2013



Source: OECD Revenue Statistics

9.1.3 Chart 9.1a indicates the relative convergence of Irish corporation tax receipts as a percentage of GDP towards the OECD average. The chart also indicates the stability of the contribution of CIT receipts within the OECD, despite the widespread

reductions in statutory corporate income tax rates since the early 1990s and the increased incidence in BEPS described by the OECD. Explanations of this broader trend include (i) the relative widening of the corporate income tax base globally through the restriction of tax depreciation for capital expenditures ('capital allowances' in the Irish corporation and income tax codes), (ii) an increasing amount of business income being tax at company level (i.e. increased incorporations and use of corporate structure to receive business income), and (iii) increased taxable profits.

Recent trends

9.1.4 Corporation Tax is the most volatile of Ireland's main taxes (Casey and Hannon, 2016). This has been particularly true since the year 2000. Corporation Tax receipts rose from €4 billion in 2000 to almost €7 billion in 2006 before falling back below €4 billion in 2009. Receipts began to rise slowly thereafter but jumped significantly in 2015 and in 2016 exceeded €7 billion for the first time.

Table 9.1 Corporation Tax receipts, 2000-2016

Year	Corporation Tax Receipts	Non-Financial Corporates	Financial Corporates
	€m	€m	€m
2000	3,887	2,843	1,044
2001	4,156	3,102	1,054
2002	4,803	3,672	1,131
2003	5,161	3,677	1,484
2004	5,332	3,835	1,497
2005	5,492	3,988	1,504
2006	6,683	4,424	2,259
2007	6,391	4,318	2,073
2008	5,066	3,336	1,730
2009	3,900	2,806	1,094
2010	3,924	2,944	980
2011	3,751	2,917	833
2012	3,964	3,078	887
2013	4,270	3,268	1,002
2014	4,614	3,567	1,047
2015	6,872	5,303	1,569
2016	7,351	n/a	n/a

Source: Department of Finance; CSO Institutional Sector Accounts

9.1.5 The split into non-financial and financial corporates in Table 9.1 is taken from the Institutional Sector Accounts published by the Central Statistics Office. In the Institutional Sector Accounts, companies and subsidiaries are assigned to each sector by the main activity of the group, if any, they are part of. The tax amounts

reflect the net cash tax paid to the Exchequer in a calendar year.²⁷ Of the €2.3 billion increase in net Exchequer Corporation Tax receipts in 2015 around €1.8 billion was due to non-financial companies and groups with €0.5 billion attributed to financial companies and groups.²⁸ Receipts from non-financial corporates in 2015 were 20 per cent above their previous peak which was recorded in 2006. Receipts from financial corporates also peaked in 2006 but by 2015 were still 30 per cent below that level.²⁹

9.2 Sectoral Breakdown from the Revenue Commissioners

9.2.1 The Revenue Commissioners provide a more detailed sectoral breakdown of Corporation Tax receipts (Tancred 2016, 2017). In this instance companies and subsidiaries are assigned based on their own activities rather than group activities. Of particular interest is the large increase in receipts that occurred in 2015. The following table looks at the sectoral receipts for 2015 and 2016 and compares them to the average of the previous four years, 2011 to 2014. Sectors are ranked according to their 2011 to 2014 averages.

Table 9.2 Corporation Tax receipts by Nace Rev 2. Sector, 2011-2016

Sector	2011-2014 Average	2015	Change over 2011-2014	Change	2016	Change over 2015	Change
	€m	€m	€m	%	€m	€m	%
Manufacturing	1,516	1,818	303	20%	1,875	57	3%
Financial & insurance activities	918	1,601	683	74%	2,058	457	29%
Information & communication	646	1,345	700	108%	1,229	-116	-9%
Wholesale & retail trade;	592	1,139	548	93%	993	-146	-13%
Administrative & support service	88	122	34	39%	177	55	45%
Mining & Utilities	75	102	28	37%	40	-62	-60%
Transportation & Storage	69	175	105	152%	244	69	39%
Professional, scientific & technical	68	230	162	240%	323	93	40%
Construction	65	113	48	73%	153	40	35%
Real estate activities	47	92	45	96%	90	-1	-2%
Accommodation & food services	33	58	25	76%	84	26	45%
Other Activities	19	39	19	101%	54	15	40%
Agriculture, forestry & fishing	17	41	24	138%	39	-2	-5%
Public administration & defence	1	8	7	714%	4	-4	-47%
Education	1	-2	-3	-343%	3	5	-
Human health & social work	-3	-8	-5	-160%	-15	-8	-95%
TOTAL RECEIPTS	4,151	6,873	2,721	65.6%	7,351	478	7%

Source: Revenue Commissioners

²⁷ Note though that around €250 million of receipts paid into the Exchequer Account in 2012 are assigned to 2011. This relates to receipts which were due into the Exchequer Account in December 2011 but were delayed until January 2012.

²⁸ The 2016 Institutional Sector Accounts were not available at time of publication.

²⁹ There is also likely to have a significant shift in the composition of Corporation Tax payers in the financial sector. In 2006, this would have been dominated by domestic retail banks. These banks will not have made significant payments in 2015.

9.2.2 Corporation Tax receipts in 2015 were 66 per cent greater than the average amount collected over the previous four years with further growth of seven per cent recorded in 2016. It can be seen in Table 9.2 that there was growth in almost all sectors in 2015 compared to the 2011-2014 averages, apart from education and health, which are insignificant from a Corporation Tax perspective. The largest sectors from 2011-2014 provided the bulk of the increase seen in 2015 though there are two sectors which stand out: the financial and insurance activities sector and the information and communication sector. Between them they accounted for more than 50 per cent of the €2.7 billion increase compared to the previous four years (though on a purely annual basis compared to 2014 the largest individual sector increase for 2015 was in manufacturing).

9.2.3 The figures for 2016 show that the seven per cent increase was largely concentrated in the financial sector, with receipts from that sector increasing by almost 30 per cent and rising above €2 billion to become the largest source of Corporation Tax. Of the other large contributions, information & communication and wholesale & retail showed declines of around ten per cent on but these were offset by increases across a range of smaller sectors. Excluding the financial sector, Corporation Tax receipts would have been largely unchanged in 2016 compared to 2015.

Table 9.3 Corporation Tax receipts by Nace Rev. 2 sector 2011-2015, % contribution

Sector	2011-2014 Average	2015	Change	2016	Change
	%	%	pp	%	pp
Manufacturing	36.5%	26.5%	-10.1	25.5%	-0.9
Financial & insurance activities	22.1%	23.3%	1.2	28.0%	4.7
Information & communication	15.6%	19.6%	4.0	16.7%	-2.9
Wholesale & retail trade	14.3%	16.6%	2.3	13.5%	-3.1
Administrative & support service	2.1%	1.8%	-0.3	2.4%	0.6
Mining & Utilities	1.8%	1.5%	-0.3	0.6%	-0.9
Transportation & Storage	1.7%	2.5%	0.9	3.3%	0.8
Professional, scientific & technical	1.6%	3.3%	1.7	4.4%	1.0
Construction	1.6%	1.6%	0.1	2.1%	0.4
Real estate activities	1.1%	1.3%	0.2	1.2%	-0.1
Accommodation & food services	0.8%	0.8%	0.0	1.1%	0.3
Other Activities	0.5%	0.6%	0.1	0.7%	0.2
Agriculture, forestry & fishing	0.4%	0.6%	0.2	0.5%	-0.1
Public administration & defence	0.0%	0.1%	0.1	0.1%	-0.1
Education	0.0%	0.0%	-0.1	0.0%	0.1
Human health & social work	-0.1%	-0.1%	0.0	-0.2%	-0.1
Total Receipts	100%	100%		100%	

Source: Revenue Commissioners

9.2.4 Table 9.3 looks at the share of Corporation Tax receipts from each sector. Even with the increases in other sectors manufacturing remained the largest source of Corporation Tax revenues in 2015 but compared to 2011-2014 there was a 10-percentage point drop in the share of Corporation Tax receipts from the

manufacturing sector with the share dropping from 36.5 per cent to 26.5 per cent. This was exactly offset by increased shares for the next five biggest sectors in 2015. The share of the top five sectors was largely unchanged going from 90.1 per cent of the four-year period to 2015 to 89.3 per cent in 2015.

- 9.2.5 In 2016, manufacturing was surpassed by the financial sector as the largest source of Corporation Tax. Reductions in proportions coming from the other top sectors meant that the share of the top five sectors fell to 86.1 per cent in 2016. The sectors to increase their share include transportation & storage, professional & technical and construction though in overall terms these three sectors remain small contributors increasing their combined share from 4.9 per cent between 2011 and 2014 to 9.8 per cent in 2016. The figures indicate that the 2015 surge was relatively broad based and that it became even broader in 2016 (notwithstanding the further increase in the financial sector).³⁰
- 9.2.6 The sectoral distribution of receipts indicates that the level-shift in receipts seen since 2015 was not the result of increased payments from one company or group of companies and, though the payments remain concentrated, there were increases in Corporation Tax receipts from virtually all sectors of the economy. This points to the receipts recurring at least in the medium term.
- 9.2.7 Other factors from Tancred (2016, 2017) that point to the broad-based nature of the increase in 2015 include³¹:
- €470 million of Corporation Tax was received from companies in 2015 who did not pay Corporation Tax in 2014.
 - €200 million of receipts in 2015 came from companies who claimed losses in 2014 that did not do so in 2015.
 - €400 million of additional Corporation Tax was received from indigenous companies who also paid Corporation Tax in 2014. The number of indigenous companies with net Corporation Tax payments of more than €1 million increased from 197 in 2014 to 289 in 2015.
 - Balancing payments received in 2015 relating to previous periods were €400 million higher compared to the equivalent receipts of balancing payments in 2014.
 - Gross Corporation Tax due on the capital gains of companies was €113 million higher in 2015 compared to 2014.
 - The concentration of payments in the top ten payers did not increase markedly in 2015 rising from 37 per cent in 2014 to 41 per cent in 2015. In

³⁰ This is subject to the caveat that payments from a corporate group could be spread across a number of sectors depending on the activities of the subsidiaries within the group. One concern is that increased receipts from the financial sector in the Revenue Commissioner's data reflects payments linked to companies operating in other sectors such as manufacturing and information and communication. This concern is ameliorated by the figures for the financial sector from the CSO which show a large increase in Corporation Tax payments for groups whose primary activity is in the financial sector rather than in other sectors.

³¹ These factors should not be considered to be separate and there is likely to be overlap between some of them.

2016 receipts from the top ten payers returned to 37 per cent of the total.³² The top ten payers of Corporation Tax in 2015 paid €2.8 billion of Corporation Tax in that year. In 2014 these same ten companies paid €1.5 billion of Corporation Tax and they paid €2.3 billion in 2016. Around one-fifth of the increase from 2014 to 2016 is due to increased payments from the top ten payers in 2015.

- The underlying increase in non-intangible asset related gross trading profits in 2015 was around €20 billion which corresponds to the increase in Corporation Tax receipts.³³

Although payments from foreign-owned companies increased in 2015 the above factors are used to show that there was not a single factor that led to the increase in Corporation Tax receipts. The distribution by sector and stability of concentration ratios indicate that, though the receipts remain concentrated, the increase in receipts in 2015 from MNCs was relatively widely dispersed.

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

9.3 Aggregate Corporation Tax Computation

9.3.1 The Revenue Commissioners produce aggregate data compiled from the individual tax returns filed by companies. In this instance, the figures for each year reflect the outturn on the returns filed for financial years ending in that calendar year. For example, the data for a company with a June 30 year-end will be included in the year in which the year-end occurs so will reflect activity (and possibly cash tax payments) from two calendar years. A summary of the aggregate outcomes in the transition from Gross Trading Profits to Taxable Income for each year from 2003 to 2015 is shown in Table 9.4.³⁴

³² This concentration is measured by company rather than by group. Information provided by the Revenue Commissioners to the Oireachtas indicates that the top ten payers in 2016 came from nine groups, i.e. one group had two companies in the top ten. The Revenue Commissioners have also published figures that show that the top ten groups accounted for 45.9 per cent of Corporation Tax receipts in 2015 and 40.2 per cent of receipts in 2016.

³³ The €26 billion increase in intangible asset related gross trading profits were offset by a €26 billion increase in capital allowances claimed against those gross trading profits.

³⁴ As a result of a systems change introduced by the Revenue Commissioners a Taxable Income figure for 2008 is not available.

Table 9.4 Aggregate Income, Allowances and Deductions for Corporation Tax

YEAR	GROSS TRADING PROFITS*	less Allowances	NET TRADING INCOME	plus Other Income	TOTAL INCOME	less Deductions	TAXABLE INCOME
	€m	€m	€m	€m	€m	€m	€m
2003	54,701	-17,328	37,373	5,118	42,491	-1,527	40,964
2004	58,186	-19,103	39,083	5,043	44,126	-1,863	42,263
2005	65,735	-22,320	43,415	6,545	49,960	-2,103	47,857
2006	72,447	-20,873	51,574	8,390	59,964	-5,070	54,894
2007	76,457	-22,126	54,332	8,828	63,160	-6,354	56,806
2008	75,014	-32,073	42,941	8,213	51,154	n/a	n/a
2009	66,187	-15,327	50,860	6,350	57,210	-19,454	37,757
2010	70,805	-16,167	54,638	6,396	61,034	-19,818	41,216
2011	73,817	-17,971	55,846	5,670	61,516	-21,454	40,063
2012	76,426	-18,569	57,858	6,463	64,321	-21,078	43,243
2013	83,234	-26,074	57,160	6,893	64,052	-23,590	40,462
2014	98,422	-33,306	65,117	8,874	73,991	-23,287	50,703
2015	149,099	-66,365	82,733	12,955	95,689	-30,612	65,077

Source: Revenue Commissioners

9.3.2 Additional figures published by the Revenue Commissioners allows us to get a better insight into the allowances and deductions used to offset against Gross Trading Profits to arrive at Taxable Income for the years since 2011. As can be seen above these allowances and deductions have increased from €18.9 billion in 2003 to €97.0 billion in 2015. The following table gives more detail of the ‘walk’ from gross trading profits to taxable income with the subsequent steps from gross tax due to tax due also shown.

Table 9.5 Aggregate Corporation Tax Computation, 2011-2015

YEAR	2011	2012	2013	2014	2015
	€m	€m	€m	€m	€m
Gross Trading Profits	72,736	74,905	80,812	95,684	144,128
plus Balancing Charges	1,081	1,521	2,423	2,738	4,971
	73,817	76,426	83,234	98,422	149,099
less Allowances					
Capital Allowances used	(8,453)	(8,475)	(15,955)	(18,621)	(46,158)
Trade Losses Carried Forward used	(9,518)	(10,094)	(10,120)	(14,685)	(20,213)
Net Trading Income	55,846	57,858	57,160	65,117	82,733
plus Other Income					
Net Rental Income	520	526	545	567	576
Gross Interest Received	706	571	447	414	539
Foreign Income	3,002	4,232	3,685	5,805	8,665
Capital Gains (regrossed)	737	625	1,699	1,595	2,536
Other Income	705	509	518	492	639
Total Income	61,516	64,321	64,052	73,991	95,688
less Deductions and Expenses					
Trade Charges	(14,877)	(14,451)	(17,396)	(16,847)	(23,885)
Current Year Trading Losses	(156)	(386)	(227)	(645)	(339)
Group Relief	(2,743)	(2,545)	(2,505)	(1,724)	(1,894)
Other Deductions	(3,678)	(3,696)	(3,462)	(4,072)	(4,495)
Taxable Income	40,063	43,243	40,462	50,703	65,077
Of which:					
Amount Chargeable at 12.5%	37,940	41,575	38,580	48,249	63,000
Amount Chargeable at 25.0%	2,122	1,664	1,883	2,454	2,076
Gross Tax Due	5,273	5,614	5,293	6,645	8,394
less Reliefs					
Double Taxation Relief	(567)	(673)	(552)	(950)	(947)
Other Tax Reliefs	(209)	(123)	(181)	(149)	(330)
plus Clawbacks and Surcharges	97	113	130	135	85
Tax Payable	4,594	4,931	4,690	5,681	7,202
less Credits Used					
R&D Tax Credit	(152)	(142)	(182)	(227)	(349)
Income Tax Suffered Credit	(65)	(178)	(77)	(47)	(43)
Gross Withholding Tax on Fees	(229)	(227)	(234)	(255)	(263)
Film Credit			(1)	(32)	(47)
	4,148	4,385	4,196	5,121	6,500
plus Credits Refunded Against Other Taxes	131	126	118	136	108
less Payment of the Excess R&D Tax Credit	(106)	(136)	(236)	(326)	(359)
TAX DUE	4,173	4,375	4,079	4,931	6,249

Source: Revenue Commissioners

- 9.3.3 From the bottom row, it can be seen that this table gives the details behind an increase in Tax Due from €4.9 billion in 2014 to €6.2 billion in 2015. This increase is €1 billion less than the increase in Exchequer Tax receipts in 2015. The difference is due to timing with the figures in the above computation reflecting returns with year-ends in each calendar year while the Exchequer figures reflect net cash paid in each calendar year.
- 9.3.4 Returning to the top of table 9.5 it can be seen that Gross Trading Profits increased by €48 billion to €144 billion in 2015, of which approximately €26 billion arose from intangible-asset related profits (Tancred, 2017). Through various steps it can be seen that this translated into an increase in Taxable Income of €14 billion with Taxable Income rising from €50.7 billion in 2014 to €63.7 billion in 2015. Although there was a substantial increase in Gross Trading Profits there was also a substantial increase in the deductions and allowances that can be set against Gross Trading Profits to determine a company's Taxable Income. The three largest items are Trading Losses Carried Forward, Trade Charges and Capital Allowances which between them accounted for €90 billion of the €97 billion of allowances and deductions used in 2015. Unlike the KDB, the R&D Tax Credit, Corporation Tax Relief for Start-Up Companies and Film Relief those three items are not tax expenditures as they form part of the benchmark tax system.

Trading Losses Carried Forward

- 9.3.5 Many firms which incurred losses during the crisis have now returned to profitability. These companies did not get a repayment of Corporation Tax to correspond to the losses but can now use the prior losses to offset against their current profits. This ensures that only positive profits are taxed. The use of Trade Losses Carried Forward remained close to €10 billion for each year from 2011 to 2013 but then increased to €15 billion in 2014 and increased again to €20 billion in 2015. This likely reflects increasing profitability amongst those companies with prior losses. There are many moving parts but, ceteris paribus, the previous losses carried forward will be exhausted at some stage and the profits currently offset by losses would be subject to tax.³⁵

³⁵ Tancred (2017) shows that €120 billion of previous losses were carried forward by companies in the financial sector to 2015. Around €40 billion of these related to companies that are in liquidation and unlikely to be used.

Table 9.6 Trading Losses Available and Used

YEAR	2011	2012	2013	2014	2015
	€m	€m	€m	€m	€m
TRADE					
Trade Losses Carried Forward Available	150,604	180,977	206,629	215,454	218,335
Current Year Trading Losses	30,649	22,746	21,011	8,527	8,977
EXCEPTED TRADE					
Trade Losses Carried Forward Available	4,398	4,118	4,031	4,208	4,508
Current Year Trading Losses	351	362	175	204	1,845
RENTAL					
Losses Carried Forward	567	781	797	837	893
Total Available	186,568	208,983	232,644	229,229	233,665
Amount Used (including offset against other income)	11,893	11,879	13,149	16,100	20,975

Source: Revenue Commissioners

Trade Charges

9.3.6 Trade Charges reflect some deductions that take place ‘below the line’ in the Corporation Tax returns filed by companies. Although a breakdown of the type of deduction is not available in the main the deductions under Trade Charges reflect certain interest and royalty payments, with royalty payments likely to be the largest component. Most expenses are deducted ‘above the line’ as an ordinary business expense under section 81 TCA 1997 and are consequently subtracted from revenue to arrive at Gross Trading Profits. Those deductions classed as Trade Charges had been between €14.5 billion and €17.5 billion from 2011 to 2014 but increased to €23.9 billion in 2015. Assuming the bulk of this relates to increased royalty payments (patent royalties) these are license payments for the use of technology developed elsewhere.³⁶

Capital Allowances

9.3.7 The amount of capital allowances claimed by companies increased by €27.4 billion in 2015 to reach a level of €51.8 billion. The use of capital allowances has increased significantly from €8.5 billion in 2011 to €45.2 billion in 2015. This likely reflects a greater amount of capital allowances available but also increased profitability of companies carrying capital allowances and thus able to use existing allowances. Unused capital allowances in one year are carried forward as trading losses for use in subsequent periods when there is taxable income to offset them against.

³⁶ Outbound royalty payments for 2015 shown in the Balance of Payments published by the CSO were €48 billion in 2014 and these increased to €68 billion in 2015. It is clear that the deduction for a large amount of these takes place “above the line”.

Table 9.7 Capital Allowances Available and Used

YEAR	2011	2012	2013	2014	2015
	€m	€m	€m	€m	€m
TRADE					
Plant and Machinery Capital Allowances	17,328	19,142	20,466	23,233	50,710
of which:					
Capital Allowances for Intangibles				2,653	28,872
Industrial Buildings Capital Allowances	551	499	522	509	561
Other Capital Allowances	345	282	237	259	241
RENTAL					
Rental Capital Allowances	241	268	322	316	268
Total Available	18,465	20,192	21,546	24,317	51,780
Amount offset against trading profits	8,453	8,475	15,955	18,621	46,158

Source: Revenue Commissioners

9.3.8 Capital allowances for intangible assets are claimed under Section 291A TCA 1997 (see Box 9.1). This section provides for the offsetting of capital expenditure on the development or acquisition of a range of intangible assets against the income arising from the use of that intangible. Ireland's national accounts have been impacted by a number of intangible on-shoring events in recent years with the profit generated by these intangible assets now included in gross measures of Ireland's national income. Most notably there was an increase in the stock of intangible assets in Ireland of around €250 billion in Q1 2015 while the Quarterly National Accounts for Q4 2016 show investment in the acquisition of intangibles of around €25 billion. There may have been other events which were not as readily identifiable in the accounts while the possibility of future large on-shoring events cannot be discounted.

Box 9.1 Capital allowances for intangible assets

Section 291A TCA1997 was introduced in the Finance Act 2009 to consolidate and expand the system of capital allowances for intangible assets. Up to that time there was no general capital allowance scheme for intangible assets. Rather, there were four specific capital allowances for trading companies in respect of (i) capital expenditure on computer software (section 291 TCA1997), (ii) capital expenditure on scientific research (section 765 TCA 1997) (iii) capital and current (revenue) expenditure on 'know how' (not strictly a capital allowance as it allows for both capital and revenue expenditure to be treated as a trading expense) (section 768 TCA1997), and (iv) capital allowances for capital expenditure on the purchase of patent rights (section 755 TCA1997).

Main features of the capital allowance for intangible assets

When introduced in 2009, the provision of capital allowances for intangible assets replaced the allowance for 'know how' and the capital allowance for the purchase of patent rights. The main features of the allowance are: (i) companies may avail of a capital allowance in respect of expenditure incurred on specified intangible assets; (ii) the tax depreciation schedule follows the accounting treatment unless a taxpayer elects for a depreciation on a straight line basis over 15 years; (iii) the specified trade for which the specified intangible asset was acquired (either (i) the management, development and exploitation of the intangible assets to which the allowance applied

or (ii) a trade involving the sale of goods or services where the majority of value is derived from the intangible asset) is treated as a separate trade; (iv) the capital allowance and the interest expense incurred to provide the intangible asset in any year is ring-fenced to the trading income arising from the separate trade (the ‘relevant income’); (iv) no balancing charge will arise where the intangible asset is held for more than five years. Where related parties acquire/sell a qualifying intangible asset it must be valued at arm’s length and the related parties may not avail of CGT relief on company reconstruction (section 615 TCA 1997) or CGT deferral on intra-group transfer of assets (section 617 1997).

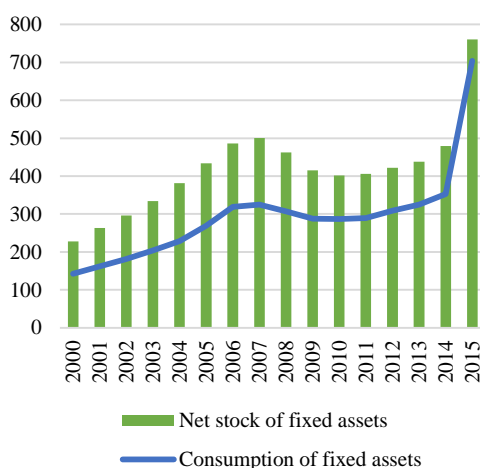
Up until 2015, a deferral on the full utilisation of the capital allowance and related interest expense applied such that 80% of the capital allowance and related interest expense in a tax year could be deducted against the relevant income.

Ireland’s provision of capital allowances for intangible assets is similar to that provided in Part 8 of the UK Corporation Tax Act 2009 in terms of providing for a capital allowance for intangible assets based on accounting depreciation. Article 33 of the draft Council Directive on a Common Corporate Tax Base (CCTB) provides for straight line depreciation of fixed intangible assets (an asset used in the business for producing, maintaining or securing income for more than 12 months) over the period for which the asset enjoys legal protection or for which the right has been granted or, where that period cannot be determined, 15 years.

IP On-shoring

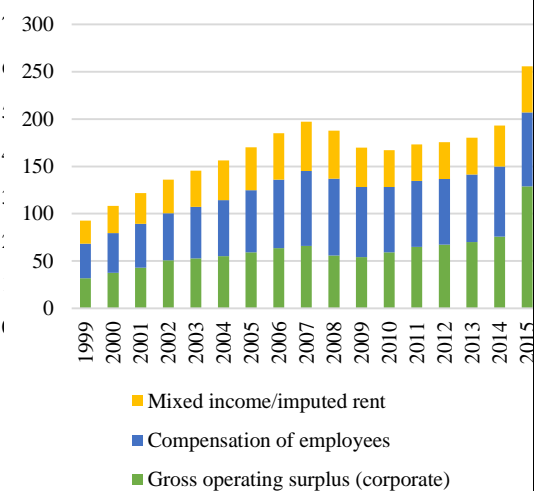
Following the publication of National Income and Expenditure 2015 in July 2016 by the CSO, an Economic Statistics Review Group was established to make recommendations regarding alternative measurements of Irish economic activity. The Report of the Economic Statistics Review Group (ESRG) noted that the level shift of real GDP of 26% in 2015 was a consequence of the re-location of entire balance sheets dominated by IP assets, with the effect that the net capital stock rose from €479 billion in 2014 to €760 billion in 2015, and the consumption of fixed capital (the national accounting equivalent to depreciation) rose from €30.9 billion in 2014 to €61.6 billion in 2015 (see chart 9.1a). Chart 9.1b indicates the large increase in Gross Operating Surplus (GOS), a national accounting concept similar to EBITDA, from €76 billion in 2014 to €129 billion in 2015, which drove the GDP increase in 2015. The rise in the consumption of fixed capital is included in measures of GDP, GNP and GNI, leading to level-shifts in all three measures of national income.

Chart 9.1a Net stock of fixed assets (lhs) at current prices and consumption of fixed capital (rhs) (€bn), 2000 - 2015



Source: CSO series CSA02.

Chart 9.1b Nominal Gross Domestic Product (Income Approach) (€bn), 1999 - 2015



Source: CSO

The increased profits associated with the exploitation of the IP assets brought into Ireland are likely attributable to resident Irish companies. *Ceteris paribus*, this would lead to a concomitant increase in tax revenue. However, a claim for capital allowances for intangible assets would likely reduce

substantially, or eliminate, the taxable income associated with the use of the IP assets, insofar as that income is related to the specified trade.

Relationship between capital allowances and consumption of fixed capital

Though consumption of fixed assets and tax depreciation are conceptually different, there was a sharp increase in the number of capital allowances available and utilised for plant and machinery (including intangible assets) (see table 9.7). The charts below indicate the capital allowances available for plant and machinery for corporations according to the aggregate CT1 computation prepared by the Revenue Commissioners, and the consumption of fixed capital by non-financial corporations outlined in the Institutional Sector Accounts. While they reflect two different conceptual bases for depreciation and timing differences there is a high correlation between the two figures using data for each year between 2004 and 2015 inclusive.

Chart 9.2a Value of plant and machinery capital allowances available (x-axis) and consumption of fixed assets by non-financial corporations (y-axis)

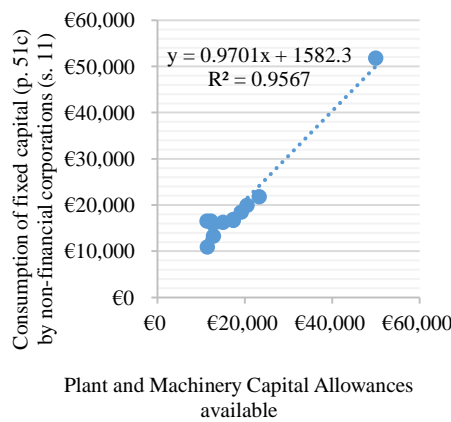
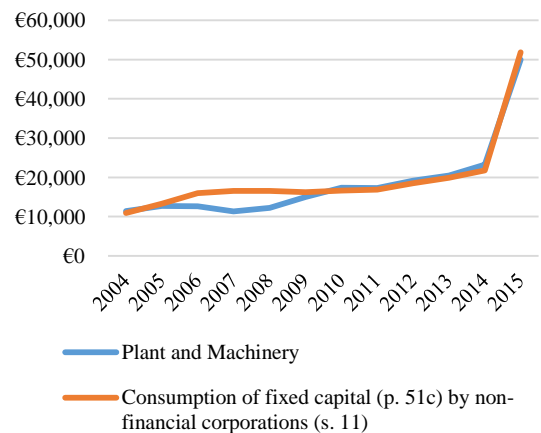


Chart 9.2b Value of plant and machinery capital allowances available and consumption of fixed assets by non-financial corporations



9.3.9 In nominal terms Ireland’s gross capital stock rose from €756 billion to €1,088 billion, an increase of €332 billion. Changes in the capital stock are usually driven by investment (either outright purchase or internal development) and obsolescence (withdrawal from use) giving entries and exits to the capital stock. However, in 2015 investment in capital was €54.1 billion. Thus nearly 85 per cent of the €332 billion increase in the capital stock cannot be explained by investment. Table 9.8 gives the composition of Ireland’s gross capital stock for 2014 and 2015. In the 2015 data, two categories have been suppressed for confidentiality reasons; transport equipment and research and development. The categories reflect aircraft leasing and the on-shoring of intellectual property assets. The categories for which data is provided recorded an increase of €42 billion in 2015 so the remaining €289 billion is accounted for by the missing categories of transport equipment and intangibles. It is probable that the bulk of this was due to intangibles.

Table 9.8 Ireland's Gross Capital Stock, nominal

	2014	2015	Change
	€bn	€bn	€bn
<i>Dwellings, excluding land</i>	283.1	305.1	22.0
<i>Other buildings and structures</i>	158.1	173.0	15.0
<i>Roads</i>	42.4	45.2	2.9
<i>Transport equipment</i>	122.1	n/a	n/a
<i>Other machinery and equipment</i>	65.7	67.2	1.5
<i>Cultivated assets</i>	2.3	2.4	0.1
<i>Computer software</i>	7.0	8.1	1.1
<i>Research and Development</i>	73.1	n/a	n/a
<i>All fixed assets</i>	756.4	1,087.9	331.4

Source: CSO.

- 9.3.10 Recent changes to the internationally-agreed national accounting methodology have amended the treatment of intangible assets. This treatment correctly reflects the increased importance of intangible assets in the global economy. This does create issues given the inherent mobility of such assets but the stock of and income arising from such assets such be reflected in national accounts. There are likely many reasons, including tax, why companies would choose to locate their intangible assets in Ireland but distortions to national accounts should not be considered a significant cost. The Central Statistics Office have begun publishing adjusted measures of Ireland's national income that, among other things, remove the operating surplus from intangible assets that is offset by the consumption of fixed capital (the depreciation) of those assets which will remove this distortion.
- 9.3.11 Figures from the Revenue Commissioners and Tancred (2017) show that there was a €26 billion increase in intangible-asset related gross trading profits in 2015. This was offset by an increase in the amount of capital allowances for intangible assets of a similar scale. These gross trading profits are included in Ireland's Gross National Income but the use of capital allowances results in a much smaller amount being included in the taxable income base for Ireland's Corporation Tax. Given Ireland's contribution to the EU Budget is calculated by reference to Gross National Income, this increase in profits has an impact. Limiting the use of capital allowances for intangibles would provide some moderate tax-revenue-smoothing benefits.
- 9.3.12 From an industrial policy perspective, the decision of companies to locate some of their intangible assets in Ireland can be considered another spoke in the wheel. Although these assets are inherently mobile the decision to locate them here strengthens existing investment in Ireland. The link to future investment is less clear but ongoing changes at international level in how the corporate income tax is

assessed have the link between profit and substance as a key motivation. Many companies who are likely considering the location of their intangibles in this changed environment already have significant operations in Ireland. This substance will likely be a factor some companies will consider when making these decisions and it is likely that further substance will follow to the location chosen.³⁷

9.4 Effective Rates of Corporation Tax

9.4.1 Coffey and Levey (2014) assess eight different approaches to estimating the effective rate of Corporation Tax in Ireland. Two of those are updated here using the most recently published data.

Effective Rate on Net Operating Surplus

9.4.2 The Institutional Sector Accounts give the Net Operating Surplus of non-financial companies. Net Operating Surplus is akin to earnings before interest and taxes (EBIT). Using the Corporation Tax figures in the accounts an effective tax rate on Net Operating Surplus can be calculated. This has averaged 9.7 per cent since 2000 as shown in Table 9.8. The effective tax rate on net operating surplus peaked at 11.8 per cent in 2006 and fell during the crisis. It has been below eight per cent since 2011 with a rate of 7.7 per cent recorded in 2015. Allowing for eligible interest costs would increase the rate and the use of previous losses carried forward likely explains the reduction in recent years. These losses can be trading losses or unused capital allowances. Gross Operating Surplus is also provided in the table with consumption of fixed capital (depreciation) giving the difference between GOS and NOS. The €30 billion rise in the consumption of fixed capital for non-financial corporates in the national accounts in 2015 from €21.8 billion to €51.8 billion reflects the rise in capital allowances (and most notably the rise for capital allowances for intangibles) in the Corporation Tax Statistics.

³⁷ Under the BEPS proposals the owner of intangibles will be entitled to the income arising from the owner's use of that intangible. This, however, does not mean that all the resulting profit remains with the owner of the intangibles. Under the BEPS proposals consideration must be given to how the real value added related to the asset is generated. The income can go to the legal owner of the intangible but the value added will be assessed on the basis of the DEMPE functions undertaken. DEMPE refers to the development, enhancement, maintenance, protection or exploitation of the intangible assets. If the owner of the intangible asset does not undertake these functions a set of service transactions must be entered to pay for these functions. The price set in these transactions will determine the profit that accrues to the owner of the intangible asset. This will depend on the level of functions carried out by the owner of the intangible and the pricing approach used by the jurisdiction where other DEMPE functions, if any, are undertaken.

Table 9.9 GOS, Depreciation, NOS and CT paid for Non-Financial Corporates, 2000-2015

Year	Gross Operating Surplus	Consumption of Fixed Capital	Net Operating Surplus	Corporation Tax	Effective Rate
	€m	€m	€m	€m	
2000	33,194	6,701	26,493	2,843	10.7%
2001	37,764	7,705	30,059	3,102	10.3%
2002	45,066	8,815	36,251	3,672	10.1%
2003	45,095	9,830	35,265	3,677	10.4%
2004	46,529	10,940	35,589	3,835	10.8%
2005	49,483	13,274	36,209	3,988	11.0%
2006	53,348	15,997	37,351	4,424	11.8%
2007	54,614	16,564	38,050	4,318	11.3%
2008	45,663	16,552	29,111	3,336	11.5%
2009	44,515	16,255	28,260	2,806	9.9%
2010	48,518	16,646	31,872	2,944	9.2%
2011	56,359	16,898	39,461	2,917	7.4%
2012	59,314	18,487	40,827	3,078	7.5%
2013	63,166	19,908	43,258	3,268	7.6%
2014	67,036	21,787	45,249	3,567	7.9%
2015	120,525	51,847	68,678	5,303	7.7%
Average					9.7%

Source: Central Statistics Office; Eurostat

Effective Rate on Taxable Income

- 9.4.3 The aggregate data from the Revenue Commissioners can be used to calculate the tax burden on Taxable Income. The tax burden is the tax due on taxable income plus the tax relief granted for foreign tax paid as in the absence of the foreign tax paid the amount subject to the relief would be payable in Ireland. This has averaged 11.8 per cent since 2003 with an outturn of 11.8 per cent recorded for 2015. The tax burden peaked as 12.1 per cent of taxable income between 2006 and 2009. The reduction since then reflects the increased use of the R&D tax credit and also the introduction of the additional foreign tax credit.³⁸

³⁸ The additional foreign tax credit was introduced in 2013. In 2015 claims for the additional foreign tax credit were €238 million. Updating the approach of Coffey and Levey (2014) to include the additional foreign tax credit in the 'tax burden' gives an effective tax rate on 'taxable income' of 11.4 per cent for 2015.

Table 9.10 Effective Tax Due and Tax Burden Rates

YEAR	TAXABLE INCOME	TAX DUE		DOUBLE TAX RELIEF	TAX BURDEN	
	€m	€m	%	€m	€m	%
2003	40,964	4,332	10.6%	486	4,818	11.8%
2004	42,263	4,420	10.5%	405	4,825	11.4%
2005	47,857	5,167	10.8%	408	5,575	11.6%
2006	54,894	6,110	11.1%	551	6,661	12.1%
2007	56,806	6,305	11.1%	569	6,874	12.1%
2008		5,122		555	5,677	
2009	37,757	4,004	10.6%	547	4,551	12.1%
2010	41,216	4,246	10.3%	619	4,865	11.8%
2011	40,063	4,173	10.4%	567	4,741	11.8%
2012	43,243	4,375	10.1%	673	5,048	11.7%
2013	40,462	4,079	10.1%	552	4,631	11.4%
2014	50,703	4,931	9.7%	950	5,880	11.6%
2015	63,658	6,249	9.6%	947	7,196	11.1%
AVERAGE			10.4%			11.7%

Source: Revenue Commissioners

9.5 Recommendations

- 17) Although it is impossible to be definitive and the volatility in receipts will remain the level-shift increase in Corporation Tax receipts seen in 2015 can be expected to be sustainable over the medium term to 2020.

- 18) In order to ensure some smoothing of corporation tax revenues over time, it is recommended that the limitation on the quantum of relevant income against which capital allowances for intangible assets and any related interest expense may be deducted in a tax year be reduced to 80%.

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APPENDIX I – STAKEHOLDER CONSULTEES

Meetings with representatives of the following stakeholders were held to better inform the review:

1. IBEC;
2. ICTU;
3. Irish Tax Institute;
4. EY;
5. PwC;
6. Deloitte;
7. Christian Aid;
8. Social Justice Ireland;
9. American Chamber of Commerce;
10. Chartered Accountants Ireland;
11. KPMG;
12. ActionAid Ireland;
13. Debt and Development Coalition Ireland;
14. Silicon Valley Tax Directors Group;
15. Oxfam Ireland.

The Department of Finance facilitated a public consultation seeking the views of the public and the interested parties on the matters identified by the terms of reference of the review. The consultation period ran from 21 February 2017 to 4 April 2017, a period of six weeks. 16 submissions were received.

1. Social Justice Ireland;
2. Chambers Ireland;
3. Grant Thornton;
4. Christian Aid;
5. Debt and Development Coalition Ireland;
6. Fianna Fáil;
7. IBEC;
8. KPMG;
9. Irish Tax Institute;
10. ActionAid Ireland;
11. Tax Justice Network Ireland;
12. Deloitte;
13. The Consultative Committee of Accountancy Bodies – Ireland;
14. Oxfam Ireland;
15. Individual submission from citizen;
16. Department of Jobs, Enterprise, and Innovation, Enterprise Ireland, IDA Ireland.