Commission on Taxation & Welfare
An Coimisiún um Chánachas ⁊ Leas

Progress Paper

Corporation and International Tax Update – *Ireland's Corporate Tax Strategy*

CONFIDENTAL AND NOT FOR WIDER CIRCULATION FOR DECISION	
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For Discussion

The Commission's terms of reference have asked them to:

- *consider how Ireland can maintain a clear, sustainable, and stable taxation policy as regards Ireland's attractiveness to Foreign Direct Investment in a changing global taxation environment, including retention of the 12.5% corporation tax rate.*
- *review how best the taxation environment for SMEs and entrepreneurs can ensure that Ireland remains an attractive place to sustain and grow an existing business or to start and scale up a new business.*

Meeting 18 presents an opportunity for members to further consider the impact of the OECD/G20 political agreement on a new tax framework will have on Ireland's general corporate tax strategy going forward and the impact it may have on Foreign Direct Investment and the broader corporation tax environment in Ireland.

Although there is still much work to be done with regard to finalising and implementing the rules set out in the framework, the introduction of a 15% global minimum corporate tax rate could have significant ramifications for Ireland's existing strategy.

This paper provides an update on the current state of play of the global framework and allows the Commission to consider the suitability of Ireland's existing corporation tax strategy going forward, with regard to its ability to:

- attract and retain Foreign Direct Investment (FDI), and
- support indigenous enterprise,

including the suitability of the ongoing use of the 12.5% corporation tax rate and to what degree Ireland may need to consider other aspects relevant to competitiveness beyond corporation tax.

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1. Introduction

As noted in the paper *Overview of Corporation and International Tax Landscape*, discussed in Meeting 5, Ireland's corporate tax strategy has been increasingly shaped by international factors - with ever greater focus being placed globally on tackling aggressive tax planning and establishing tax rules that are reflective of modern business practices arising from digitalisation and globalisation.

Since Meeting 5, Ireland, along with 136 other countries,[1] has signed up to the OECD/G20 Inclusive Framework agreement on a new tax framework to address the international tax challenges arising from these modern practices (BEPS 2.0).

As noted previously, there are two *Pillars* to the agreement:

> *Pillar One* which seeks to establish greater linkages for large multinationals between taxing rights and the source of their revenue (i.e. where the customers are located), irrespective of physical presence in a jurisdiction. Pillar One also requires countries to withdraw their digital services taxes[2] and refrain from introducing new ones in an effort to stave off tax and trade wars.
>
> *Pillar Two* which provides for minimum taxing rules for large multinational corporate groups.

An (updated) recap of the Pillars is available in Appendix 1.

Since Ireland signed up to the framework in October 2021, the OECD model computational rules for the Pillar Two top-up tax have been agreed, finalised and were published in December 2021[3]. Furthermore, a draft[4] EU Directive[5][6] setting out the EU's intended application of Pillar Two was also published with a view to facilitating timely and uniform implementation by the EU27.

The OECD is expected to release commentary relating to the model Pillar Two rules and also to address how these rules will co-exist with the US GILTI[7] minimum tax rules shortly. Further steps are expected

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[1] Correct as of 18 February 2022
[2] And other similar unilateral measures
[3] Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)
[4] May be subject to change
[5] As noted previously, EU Directives set out general rules and parameters in respect of a measure that are agreed by all Member States and are required to be transcribed into national law by each Member State.
[6] Fair Taxation: Commission proposes swift transposition of the international agreement on minimum taxation of multinationals
[7] The United States has already provided for a minimum tax regime - the Global Intangible Low-Taxed Income (GILTI) regime.

to be taken thereafter with regard to administrative, compliance and co-ordination issues relating to the top-up tax.

Work will continue at the OECD throughout 2022 on finalising the Subject to Tax Rule (see Appendix 1) and details regarding its implementation.

The model rules for Pillar One as well as the terms of a multilateral convention to facilitate its introduction are still being negotiated and discussed at OECD level. Draft model rules relating to one aspect of Pillar One were published as part of a consultation process in February 2022[8]. The European Commission has committed to propose a Directive in 2022, once the details of the OECD/G20 Inclusive Framework agreement on Pillar One are finalised, implementing the Pillar One agreement in line with the requirements of the Single Market[9].

Signatories to the OECD framework initially agreed to an implementation date for both Pillars of 1 January 2023, but this date is proving challenging. Despite the current US administration's active support for the Pillar One plans, it is uncertain how Pillar One will be implemented into US law, in particular whether it will be approved by the US Congress. Delays to the approval of Pillar One in the US, may ultimately lead to the implementation of one or both parts of the project being delayed more broadly, with a number of EU countries[10] indicating a strong preference to implement both Pillars simultaneously or not at all (despite both Pillars being fully independent of one-another). Furthermore, several countries[11] have expressed practical concerns at the short timeline provided for transposing Pillar Two into national law[12].

As the computational rules for Pillar Two have been established, this paper focuses on the impact that these rules could have on Ireland's corporation tax strategy going forward.

NB: It should be noted that how these rules will actually apply in practice will be dependent on how the Pillar Two and the US GILTI minimum tax rules ultimately interact.

There are still a range of possible scenarios for the timing of the final agreement and how it will affect tax corporation tax revenues in Ireland.

[8] OECD invites public input on the draft rules for nexus and revenue sourcing under Pillar One Amount A
[9] The Commission proposes the next generation of EU own resources
[10] Estonia, Hungary and Poland
[11] Czech Republic, Bulgaria, Malta, Slovenia and Sweden
[12] Europe's veto threatens to stall global tax reform

2. Implications of Pillar Two rules

2.1 Corporation tax rate

As mentioned in *Overview of Corporation and International Tax Landscape* paper discussed in Meeting 5, Ireland's 12.5% corporation tax rate has been in place since 2003 and has been a key component in Ireland's economic policy, contributing towards its success in attracting investment and employment. Many studies have demonstrated how this rate was central to the location decision of many foreign corporate investors.

As such, the adoption of a minimum corporation tax rate of 15% under Pillar Two rules would appear to create a risk to Ireland's existing competitive corporate tax offering.

However, the goal of Pillar Two's minimum tax rate is not to eliminate tax competition – rather to prevent a race to the bottom by larger entities by introducing multilaterally agreed limitations to its scope – effectively placing a floor on tax competition.

The OECD agreement provides that Pillar Two does not need to be applied to entities in multinational groups who have a gross group revenue of less than €750m.[13] This threshold was chosen partially in recognition of the fact that groups with revenue of €750m or greater control approximately 90% of global revenue, but only represent 10%-15% of companies worldwide, but was also chosen to allow for there to be no adverse impacts for SMEs[14].

As part of Ireland's agreement to sign up to BEPS 2.0, assurances were received from the European Commission that the EU transposition of the agreement would be reflective of the scope agreed at OECD level and that the 12.5% corporation tax rate could be maintained for businesses out of scope of the OECD agreement. Furthermore, as the 15% rate is applied to a different base than domestic corporate tax, the existing 12.5% regime may continue to have relevance, even for entities in scope (see Chapter 2.1.1).

Nevertheless, it can be expected that questions will arise as to whether the 15% rate should be applied more broadly.

[13] The OECD rules provide that this threshold may be set lower, but the current draft EU Directive for implementing Pillar Two has currently set a fixed €750m threshold.
[14] Tax Challenges Arising from Digitalisation - Report on Pillar 2, (OECD), 2021

2.1.1 Consequences of broad application of 15% rate

At first glance, the broad application of a 15% rate appears to have revenue raising potential and general equity by applying the same rules across the board.

However, in practice there are significant nuances that must be considered. Although Pillar Two is referred to as the application of a 15% rate, in practice, it does not involve applying 15% to the Irish taxable profits[15] of an entity and the tax is not levied at the entity level.

Pillar Two instead provides for a *jurisdictional "top up tax,"* calculated by reference to the aggregate tax liability and accounting profits of **all group entities in a jurisdiction.** Where the aggregated effective tax rate for a jurisdiction is below 15%, a top-up is required. The top-up required may be reduced by reference to the substance of the entities in a jurisdiction (substance in this case refers to the level of payroll and/or assets in a particular jurisdiction). This measure is referred to as the *substance-based carve out*[16].

As the top up tax is subject to a different base, ultimately the amount required to be paid at the jurisdictional level under Pillar Two may be lower than the amount required if a 15% rate was applied at the individual entity level. From the perspective of companies in scope of the Pillar Two rules, a domestic 15% rate could represent further increased costs beyond those envisaged by Pillar Two.

Approximately 10%[17] of Irish companies registered for corporation tax are part of either an Irish or foreign multinational group. The 12.5% rate as part of the existing corporation tax regime, will likely continue to play a key role in retaining out of scope multinationals in Ireland (on the basis that current estimates indicate only 5% of companies will be affected by Pillar 2) and in attracting emergent FDI. As noted previously, studies by both the ESRI and the Department of Finance have found significant relationships between the Irish Corporation Tax rate and the level of inward FDI.

Furthermore, the assurances granted from the European Commission with regard to the retention of the 12.5% rate were initially communicated to the public in October 2021, were reiterated by the Minister for Finance during his budget speech that month and repeated again at the Committee on Finance, Public Expenditure and Reform, and Taoiseach in November 2021.

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[15] Being entity accounting profit, subject to entity level adjustments provided for the in the Taxes Consolidation Act 1997.

[16] Pillar Two Model Rules in a Nutshell, (OECD) 2021

[17] Revenue's Research report in respect of Corporation Tax Payments 2020 Payments and 2019 Returns indicates that there are 17,366 multinationals (14,545 foreign owned and 2,821 domestic multinationals) out of 167,769 companies active on Revenue records (filing returns for 2019).

It should also be noted there is no obligation for countries to adjust their approach in respect of companies not in scope. Ireland needs to be cognisant of the fact its main competitors for FDI may retain their current offering with regard to out of scope entities.

In practical terms, it is likely that many of the unaffected companies represent smaller Irish indigenous businesses. Such companies are less able to react to such a rate change through relocation and are effectively obliged to pay the higher rate. However, as such companies only reflect 11%[18] of corporation tax receipts, this increase may represent a further cost burden in a less profitable sector and may hinder economic activity. Assurances from the Commission that the rate can remain unchanged may allow Ireland an opportunity to support these entities without the need to incur further cost or a potentially lengthy State Aid assessment.

Consideration also needs to be given to the incidence[19] of an increase to the corporation tax rate. The Department of Finance have previously noted that where capital is more mobile than labour the incidence of taxation tends to fall on wages and employment.

2.2 Impact of Pillar Two on expenditures

Although some carve outs/exclusions may apply to Pillar Two, the rules have the potential to restrict the level of tax expenditures that Ireland can offer in practical terms, insofar as expenditures which reduce taxable profits may attract a top-up charge.

Notwithstanding the above, the Pillar Two rules recognise that certain refundable tax credits are more in the nature of grant income, such as research and development tax credits.

Where appropriate, Pillar Two rules allow for certain tax expenditures to be treated as *"qualifying refundable tax credits"* subject to certain criteria being met[20]. Where a credit is qualifying, it may be treated as an amount that increases the aggregate profits of the jurisdiction, rather than as an amount that effectively reduces the tax paid in a period in a jurisdiction. Less top up tax would expected to arise as a result.

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[18] Per Revenue's Research report in respect of Corporation Tax Payments 2020 Payments and 2019 Returns

[19] This refers to the final distribution of the tax on foot of any behavioural adjustments arising after the tax has been imposed. The person whom a tax proposal is targeted at or levied on may not ultimately bear the burden.

[20] The expenditure should take the form of a refundable tax credit that is paid as cash (or cash equivalents) within 4 years from when the entity satisfies the conditions for receiving the credit. A review process will look to determine if further criteria are required.

The assessment as to whether a credit is qualifying or not is applied to the regime as a whole and not to the facts and circumstances applicable to an individual taxpayer.

Ireland has received assurances that the existing benefits of the refundable R&D tax credit can generally be maintained.[21]

Furthermore, the Pillar Two rules should not give rise to any top-up tax due to differences in timing for depreciation of tangible assets under accounting principles compared to local tax rules.

3. Ireland's corporate tax strategy going forward

As noted previously, Ireland's industrial policy has always been heavily focused on attracting and retaining foreign direct investment (FDI). A competitive corporate tax strategy is a key tenet of that policy - to date this has included the use of a low corporate tax rate.

A low corporate rate can continue to be of significance to that strategy going forward as:

- the 12.5% rate can be retained to attract emergent FDI, and
- the application of the top up at the global minimum rate will remain competitive in comparison to jurisdictions which apply a higher corporation tax rate.

The use of a low rate not only attracts FDI, but also provides support to indigenous industries for scaling businesses.

Furthermore, there remain aspects within the current corporation tax strategy, which will continue to have broad application for both companies in scope of Pillar Two as well all other entities in the State.

1. *The manner in which domestic corporation tax is calculated:* All companies will continue to be required to calculate domestic corporation tax going forward. The manner in which it is calculated can remain on a fairly stable and standardised basis. There is a clear starting point calculating taxable profits across all domestic entities, being accounting profit. The domestic trading rate is also applicable to a broad base of income i.e. there is little and limited rate variation.
2. *The manner in which taxes are paid and filed in the State:* As has been noted on several occasions, Ireland is generally perceived as a location where the payment of taxes is relatively

[21] An amendment may be required to ensure that the R&D credit is repaid within 4 years.

straightforward and has been ranked first in the EU (and fourth worldwide) for ease of paying taxes for businesses in the 2020 PWC-World Bank Paying Taxes report[22][23] – a position it has held for several years.

Ireland is considered to have a competitive tax system in terms of monetary and time costs of compliance. This may have the potential to be further improved through modernisation of the tax administration.

3. *Certainty and stability with regard to the application of rates and rules:* Changes to Corporation Tax rules are increasingly designed with a view to minimising disruption. This is achieved through the following:
    - Providing clear timelines for expected changes by way of roadmaps or the transitional legislative measures, which allows companies to plan for change.
    - Engaging in consultation with stakeholders in consultation in relation to changes with a view to ensuring they are operationally effective. Feedback Statements have been increasingly used as a measure to communicate measures in advance of change as well as to seek feedback in respect of possible approaches or legislative amendments prior to implementation.
    - Transposing international legislation in a faithful, sustainable and timely manner to mitigate any uncertainty or risk arising (such as infringement) arising from a broad or aggressive interpretation of same.
4. *Access to a large tax treaty network:* Ireland has signed comprehensive Double Taxation Agreements (DTAs) with 76 countries; 73 are in effect[24].

Further improvements to the corporate tax offering are possible. One such measure to further improve simplicity and certainty could be the simplification and modernisation of the Taxes Consolidation Act 1997 (TCA). The TCA integrated 30 years of direct taxes legislation from three Taxes Acts and more than 30 Finance Acts into a single volume. The final Act contained 1,104 sections and 32 schedules and cut the level of existing direct taxation legislation in half.

However, more than 25 Finance Acts have passed since its introduction. The TCA now has approximately 1,954 sections and 53 schedules in force. This alone may be sufficient to justify a streamlining exercise, but there are other factors that make this a timely proposal such as:

[22] PwC Paying Taxes 2020 report shows Ireland maintaining lead in the EU
[23] Paying Taxes 2020 - Overall ranking and data tables
[24] Revenue.ie - Double Taxation Treaties

- The TCA uses language from the 1800s in places which can be outdated and less accessible to those who do not have English as a first language – lessons can likely be drawn from the tax simplification and tax law rewrite projects in the UK[25].
- A large amount of legislation relating to international tax reform has been inserted into the TCA in a relatively brief amount of time. There may be scope to better integrate these measures into the tax code, without changing their intended operation.
- Although best efforts are made to keep similar provisions grouped together, this does not always happen[26] and it can be difficult users to ensure they have identified every measure relevant to their need. Furthermore, such efforts have led to an extensive use of lettering to ensure items are properly grouped.[27]
- The manner in which people conduct business and the tools which have can be used to collect taxes have significantly changed since 1997. Digitalisation and globalisation can often mean that the administrative measures included in the current tax code can be streamlined – ensuring legislation reflects administrable practices is a key part of tax administration modernisation.

Such an exercise may provide greater clarity to users, both in the FDI and indigenous SME space as to their tax obligations and how to comply with same.

3.1 Beyond corporation tax

The introduction of the global minimum rate means that the value of rate competition is diminishing, and Ireland cannot expect to compete for FDI on a competitive corporate tax offering alone. Although corporate tax is an important part of Ireland's FDI current offering, it is not the only element. The use of a common law system[28] and domestic accounting systems broadly in line with International

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[25] Conversely, the language links can help identify when an item was introduced and the context for its introduction.
[26] For example, section 81 relates to the deductibility of expenses generally and section 840 relates to the deductibility of business entertainment expenses
[27] A section 835AAO was introduced into the TCA in Finance Act 2021 to ensure correct location of a provision.
[28] Common law is practiced in Australia, Canada (excluding Quebec), Hong Kong, India (excluding Goa), New Zealand, Pakistan, South Africa, most of the United Kingdom (England, Wales, and Northern Ireland) and the United States among others.

Financial Reporting Standards allow for certainty. Furthermore, EU market access, a highly educated[29] English speaking workforce and other factors will remain key draws.

However, in an era of fast paced technological and green transition, the jobs available will change and will require high quality educational solutions in order to maintain a pool of relevant, skilled workers[30]. More may need to be done in this space to ensure Ireland remains an attractive location.

All other things being equal, any top-up tax arising[31] under the Pillar Two rules will be the same regardless of where the company locates as the rules are broadly standardised. In such instances, Ireland may begin to seem interchangeable with any other country subject to a top-up. Although it should be noted that where a top up applies under Pillar Two, the rules may allow for that top up to be reduced in jurisdictions where there is a substantive payroll presence. This may further drive location decisions without the need for engaging in other methods of competition.

Nevertheless, other competitiveness issues, including housing costs will become more relevant.

4. Conclusion

Although there is still much work to be done with regard to finalising and implementing the rules set out in the framework, the introduction of a 15% global minimum corporate tax rate could have important ramifications for Ireland.

Ireland's corporate tax strategy has long moved beyond simple rate competition and has many attributes that will continue to remain attractive to FDI but can also support and develop indigenous industry. Nevertheless, a low corporate rate can continue to be of significance to both groups. There may be scope to further improve the corporation tax offering through modernisation and simplification of the Taxes Consolidation Act as well as through modernisation of the tax administration.

However, Ireland may need to give more consideration to how non-tax measures can impact on its offering as a location for investment.

The terms of references have asked the members of the Commission to:

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[29] In 2019, Ireland had the fourth highest third level educational attainment level in the EU27 at 55%, behind Cyprus (59%), Lithuania (58%) and Luxembourg (56%) Ireland, the EU and Educational Attainment, CSO
[30] EU Commission, 2021 Strategic Foresight Report and OECD, Trends shaping Education 2022.
[31] Noting some countries will always incur a higher corporation tax cost than Ireland.

- consider how Ireland can maintain a clear, sustainable, and stable taxation policy as regards Ireland's attractiveness to Foreign Direct Investment in a changing global taxation environment, including retention of the 12.5% corporation tax rate, and
- review how best the taxation environment for SMEs and entrepreneurs can ensure that Ireland remains an attractive place to sustain and grow an existing business or to start and scale up a new business.

To this end, members are invited to give their collective view on Ireland's corporate and international tax strategy – whether it should be modified and if so, how. The goal of the discussion at Meeting 18 will be to reach a consensus on priorities and areas of focus, and to agree how the Commission will progress towards making recommendations with regard to corporate and international tax.

Appendix 1 Pillar One and Pillar Two Rules - Recap

Pillar One – Profit Allocation Rules

The Pillar One rules seek to reflect the fact that globalisation and digitalisation allows businesses to participate in the economic life of a jurisdiction without physical presence. It achieves this by ensuring that the largest and most profitable[32] multinational enterprises (MNEs)

- re-allocate, and
- (ultimately) tax,

a certain portion of their worldwide profits in the market jurisdictions (the countries where the end-consumers and users of their products and services are based) where they have a significant economic presence[33], irrespective of whether the MNE has a physical presence in that jurisdiction or not.

It is anticipated that these rules will initially apply to approximately 100 MNEs[34].

It is proposed that a multilateral agreement governing the reallocation of profit to market jurisdictions will be developed and opened for signature in 2022, with the new rules coming into effect in 2023.

The statement also provides for the removal of all digital services taxes and other relevant similar measures.

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[32] Affected MNEs will generally have global sales exceeding €20bn per annum (this may be reduced to €10bn in 7 years) and profitability (measured as the ratio of profit before tax to turnover) exceeding 10%.
[33] Being jurisdictions from which the MNE derives at least €1m in a year. For smaller jurisdictions with low GDP, this the threshold is reduced to €250,000.
[34] The rules shall not apply to MNEs operating in extractive industries or those engaged in Regulated Financial Services.

Pillar Two – Minimum Taxation Rules

The Pillar Two proposals contain a series of co-ordinated rules which seek to ensure that MNEs with worldwide group revenue of €750m (although a country may choose to apply a lower threshold) or greater[35] pay at least a minimum effective rate of taxation on their profits[36] in each jurisdiction in which the group operates.

The rules will apply by charging a top-up tax to bring the effective rate of taxation up to the minimum rate.

The minimum rate as agreed by 137 jurisdictions to date is 15%.

The OECD model rules provide that the top will be applied to the parent company in the first instance under the *Income Inclusion Rule* by taxing the parent company an amount of tax equal to the deemed underpayment[37] by the foreign subsidiary, on a per jurisdiction basis, up to the minimum rate. Where this rule does not apply, the *Undertaxed Payments Rule* requires the top-up tax to be paid in other jurisdictions in which the group operates.

The draft EU Pillar Two Directive proposes that the top-up amount could instead be paid in the jurisdiction where the underpayment takes place.

The OECD proposals do not technically require a jurisdiction to change its rate of CT. However, the OECD rules propose that if an MNE operating in Ireland paid less than the minimum effective rate of tax in Ireland, another jurisdiction would collect the top-up tax instead, which would effectively represent an Irish Exchequer loss (as the amount is required to be taxed somewhere) and ultimately affect the stability of the operation of corporates in Ireland. As such, it seems logical that Ireland would avail of the option in the EU Directive to apply the top up domestically.[38]

The rules do not prohibit Ireland from keeping its 12.5% rate for Irish companies, including SMEs, to the extent that they are outside the scope of minimum tax rules. Assurances have been received from the EU Commission that maintaining the headline 12.5% corporation tax rate for businesses out of scope of the OECD agreement does not present difficulties.

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[35] Exclusions are expected to be agreed for certain entity types such as governmental entities, non-profit organisations, pensions funds, and certain regulated investment funds. Income earned from international shipping is also out of scope.

[36] Refers to profits as calculated in accordance with International Financial Reporting Standards or an equivalent standard subject to certain agreed adjustments.

[37] The tax payable by the parent is proportionate to its holding in the subsidiary i.e. if the parent holds 75% of the subsidiary, it will be required to pay an amount equal to 75% of the deemed underpayment.

[38] Subject to Ministerial approval.

The Pillar Two rules are expected to have much broader application than Pillar One.

Although some carve outs/exclusions may apply, the rules have the potential to restrict the level of tax expenditures that Ireland can offer, insofar as expenditures which reduce taxable profits may attract a top-up charge in another jurisdiction.

The United States has already provided for a minimum tax regime – the Global Intangible Low-Taxed Income (GILTI) regime. Consideration will be given to the circumstances under which Pillar Two rules and GILTI rules can co-exist. Subsidiaries of US MNEs in Ireland are generally already subject to GILTI rules.

Pillar Two also proposes a bilateral tax treaty rule – known as the Subject to Tax Rule – which would apply when certain payments (such as interest and royalties) are made to another jurisdiction which imposes low levels of taxation on the payment. The rate applied to such payments will be 9%. The Subject to Tax Rule minimum rate is lower because it applies to the gross amount of whatever payments are finally agreed to be within its scope, whereas the other rules are applied to net profit, rather than gross payments or receipts. This rule is of particular importance to developing countries in the wider Inclusive Framework.