



Pre-Budget 2012 Submission to Department of Finance

Addendum to A Tax Strategy for Irish Companies and Irish Exports – Irish Tax Institute Report

1. Importance of “above the line” relief

The economic conditions in which Irish businesses are currently operating mean that many businesses are not generating sufficient profits for a corporation tax liability to arise. Accordingly, where new incentives are being considered to support such businesses, they would be particularly welcome if the benefit could be reflected “above the line”.

2. Simplification and business compliance costs

(a) Payroll tax amendments

Payroll managers have had a number of complex payroll tax amendments to make in recent times, particularly with the introduction of the income levy and its subsequent replacement with the USC. Wide-scale payroll changes that are hurriedly introduced can create uncertainty and significant business cost. The Institute would like to see all tax changes that will impact payroll in particular, clearly signalled at least 6 months ahead of their commencement.

(b) Capital gains tax clearance

Currently, companies are required to complete the CG50 tax clearance procedure in respect of intra-group transactions. In light of the CGT group relief provisions for the intra-group transfer of assets (which apply automatically), the CG50 procedure does not appear to serve any useful purpose in that context and places an unnecessary administrative burden on companies. We therefore recommend that this requirement be dropped for intra-group transactions which qualify for CGT group relief.

(c) Preliminary tax for “large” companies

Currently, the second instalment of preliminary corporation tax payable by “large” companies must bring the total preliminary tax paid to 90% of the corporation tax liability for the current accounting period.

Companies are facing significant difficulty in estimating their tax liability for an accounting period before the end of that period and punitive interest rates apply in relation to underpaid preliminary tax. In order to lessen the burden on companies, and to encourage voluntary compliance with the preliminary tax rules, it is proposed that “large” companies be given the option to base their preliminary tax payment on 100% of the prior year final liability. The

prior year liability for this purpose should be the liability shown on the tax return submitted for that period.

Large companies are required to make their first preliminary tax payment during the sixth month of the accounting period. The option of basing this payment on 50% of the corporation tax liability for the preceding accounting period is of limited benefit, as companies generally will not finalise the prior year liability until the ninth month of the period, when the return is required to be filed. Accordingly, companies should be given the option of basing the first preliminary tax payment on a specified percentage of the final liability for the second preceding period, which, in the majority of cases, will have been finalised.

3. Innovation

(a) Research and Development (R&D) tax credit

Currently, relief for expenditure incurred on outsourcing R&D work is only available up to a maximum of 10% of the R&D expenditure incurred by the company itself. It appears that this limit disproportionately affects smaller companies.

Small companies, by their nature, will need to outsource significantly more R&D work in comparison to multinationals, whose greater resources may permit them to conduct their own R&D activity in-house. Interaction between smaller indigenous companies and more established multinationals should be encouraged in order that synergies can be achieved and to allow “cross-fertilisation” of innovative ideas between the sectors.

In order to promote such collaboration, the amount of subcontracting allowed over the life of the project should be increased.

(b) Intellectual property (IP)

It was widely acknowledged by participants in our research project that the introduction of the IP regime was a very positive move and improved Ireland’s competitiveness as a holding location for IP. However, there were a number of issues raised in relation to the current system.

Relief for expenditure on goodwill is currently only available to the extent that it is directly attributable to a particular “specified intangible asset”. It is often the case when IP assets are acquired that a “bundle” of assets are acquired together and are then classified as a single asset for accounts purposes. The amount capitalised will ordinarily include an element of goodwill, which would not have a directly attributable purchase price. Accordingly, companies are finding it difficult to separately identify the goodwill element relating to particular items of IP, as is currently required under the legislation. This is resulting in no relief being claimed for ostensibly qualifying expenditure.

It was also noted that, in order to qualify for the relief, an intangible asset must satisfy two requirements:

- (i) it must be classified as an intangible asset under generally accepted accounting practice (GAAP), and
- (ii) it must fall within one of the definitions of “specified intangible asset”.

This is in contrast with the position in competing jurisdictions such as Luxembourg and the Netherlands, whose tax regimes define qualifying IP in the same way as it is defined for accounting purposes, without any further limitations.

The definition of “intellectual property” should be broadened to include all assets classified as intangible assets under GAAP. Certain categories of asset could then be excluded if it is felt that they should not qualify for the relief.

The requirement that goodwill be “directly attributable” to a specified intangible asset in order for it to qualify for the relief should be removed. Alternatively, the rule could be amended to require that goodwill be “connected with” rather than “directly attributable” to a specified intangible asset.

(c) Employment and Investment Incentive Scheme (EIIS)

The introduction of the new EIIS is very welcome, and EU approval of the scheme is eagerly awaited.

However, if the purpose of the new scheme is to promote investment in Irish business, it is counter-productive to limit the benefit of the relief for taxpayers. Accordingly, the Institute recommends that the relief not be included in the list of “specified reliefs”.

4. Ireland as a Holding Company location for Indigenous Business

(a) Foreign dividends

For a country such as ours, with a limited internal market, indigenous enterprises must look to overseas opportunities if they wish to expand significantly. The credit method currently in force in respect of foreign dividends represents an administrative obstacle for companies with overseas operations which seek to repatriate profits to this country for the purposes of further investment.

The companies to whom we spoke as part of our research indicate a preference for a move to a participation exemption system for dividends, in order to bring the system into line with that currently operated by our competitors, including the United Kingdom, France, Belgium, Denmark, Germany, The Netherlands, Luxembourg, Spain, Sweden and Switzerland.

An alternative to a participation exemption may be to compile a “white list” consisting of EU and tax treaty countries and deem dividends out of profits generated in such countries to have suffered a specified rate of tax.

The Institute is concerned that companies’ uncertainty regarding the s247 TCA 1997 tax treatment of interest could adversely affect business investment decisions. In addition, companies are incurring considerable compliance costs in contending with the technicalities of the legislation.

In light of these difficulties, and the potential economic consequences, it is advisable that the legislation in this area be substantially re-written.

(b) Special Assignment Relief Programme

The SARP scheme was introduced in Finance (No.2) Act 2008, with the aim of encouraging employers to relocate key employees to Ireland. However, our understanding is that, to date, there has been very little experience of claims being made under the scheme. There are a

number of key improvements which can be made to the scheme in order to incentivise the repatriation of skilled individuals:

- The relief is currently only available to individuals who are not Irish-domiciled. The Institute recommends that the relief be extended to Irish-domiciled individuals for a period of three years, in order to encourage talented Irish professionals to relocate to Ireland.
- The requirement to pay the tax initially and then seek a refund should be removed, as it creates cash flow disadvantages and administrative difficulties, which discourage employers and employees. Instead, the relief should be applied at source.
- The conditions to be satisfied in order to qualify for relief are complex and difficult to explain to companies. In order to achieve its intended objectives, the scheme must be simplified. The current threshold level for the relief calculation should also be reviewed, along with the exclusion of relief against the USC.
- Individuals who have previously been tax resident in Ireland (at any time) are currently excluded from the scheme. In addition, the scheme excludes any individual who has previously exercised an employment in Ireland (at any time). The Institute recommends that these aspects of the scheme be reconsidered with a view to enhancing its attractiveness to foreign *diaspora* in particular.

5. Tax and Pensions

Tax relief plays a pivotal role in encouraging taxpayers to make adequate provision for their pension. This provides a dual benefit in ensuring taxpayers provide for their old age and reducing their dependence on the State. According to the latest CSO figures, pension coverage in Ireland is quite low, only 51%¹ of those in employment have a pension. As the profile of our population is getting older, less money will be available to the State to fund pensions, with less people working. Short term measures now to save money may ultimately cost the State more in the longer term. Already this year, money put into pensions by employees will no longer qualify for relief from pay related social insurance (PRSI) or from the new Universal Charge (USC). The employer PRSI exemption for employee pension contribution has been reduced by 50%.

The behavioural impact from pension measures already made means that the cost of pensions tax relief to the Exchequer has substantially reduced – i.e. there is evidence to support the argument that savings behaviour has changed to such an extent that the cost of relief has been reduced to a level that suggests future restrictions are no longer necessary to meet IMF/EU savings targets.

It is important to recognise that tax relief on pension contributions is really only a tax deferral rather than a permanent forgoing of revenue by the Exchequer. Relief is currently granted at 41%. Income coming from a pension scheme is taxed at the marginal rate of 48% (41% income tax and 7% USC).

¹ Quarterly National Housing Survey, pension provision, CSO 21 April 2011

Any further reduction in relief will be a major disincentive to saving for retirement. In the interests of parity, at a minimum tax relief for pension contributions should be granted at the same rate as pension income is taxed. However to provide an incentive to save for retirement would require tax relief for contributions to be more than the rate that pension income is taxed at.

There have been several adverse tax changes in the pensions area recently in addition to funding problems caused by the economic situation. There is a real need for certainty as to the tax position as opposed to further adverse tax changes. The behavioural changes that are arising from the tax changes so far and the uncertainty in the pension area will have long term consequences for adequate pension provision.