

Threats and Opportunities Facing Ireland's Corporation Tax Regime

It is almost 20 years since Ireland announced the introduction of a 12.5% corporation tax rate for trading income. With the UK moving towards a corporation tax rate of 17% and the US proposing 15%, perhaps the only major surprise on international tax rates has been the time it has taken for the governments of the world's major economies to realise that a high corporate tax rate inhibits growth.

For Ireland's open economy, the change in other countries' tax rates and multiple other changes to the international tax environment provide opportunities for multinational groups to review existing operating structures and realign their businesses with the new international tax environment.

Brexit and the Trump Effect

Ireland can expect both the UK and US to reduce their corporate tax rates. However, the mere reduction of these countries' tax rates does not mean that the business case for using Ireland as a relatively low tax rate hub is diminished. In particular, US companies will continue to need access to the EU and with Brexit looming, the benefit of using Irish corporates as a platform to transact into one of the largest trading blocks in the world may become even more compelling.

EU

In mid-2016 the EU passed its Anti-Avoidance Tax Directive. One aspect will be that Ireland will need to introduce a Controlled Foreign Company ("CFC") regime by the end of 2017. CFC legislation is designed to dissuade Irish parented groups from maintaining intellectual property and passive investment income in low or no-tax territories.

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It will deem certain "passive" income and gains of such offshore entities as being liable to tax in Ireland. The introduction of such legislation is likely to cause existing offshore finance and other intellectual property companies to be brought onshore to Ireland, with the consequent increase in economic activity in Ireland. Moreover, if Ireland wishes to remain internationally competitive, it should amend its laws to exempt dividends from foreign subsidies as a quid pro quo for the introduction of a CFC regime. Such a move will increase Ireland's attractiveness as an international tax-neutral holding company location and be in line with other EU proposals.

Of more concern to Ireland must be the EU's latest proposal for a directive (First Directive) on a common tax base followed by another directive (Second Directive) on a Common Consolidated Corporate Tax Base ("CCCTB"). The First Directive would seek to adopt a pan EU code to harmonise the tax deductions available in each Member State from each companies' taxable profits. It would restrict interest deductions, exempt certain dividends and provide enhanced R&D deductions. However, the Second Directive looks to determine a mechanism by which profits are allocated across EU Member States having regard to three equally weighted indicia; namely personnel, assets and sales.

If groups wish to maximise the benefits of Ireland's 12.5% corporation tax rate, then the establishment of major facilities in Ireland will be a pre-requisite to ensuring that other EU Member States do not have extensive taxing rights under the Second Directive. Needless to mention that Ireland will campaign strongly to avoid CCCTB but without the UK at the negotiating table, its negotiating position is significantly weakened.



OECD and BEPS

In 2013, the OECD launched an initiative to dissuade multinational groups from using the differentiating factors of different countries' tax regimes for Base Erosion and Profit Shifting ("BEPS"). Whilst much of the initial action plans are moving into implementation phase, two key areas in relation to corporate Ireland's offering deserve special attention:

1. Reopening of Action 1 Taxation of the Digital Economy

The original BEPS action plan looked to change the basis of taxation of the Digital Economy. The original conclusion was to not alter the current system but this is being revisited. The latest EU CCCTB proposal, and indeed some of the US Republican proposals, also take aim at a revised approach to taxing such profits by reference to the location of ultimate sales. To maximise real benefits from an Irish presence, multinationals need to plan for major spend, research and development, and employment focus from an Irish base.

2. Multilateral Treaty

One of the key benefits of Ireland's treaty network is the ability to reduce withholding taxes on income flows into an Irish tax resident company without necessarily having regard to the ultimate recipient of such flows.

A key feature of any multilateral treaty is likely to be a principal purpose test. The overriding aim of such a clause is to limit the ability to avail of reduced rates of withholding taxes under existing treaties where obtaining the favourable rate is one of the principal purposes of the arrangement. The introduction of a multilateral treaty may cause Irish recipients to suffer withholding tax on some inward payments. Such withholding should be creditable against Irish tax but its impact needs to be modelled through.

Conclusion

A multitude of forces is converging on a common theme for reform of the basis by which groups operating cross-border are taxed. Historic operating regimes and rulings are being challenged – the recent publication of the EU's determination of state aid in the Apple case highlights the uncertain environment that exists for businesses reliant on historic practices.

Internationally-focused groups need to review existing structures, bring onshore that which has been generally operated offshore and consider Ireland as a base for critical mass. The only certainty within the world of change will be Ireland's 12.5% low corporate tax rate and EU membership. Major groups should commence 2017 conducting an international tax strategic review of their global operations with a view to realigning their business with the likely new international tax norms.

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