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CORPORATE TAX POLICY IN IRELAND: TIME FOR A CHANGE?*

by Jim Stewart

Tax incentives to attract foreign direct investment (FDI) have been the main tool of industrial policy in Ireland for over 50 years. As a result, Ireland has attracted large inflows of FDI, and is the European headquarters for many US digital-based firms, such as Facebook and Google. The paper argues that a tax-based industrial policy has become more risky, because of changes to international tax rules in response to criticism of low-tax strategies. The risk is that resulting changes will mean the Irish tax regime is far less attractive, and will result in an outflow of FDI.

The paper argues that a tax-based industrial policy is not likely to result in an innovative, research-led economy, rather there is a need for new policies.

Gli incentivi fiscali finalizzati ad attrare gli investimenti diretti esteri (IDE) hanno rappresentato lo strumento principale della politica industriale in Irlanda per più di 50 anni. Di conseguenza, l'Irlanda ha attratto flussi significativi di IDE e ospita la sede di molte imprese statunitensi del settore digitale (ad esempio, Facebook e Google). Il presente saggio sostiene che una politica industriale basata sulla fiscalità è divenuta più rischiosa a seguito dei cambiamenti alla normativa fiscale internazionale, introdotti in risposta alle critiche riguardanti le strategie imperniate su una bassa imposizione fiscale. Il rischio sta nel fatto che tali cambiamenti renderanno il regime fiscale irlandese molto meno appetibile, e comporteranno una fuga degli IDE.

Il presente contributo sostiene che una politica industriale che fa leva sulla fiscalità non porterà a un'economia innovativa basata sulla ricerca. A tale scopo, sono invece necessarie politiche nuove.

This paper consists of four parts:
i) FDI and Ireland;
ii) the changing nature of FDI;
iii) the changing nature of corporate tax;
iv) time for a change in corporate tax policy?

The paper argues that the nature of Foreign Direct Investment (FDI) has changed in Ireland. There have been very large FDI inflows in recent years, it has become very

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profitable, intellectual property (I.P.) intensive, and because manufacturing has been replaced with service-type activities, has far lower linkages with the domestic economy.

These trends are mirrored internationally. Data for five large groups show that profits are large, property and equipment as a percentage of balance sheet values are low and even lower as a percentage of market values. The main source of value added is I.P.

These characteristics pose difficulties for revenue authorities in many countries. As a result, there have been initiatives for tax reform from both the Organisation for Economic Co-operation and Development (OECD) and the EU. Ireland has accepted some of these reforms but resisted others.

It is likely that reforms, such as a digital tax, which have been adopted by a number of countries outside and within the EU, e.g. Italy, will be adopted by other EU countries. There will also be other reforms. Given the current nature of FDI in Ireland, changes in corporate tax regimes in other countries, current and proposed changes by OECD, and especially changes by the EU have considerable implications for FDI located in Ireland, profits reported, and corporate tax revenues.

This poses risks not only to Ireland's tax base, but also to an industrial policy based on tax reliefs.

1. FDI and Ireland

Tax incentives to attract FDI have been the main tool of industrial policy in Ireland for over 50 years. In recent decades, they have been described as the cornerstone of industrial policy[1]. Other factors, including ease of incorporation, ease of establishing a holding company, and a flexible response by State agencies to the needs of FDI, comprising relatively light-touch regulation, have led to Ireland acquiring many of the features of a tax haven and often appearing in lists of tax havens, for example in Oxfam's list of corporate tax havens[2].

FDI in Ireland has changed dramatically over the last decade in terms of size. FDI stocks amounted to EUR 880 billion for 2017, larger than that of France at EUR 874 billion. A large proportion consists of I.P. assets, and assets associated with internet-based commerce (service centres and data centres), while a much reduced proportion consists of assets associated with manufacturing. Foreign-owned firms are highly profitable, resulting in large corporate tax revenues even though corporate tax rates are low.

Ireland ranked third amongst OECD countries in terms of inward FDI flows in 2017 (after the Netherlands and Germany), and ranked third in terms of the stock of FDI as a percentage of GDP after Germany and the Netherlands, but ahead of France (OECD

[1] The then Tánaiste, Marry Harney, is quoted in 2003 as stating: "Ireland recognised many years ago that economic growth can only be achieved with low taxes" ("Independent", 21 May 2003). In 2007, the then Taoiseach, Bertie Aherne, opposed a Common Corporate Tax Base (CCTB) as it would pose a threat to the low corporate tax rate, which was the cornerstone of industrial policy (Reuters, 30 April 2007). More recently, the Minister for Finance repeated that the 12.5% corporate tax was the cornerstone of industrial policy (speech to the Irish Taxation Institute, 23 February 2018). Others, such as the American Chamber of Commerce, state: "An internationally competitive and certain Corporate Tax Policy is a necessary part of Ireland's ability to retain and attract substantive FDI" (American Chamber, 2018, p. 2). Analysis of industrial policy in earlier decades did not always emphasise low corporate tax as a tool of development. For instance, the Industrial Policy Review Group (1992), also known as the "Culliton Group", stated that "no indication should be given of any continuation of the 10 per cent corporation tax beyond 2010" and "the range of activities to which it applies should not be extended".

[2] See also Torslov, Wier and Zucman (2018).

International Investment Statistics, 2018, Tables 1 and 2). For the year 2015, Ireland accounted for just over 41% of total FDI inflows to the EU.

The stock of FDI in Ireland has also shown large increases in recent years. In 2006, the stock of FDI in Ireland amounted to EUR 183.9 billion (CSO, 2017, International Investment Position, 2016). In 2016, the stock of FDI amounted to EUR 799.6 billion (CSO Foreign Direct Investment Annual, 2016). There was a particularly large increase between 2014 and 2015 from EUR 342 billion to EUR 815 billion, reflecting new tax strategies involving the location of I.P. in Ireland, coinciding with significant tax changes (the ending of stateless income, and restrictions on the use of the double Irish structures)[3]. US companies are particularly important in terms of FDI flows into Ireland[4].

Foreign-owned firms are also particularly profitable in Ireland. A report produced for the European Commission (2017) shows a measure of profits (gross operating surplus) as a percentage of value. On this measure, foreign-owned firms in Ireland are the most profitable in the EU. The gross operating surplus of foreign-controlled firms as a percentage of total operating surplus is 73.6% for Ireland, and is substantially larger than the fraction of turnover or value added (European Commission, 2017).

Table 1. Net income of US multinational enterprises (MNEs) in various countries ($ billion)

	2013	2013	2013	2014	2014	2014	2015	2015	2015
Low-tax countries	Net income	Tax paid	Tax rate %	Net income	Tax paid	Tax rate %	Net income	Tax paid	Tax rate %
Netherlands	134.1	3.7	2.7	152.6	5.6	3.5	186.5	3.8	2.0
Luxembourg	112.7	0.4	0.4	124.4	0.8	0.6	81.6	0.8	1.0
Ireland	106.8	3.6	3.3	115.3	4.0	3.3	131.6	4.0	2.9
Bermuda	76.5	0.2	0.2	84.2	n.a.	n.a.	70.4	0.7	1.0
Switzerland	64.5	2.9	4.3	70.6	2.8	3.8	69.9	3.1	4.2
UK Islands Caribbean	49.6	0.9	1.7	74.2	0.7	0.9	63.0	0.6	0.9
Others									
France	6.8	3.5	33.9	2.4	4.1	63.0	7.9	3.5	30.1
Germany	16.9	3.9	18.7	23.0	6.7	22.6	21.1	4.9	18.8
United Kingdom	72.3	8.6	10.6	9.7	9.1	48.4	11.8	7.1	37.6
EU	483.2	32.0	6.2	544.3	40.3	6.9	585.8	32.6	5.3
Total world	1044.6	138.9	11.7	1166.2	160.6	12.1	1065.8	91.2	7.9

Source: US Bureau of Economic Analysis, various issues.

[3] This is likely to reflect large inflows of I.P. as part of a tax strategy, for instance by Apple. See: *Paradise Papers: Apple's secret tax bolthole revealed*, "BBC Panorama", 6 November 2017; and Hopkins and Bowers, *Apple secretly moved parts of empire to Jersey after row over tax affairs*, "The Guardian", 7 November 2017.

[4] See Bureau of Economic Analysis, Majority Owned Foreign Affiliates, Table II.D.1, available at: http://bea.gov/international/usdia2013p.htm.

If US firms alone are examined, Table 1 shows that the EU accounts for 55% of the non-US worldwide profits of US firms, but that most of these profits (68%) are declared in just three EU countries (Netherlands, Luxembourg, and Ireland) with low effective tax rates.

Table 1 reflects the value of incentives to attract FDI. High profits declared in Ireland and Luxembourg also mean that corporate tax as a percentage of total tax is also high. This has led to comments that proposed changes to EU tax rules would reduce Irish corporate tax revenues substantially[5]. Using OECD definitions, taxes on corporate income as a percentage of total tax amount to 11.9%, 11.3%, and 7.2% for Luxembourg, Ireland, and the Netherlands, compared with 4.6% and 4.7% for Germany and France.

It is thus not surprising that Luxembourg, Ireland, and the Netherlands (together with other countries such as Cyprus and Malta) oppose EU initiatives such as apportioning profit using a formula via a consolidated corporate tax base (Common Consolidated Corporate Tax Base), and a digital tax.

Proposed and actual corporate tax changes will be discussed later. First, it is important to note that the nature of FDI investment in Ireland has changed.

2. The changing nature of FDI

2.1. Evidence from linkages

The Industrial Development Authority in Ireland (IDA) in its annual report shows that statistical data relating to IDA supported enterprises, including data on local expenditures as a percentage of sales (Table 2).

Table 2. Impact of IDA-supported companies: local expenditures as a percentage of sales, various years

Year	IDA Annual Report 2015, p. 12	Year	IDA Annual Report 2009, p. 16	Year	IDA Annual Report 2001*	Year	IDA Annual Report 1997**
2011	12.5	2006	17.2	1999	27.1	1990	33.7
2012	12.2	2007	17.3	2000	27.0	1991	34.0
2013	13.0	2008	17.5			1992	37.3
2014	13.3					1993	37.5
						1994	35.1
						1995	36.2
						1996	37.4

* The report states that a new methodology is applied using the survey unit of the Economic and Social Research Institute (ESRI).
** This is the first report for which this analysis was performed. The data refer to "supported manufactured and internationally traded services", excluding companies employing fewer than 19 employees.

[5] The Chairman of the Irish Fiscal Advisory Council has stated that the proposed EU tax harmonisation rules are a greater threat than Brexit ("Irish Times", 14 September 2017). In relation to the proposed digital tax, commentators have stated that "people at the very top of Government believe it's as serious as Brexit" (Leahy, "Irish Times", 28 October 2017).

The data show a generally declining proportion of local expenditures as a percentage of sales, from an average of 35% in the period 1990-1996 to 12.7% in the period 2011-2014 This can be explained by the changing nature of FDI in Ireland, that is, a switch from manufacturing to digitally provided services. Digitally provided services need far lower locally provided manufactured inputs from other firms, or services such as transport and maintaining equipment.

While local expenditures as a percentage of sales are low and falling, it is likely that royalty payments as a percentage of sales are high. The European Commission reports that royalty payments as a percentage of GDP amounted to 29.6% for 2015 compared with an EU average of 1.29% (European Commission, 2017). This reflects the partial ending of the "double Irish" tax strategy, and the "stateless income" tax strategy used by Apple, to a strategy based on tax write-offs from switching I.P. to Ireland.

The location of group holding structures using Ireland as a base (often referred to as EMEA – Europe, Middle East, and Africa – structures) requires skills that may not be available in Ireland. Many internet-based firms offering services within an EMEA group require language skills. In 2015, Google employed people speaking 65 different languages from 60 countries ("Irish Times", 22 January 2015). In 2013, it was reported that at Facebook 25 different languages are spoken ("Irish Times", 9 February 2013[6]). Apart from a shortage of language skills, there is a shortage of internet/computer-based skills. Hence, a greatly expanded visa programme was introduced in 2013[7].

Table 3 shows balance sheet values for five large MNE groups. The table shows that property and equipment as a percentage of balance sheet values are low at 13.5% for 2016[8]. The main balance sheet assets consist of cash and liquid assets (58% of balance sheet values). Total balance sheet values as a percentage of market value is around 36% for 2016.

These numbers may be explained as follows: the main asset consists of I.P. and organisational competencies. Organisational competencies enable Apple to outsource the production of complex products to China (Foxcon), and Amazon to organise supply chains and develop logistics to deliver thousands of products across continents. Profits are high partly because of first-mover advantages, which enable competencies acquired in one area to be applied in another; for instance, Amazon, Google, and Microsoft have all extensive cloud computing operations. Internet-based firms are particularly adept at exploiting regulatory arbitrage, for instance Uber in relation to the distinction between employees and self-employment, AirBnB in relation to providing accommodation, but not as a much more regulated commercial hotel, Facebook and Google as publishers/media firms but not as a regulated media or publishing firm[9].

Profits and market values are also high because of market structure. All the firms shown in Table 3 are dominant in their respective markets. Market structure enables anti-competitive practices such as restrictions on user access, product incompatibilities and market segmentation, and has resulted in large fines levied by the EU on Facebook,

[6] Una Mullaly writes: "Young European are flocking to Dublin to work in the mini boom town created by Facebook, Google, PayPal, and others".

[7] See Mason Hayes & Curran (2014).

[8] Apart from office buildings, the main fixed assets of internet firms in Ireland is likely to be data centres ("Irish Independent", 18 June 2018).

[9] See, for instance, "The Guardian", 11 October 2017 and 3 July 2018.

Google, and Microsoft[10]. Facebook also faces large potential fines for breeches of data privacy rules from the US Federal Trade Commission ("Washington Post", 9 April 2018) and the European Union (David Ingram, Reuters, 19 April 2018). Amazon and Apple have been subject to penalties because of illegal tax benefits.

Table 3. Profits and balance sheet data for Amazon, Apple, Facebook, Google, and Microsoft ($ billion)

Year	Profits	Market value	Balance sheet values	Cash and liquid assets	Property and equipment
2016	127.793	2,449.174	876.867	511.639	115.407
2015	108.536	2,101.535	748.082	430.814	106.644
2014	113.080	1,502.721	632.756	344.695	80.172
2013	99.063	1,621.026	546.951	315.083	59.963

Source: SEC filings.

3. The changing nature of corporate tax

As noted, US companies declare most of their non-US profits in three countries, including Ireland, within the EU. They are highly profitable. International and country-specific tax changes will mean a continued presence within the EU, but not necessarily in Ireland. Internet-based FDI in Ireland is characterised by high I.P. values as a proportion of total assets, skill sets by employees that are internationally mobile (computing skills, language skills, and internet business-based skills). FDI in Ireland is thus more mobile internationally. These characteristics pose severe difficulties for a tax-driven industrial policy in Ireland.

OECD (2015a) notes that the characteristics of the digital economy pose particular problems for international taxation. For instance:
– an unparalleled reliance on intangibles;
– the massive use of data (notably personal data);
– the widespread adoption of multi-sided business models (many different types of customers purchasing different products and services), which creates value from externalities.

The most significant characteristic is:

> the difficulty of determining the jurisdiction in which value creation occurs. This raises fundamental questions as to how enterprises in the digital economy add value and make their profits (OECD, 2015a, p. 16).

The issue of where a company is located, or where it has a "permanent establishment" is at the centre of tax minimisation strategies. This is the case for both digital and non-digital

[10] Google was fined EUR 4.3 billion in July 2018 and EUR 2.42 billion for market dominance abuse (http://europa.eu/rapid/press-release_IP-17-1784_en.htm); Microsoft EUR 561 million (http://europa.eu/rapid/press-release_IP-13-196_en.htm); and Facebook EUR 110 million (http://europa.eu/rapid/press-release_IP-17-1369_en.htm).

firms. For instance, Diageo has a tax strategy for several years, which transferred ownership of many brands of Scotch whisky to the Netherlands ("The Guardian", 2 February 2009). The bulk of profits are attributed to these brands. Thus, as noted by OECD (2018), firms (both digital and non-digital) may have a significant economic presence in a jurisdiction without having a physical presence.

OECD states that changes to tax systems must "ensure that profits are taxed where economic activities take place and value is created" (OECD 2015b, BEPS Explanatory Statement, 2015, p. 4). A principle restated by the European Commission[11].

As a result, OECD has introduced 15 different "action plans" for change. Some of these action plans are useful in combatting aggressive tax planning (ATP), whereas others are not so useful, for instance the continued advocacy of "arm's-length" pricing and weak proposed changes to the definition of "permanent establishment".

The EU has introduced several directives that have a direct bearing on tax policy, for instance by providing for inter-country sharing of information; in contrast to OECD, these directives are mandatory and subject to legal sanction.

While stating that the corporate tax rate is of vital national significance (a "cornerstone of industrial policy"), Ireland has at the same time agreed on various measures at EU level that have implications for tax policies and the tax base. Ireland has however opposed a Common Corporate Tax Base (CCTB) and a Common Consolidated Corporate Tax Base (CCCTB), which would mean apportionment of profits by a formula, and a digital tax. The Treaty on the Functioning of the European Union (TFEU, also known as the Treaty of Rome) – Article 99 – refers to mechanisms for the harmonisation of indirect taxes but not direct taxes[12]. The Irish Government has stated that a veto would be used at the European Council (with some other countries) if these measures were proposed.

The Irish Government has also stated that it is in favour of tax change at a multilateral level. This is also the stated position of the American Chamber of Commerce representing US business in Ireland. The US Chamber of Commerce is opposed to unilateral action as is OECD. The latter (OECD 2013, p. 48) states in relation to unilateral change in tax policy:

> The consequences could be damaging in terms of increased possibilities for mismatches, additional disputes, increased uncertainty for business, a battle to be the first to grab taxable income through purported anti-avoidance measures, or a race to the bottom with respect to corporate income taxes.

However, it is unlikely that agreements on proposals for CCCTB or a digital tax will be achieved by consensus. What is more likely is that there is limited scope for further multilateral agreements, given the current policies of the Trump administration.

It is for this reason that various EU and non-EU countries have unilaterally introduced or proposed a form of digital tax. For instance, Italy and the United Kingdom have introduced a form of digital tax, and Spain is proposing to introduce such a tax. It is likely that more EU countries will follow. India and Indonesia have introduced a form of digital

[11] European Commission, Communication from the Commission to the European Parliament and the Council, Time to establish a modern, fair and efficient taxation standard for the digital economy, COM(2018) 146 final, 21 March 2018.

[12] Article 99 states changes to indirect taxes may be made by the European Council "acting unanimously on a proposal from the Commission and after consulting the European Parliament". More recently, the Treaty of Lisbon states in Article 2 (Title II Taxation): "Nothing in the Treaty of Lisbon makes any change of any kind, for any Member State, to the extent or operation of the competence of the European Union in relation to taxation".

tax, and Australia has proposed a digital tax[13]. The choice for Irish corporate tax policy is whether to enter into EU negotiations in relation to proposed tax reforms, or allow reforms to be introduced unilaterally by larger EU Member States without any influence on the outcome.

4. Time for a change in corporate tax policy?

A tax-based industrial policy is not likely to result in an innovative, research-led economy. It is more likely to lead to an emphasis on tax reduction. Those skilled in knowledge of the tax system become influential in management decisions[14]. The tax avoidance industry and those firms specialised in understanding the tax system and selling tax services become large and powerful, and may exert considerable influence in formulating tax policy and legislation.

The challenge for researchers and policy makers is to develop and implement industrial policy measures not dependent on tax incentives and tax minimisation strategies. Increased regulation and prohibition of "aggressive" tax strategies also imply change in management strategy and firm organisation. The implications for location of FDI is an important avenue for future research and for the development of alternative policies emphasising high value added indigenous firms.

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[13] Stewart (2018); for Australia, see Karp, *Crossbench support for tax on digital giants may pave the way for company tax cuts*, "The Guardian", 21 May 2018.

[14] There are over 24,000 members of the main professional body of accountants in Ireland in 2015. Of them, 63% work in business and 66% work in Ireland (Chartered Accountants Ireland, Annual Report, 2015). See also Clancy *et al.* (2010).