American Chamber of Commerce Ireland

Pre Budget 2017 Submission

to the

Department of Finance

July 2016

Executive Summary

The American Chamber of Commerce Ireland's priority is that Ireland remains a unique transatlantic trade and investment gateway and a location of choice for US inward investment to Europe. Central to this ambition is our ability to retain existing talent in Ireland, encourage émigrés back to develop their careers and ensure that working in Ireland is a rewarding proposition to attract needed skills and leadership talent.

The Chamber believes that an internationally competitive and certain tax policy is a necessary part of Ireland's Foreign Direct Investment (FDI) offering. Ireland must continue to evolve its corporate taxation regime in response to the post-BEPS landscape to remain competitive, including resourcing critical international functions within Revenue.

Following extensive consultation with FDI leadership within the Chamber, this submission highlights the key priorities for Budget 2017 with a focus on:

- **Innovations in the Income Tax Code** focused on rewarding productivity through enhancing the taxation outcomes of share-based remuneration programmes, attracting talent by amendments to the SARP regime and incentivising those taking leadership responsibility by protecting pension provision incentives – while clearly signalling the pathway for further reform to remain competitive.

- **Strengthening Ireland's Tax Roadmap**: The introduction of the EU Anti-Tax Avoidance has the potential to have a significant impact on Irish tax legislation over the coming years and the Chamber believes that there are a number of key tax policy aspects concerning the implementation of the Directive that should be carefully considered.

The Chamber believes that measures suggested in this submission will help drive growth by making Ireland more attractive for future inward investment and employment creation.

Introduction

Talent in Ireland will sustain and build the economy.

The priority for the American Chamber of Commerce Ireland is that Ireland remains a global location of choice for US foreign direct investment (FDI) into Europe. Ireland's ambitions to develop an innovation driven economy is facing competitive headwinds in a post-Brexit environment. Central to this ambition is our ability to retain talent in Ireland, attract emigres back to develop their careers and ensure that working in Ireland is rewarding for needed international talent. Achieving this will 'future proof' the country and its industrial base in an ever-changing business environment.

Ireland has established its reputation as a unique transatlantic gateway for FDI into Europe. Today, over 140,000 people are directly employed in over 700 US firms in Ireland, accounting for over 70% of all IDA supported employment. Collectively US companies have US $310bn in foreign direct investment in Ireland, representing over 11% of all US investment in the EU. This investment remains instrumental in helping to create and develop a world class labour force; critical in dispersing technology and innovative capabilities across the economy; and key in expanding the global reach of indigenous firms.

Ireland's competitive corporate tax regime and certain policy around the 12.5% rate is a necessary part of Ireland's offering, but it is by no means sufficient. **Ireland must build its international reputation for the availability of talent and as a source of innovation, as these factors are becoming increasingly important in FDI decision making for high-value projects in Information Technology, Biopharma, Digital Content, Medical Devices, Nutritionals, and Financial Services**.

To enhance Ireland's competitiveness the Chamber has identified aspects of our tax system that need attention for Ireland to continue to compete successfully for inward investment opportunities.

These areas are set out below.

1. Personal Tax and Talent

The American Chamber welcomes the Government's commitment in recent Budgets to lower personal taxation rates for low and middle income earners – a key recommendation of the Chamber in recent years, and one that will send a positive signal that Ireland seeks to reward talent and ambition, not penalise it.

A competitive income tax regime is an important deciding factor for many of those with the option to choose where they wish to locate to develop their career. And in this regard Ireland's proposition should be strengthened. As the Chamber has previously stated in past submissions, the marginal personal income tax rate (together with PRSI and USC) with its low entry threshold should be reformed to enhance Ireland's ability to retain and attract leadership talent and specialised skills, improve productivity and reduce upward pressures on labour costs.

The evidence from our members is that Ireland's high marginal income tax rate continues to be a dissuasive factor in the retention and attraction battle for advanced skills and leadership experience. Ireland must remain sensitive to the fact that this vital talent pool is in short supply globally and both employees and potential recruits are being attracted to jurisdictions where their total income tax and national insurance burden is lower – often significantly so.

The current higher marginal income tax rate of 52%, when one includes PAYE/PRSI and USC, is among the highest when compared with countries that Ireland currently competes with for investment. The relatively early entry point that income is exposed to the highest marginal personal tax rate is especially uncompetitive for a traded economy reliant on a highly mobile labour market within Europe.

In light of the current fiscal environment, the Chamber is recommending an approach to personal taxation in 2017 designed to reward productivity, attract talent and incentivise those taking leadership responsibility – and signalling the pathway for further reform to remain competitive. By targeting these three areas, the Chamber believes that the ability of our members to attract and retain critical technical and leadership talent within the jurisdiction would be significantly enhanced. We have provided further details on these recommendations below.

(i) Taxation of Share Based Remuneration

The Chamber made a submission to the Department of Finance as part of the recent public consultation on the Taxation of Share Based Remuneration. The Chamber believes that certain amendments to the current taxation treatment of share based awards could, in conjunction with other reforms to Ireland's personal tax regime, significantly enhance Ireland's overall FDI offering by rewarding productivity.

In this context, for completeness, we have detailed below the recommendations made in the Chamber's submission to this consultation:

1. **The personal tax treatment of shares acquired under all share based remuneration arrangements (e.g. share option schemes, Restricted Stock Units, etc.) should be enhanced by removing the income tax charge on the acquisition/granting of such remuneration in favour of a capital gains charge on the realisation of the share based income to the individual.** Hence, move the marginal charge from today's marginal income tax, PRSI and USC liability to a capital gains tax (CGT) of 33%.

2. As an alternative to the above suggestion, improve the tax treatment of all share based remuneration arrangements by removing Employee PRSI and the USC. This would lead to direct take home pay benefits to all workers in such schemes, enhancing their attractiveness and reduce the administrative complexity for business/employers.

3. Under various approved Profit Sharing Schemes employees, under certain conditions, can receive up to €12,700 worth of shares in any one tax year free of income tax, PRSI and USC. The limit of €12,700 has been in place for a significant period of time and accordingly the value of this benefit has declined over time. We recommend that limited threshold should be significantly increased to not just reflect indexation but also to continue to encourage employee share ownership.

4. The current employer social security position on the granting of share based remuneration should be maintained. This represents a 10.75% cost saving for all employers and represents a significant cost saving for US MNCs with operations in Ireland as such companies generally commit to strong levels of share awards.

(ii) Assignees and Bringing Back Irish Talent from Overseas

It should be recognised that one of the key factors of the success in establishing Ireland as a world leader in the IT and pharmaceutical industries during the 1990's was the ability to attract Irish nationals who had been living abroad, and who had acquired valuable skills and experience, to return here. Many of these returning Irish went on to take up senior leadership positions in some of the largest FDI companies established in Ireland and have since been influential in attracting further investment here.

Accordingly, the Chamber recommends that, in a move to encourage Irish domiciled individuals with key skills who are working and living overseas to return, returning workers should, subject to certain conditions, be allowed to claim Special Assignee Relief Program ("SARP") for a period of three years upon arrival back into the jurisdiction.

In order to facilitate this, **the required period of residence outside the State should be reduced to three years, and the requirement to have been employed by the same entity overseas, or an associated employer of that entity, should also be removed**. The existence of the €75,000 earnings floor would help to ensure that the incentive would be focussed on the kind of high quality jobs which the relief aims to encourage and create.

Reforms to the SARP regime announced in recent Budgets confirm Ireland's ambition to have a best-in-class programme making a tangible contribution to economic growth. In addition to the above, the Chamber would also make the following recommendations in relation to the current SARP regime:

- The relief should be extended to USC to make the regime internationally competitive.
- The relief should be simple to administer, especially in the context of the many other issues that assignees need to consider when moving to Ireland. Chamber Members believe that the current process of having the individual seeking approval in relation to making a claim be abolished, with the responsibility to administer the relief resting with the employer in line with the self-assessment regime that applies to all other taxes. The proposed change to a scheme which is administered by the employer is consistent with the existing provisions which allow SARP relief to be granted at source through payroll, and can be underpinned by reporting obligations if necessary. It is also underpinned by the treatment of the claimant as a Chargeable Person, thereby ensuring that a statutory claim for the relief is filed with their annual tax return.
- The Chamber also recommends that the obligation for the employer to certify within 30 days of the assignees arrival that the employee is a 'relevant employee' should be removed. This condition was introduced in Finance Act 2015 and is proving problematic to administer, while not adding anything to the operation of the relief. When an assignee arrives in Ireland there will usually be many pressing business matters that will require attention, this is particularly true of senior executives. By imposing the 30 day deadline for notification, there is a risk that these individuals will be denied the relief entirely for the duration of their assignment. The Chamber believes that such a strict administrative approach would be inconsistent with the broader policy objectives that SARP seeks to achieve and should therefore be removed. To the extent that the Government does not wish to abolish this time period, at a minimum we would recommend that the time limit for this certification is extended to 90 days.

(iii) Pensions Policy

The Chamber welcomed the abolishment of pension levies in 2015. This will positively affect members of a retirement benefit pension scheme, a retirement annuity contract, a trust scheme and a Personal Retirement Savings Account (PRSA) and should encourage further pension provision by our Member's employee base.

It is of the utmost importance that pension policy changes do not adversely impact upon the sustainable competitiveness of doing business in Ireland and our Member's ability to retain experienced leadership talent for Irish based operations. While a one-off move to a higher threshold would be a more impactful option, the Chamber believes that a commitment by Government to index linking the thresholds would be a more equitable way of ensuring that the limits are annually revised to ensure the real value of the current limits are maintained at current levels.

Thus, **the Chamber strongly recommends that the individual's Personal Fund Threshold and the Standard Fund Threshold should be increased in line with the Consumer Price Index (CPI) and this indexation should henceforth occur automatically each year**.

Furthermore, the views of the Chamber in relation to pension policy remains that the Standard Fund Threshold ("SFT") should be maintained at its current level, recognising it has significantly decreased in recent years. In addition, our Members would be wholly opposed to any change which would give rise to a restriction in the age-based thresholds and annual earnings cap which determine the maximum pension contribution of an individual qualifying for income tax relief. Any such amendment would only serve to further dis-incentivise individuals from contributing to the funding of their future pensions.

2. Approach to the recent EU Anti-Tax Avoidance Directive

The announcement in recent weeks of the EU Anti-Tax Avoidance Directive ("ATAD") will lead to a number of changes to Irish tax legislation with effect from 1 January 2019. While the information included in the Directive is still relatively new and there are a number of key questions in relation to how certain aspects of the Directive will be implemented by Member States, it is clear that a number of the proposals have the potential to impact a number of enterprises with significant operations here in Ireland.

Against this background, we believe that there are important tax policy aspects concerning the implementation of the Directive that should be carefully considered. The Chamber have summarised its current perspective on these key areas below following extensive consultation with its leadership. We would be more than happy to consult further with the Department on any aspect of the implementation of the ATAD.

(i) Interest Limitation

- On implementation, the 30% interest limitation should be included.
- Given the current Irish tax legislation in this area, the Government should agree that the Ireland has "equally effective" legislation in this area such that the extended deadline for this legislation as currently outlined in the Directive can be adopted by Ireland.
- On implementation, the proposed "grandfathering" of loans entered into pre 17 June 2016 should be included.
- The Government should consider how the Interest limitation provisions can be efficiently implemented in conjunction with Ireland's existing tax legislation in this area. The Chamber believes that simply adding the proposed interest limitation provisions into Irish legislation with amending current Irish tax legislation (potentially on a phased basis) would put Ireland at a significant competitive disadvantage in this context when compared to most other Member States.

(ii) Controlled Foreign Company (CFC)

- In-line with most countries that currently have a CFC regime, on introduction of the proposed CFC legislation we recommend that the Government considers introducing a participation regime in the context of dividends received from non-Irish subsidiaries.

(iii) Exit Tax

- On implementation, the extended introduction date of 1 January 2020 should be included.
- Consideration of the rate of tax applicable where the Exit Tax provisions apply should be undertaken. The current application of the 33% capital gains tax rate places Ireland at a competitive disadvantage when compared to other Member States. While further consultation should be undertaken, the Chamber would recommend that the 12.5% tax rate should apply where the relevant assets are used as part of a trade carried on in Ireland.

3. Strengthening Ireland's Tax Roadmap

As outlined in previous submissions, there are a number of other areas of the Irish tax regime which should respond to the changing international tax competiveness landscape. Included here are some further comments on these areas, together with specific amendments that the Chamber recommends.

(i) R&D Tax Credit Regime

The Chamber believes that Research and Development (R&D) activity is fundamental to growing the Irish economy. Global competition has intensified within the EU in recent years. This is mirrored on a global scale with the likes of Israel and Singapore establishing themselves as technological hubs for international companies.

It is well established that the location of R&D activity has a significant impact on long term economic growth potential as it helps anchor related manufacturing and service activities in the State and drives enhanced skill levels.

Ireland's R&D Credit Regime is intended to be best-in-its class. However, it is the Chamber's very considered assessment that the regime requires urgent targeted reform. The Chamber is of the view that a "mis-match" has emerged between the principles underpinning the Regime, its promotion and its implementation. **The Regime needs to be clear and consistent if it is to be effective. As such, it needs to reflect the overarching policy, as outlined by Government and the Department of Finance, to be strategically focussed on reducing the business cost of undertaking R&D in Ireland**.

To remove a level of uncertainty within member companies further R&D-led investment the Chamber recommends the following enhancements:

1. Section 766 TCA 1997 should be amended to delete the term "wholly and exclusively in the carrying on….of research and development" and replaced with "for the purposes of research and development." This is a broader test and is more aligned with the aim of reducing the business cost of undertaking R&D in Ireland. It is also more in keeping with the broader Revenue interpretation previously outlined in pre-December 2013 Guidelines.

2. The R&D legislation should be amended to ensure that certain costs incurred in undertaking a qualifying R&D activity under the general framework of S.766 TCA 1997 should be allowable notwithstanding that they may be capitalised as a component of the valuation of an IP asset and potentially come within the ambit of S.291A TCA 1997.

3. In order to support global R&D projects the regime needs to become more flexible in allowing Irish subsidiaries engage with connected parties (i.e. parent companies in the US). Therefore the territoriality and connected parties restrictions contained in S.766 TCA 1997 need to be relaxed to allow Irish subsidiaries' collaborations to be catered for in the legislation.

4. The regime while remaining based on the OECD Frascati model needs to evolve to expand the qualifying fields of science to emerging areas (e.g. such as the interaction between technology and human behaviour). This can be done by amending Statutory Instrument No.425 of 2004 and in particular Appendix 2 that outlines categories of activity that are not research and development activities.

5. The concept of 'scientific or technological advancement' contained in S.766 TCA 1997 needs to be more aligned to the specific requirements of a small island economy like Ireland. International R&D regimes have different novelty requirements, the most common being 'new to the company' rather than the more stringent "new to the world" approach. Typically the "new the world" approach is difficult to administer and is unlikely to capture the very significant 'D' that is undertaken in Ireland as it focuses more specifically on the pure 'R'. The Chamber recommends that the level of novelty required to be sought in the Irish regime is clarified to reflect conditions on the ground and to allow Irish companies continue on the path from 'D' to 'R' over time.

6. At present Ireland markets the benefits available in respect of R&D investment as an effective 37.5% benefit, being a 25% R&D credit and a 12.5% corporate tax deduction for qualifying expenditure. A further potential innovation which would be welcomed by the Chamber would be an election option for the R&D Credit regime to allow claimants with a tax base to forgo corporate tax deductions and take the benefit foregone by way of R&D credit. Such an election would lead to a 50% increase in the potential "above the line" benefit. This increase in "above the line" R&D credits would make Ireland significantly more competitive when competing for mobile R&D investment.

   The denial of a corporate tax deduction at 12.5% on the qualifying R&D expenditure means that the proposal is a cost neutral for the Exchequer. The Chamber is conscious that without an appropriate restriction, a loss making company could claim an unintended benefit but believe that this can be avoided by building appropriate safeguards into the legislation.

(ii) Intellectual Property (IP)

The Chamber believes that the continued enhancement of Ireland's IP offering is critical from an Irish tax policy perspective in order to create an environment where Ireland can compete for mobile IP related investment.

<u>IP amortisation regime</u>

The Government and Department of Finance have stated that they regard Ireland has having a suite of offerings to attract knowledge intensive activity to Ireland from an IP perspective. **The Irish IP amortisation regime (included in Section 291A TCA 1997) is a key pillar within this suite and there are a number of areas where the Chamber believes enhancements should be made in order to improve competitiveness and attract further IP related investment.** These recommendations are:

1. Amendments to provide that there is no claw-back of IP amortisation allowances previously claimed.

2. Provide further guidance (potentially certain "safe harbour" tests) in relation to what activities should be regarded as trading in an IP context.

3. Amend the definition of "specified intangible asset" to include goodwill where such an amount is amortised for accounting purposes.

4. The current requirement included in Section 291A to regard the income and expenditure from qualifying IP as a "separate trade" from an Irish tax perspective causes a number of practical issues for some of our Members. In this context, the Chamber would recommend that the impact of this requirement is fully considered in conjunction with any potential costs that would be associated with removing this requirement with a view to ascertaining whether the removal of the "separate trade" calculation could be a worthwhile enhancement to Section 291A. The Chamber would be more than happy to discuss this issue in more detail as required.

5. There have been recent proposed amendments in the US around how amortisation regimes (such as Ireland's) should be accounted for under US accounting principles. In a number of instances, this is could be a key issue for our Members. In this context, the Chamber recommends that the Government considers the nature of these changes and whether the IP amortisation regime could be amended in order to deal with certain potentially negative consequences arising from these changes. The Chamber would be happy to explore these issues further with the Government and the Department of Finance as required.

Knowledge Development Box (“KDB”)

The Chamber has been a key contributor to the consultation process initiated thereafter to consider the creation of a ‘Knowledge Development Box’ (KDB) regime for Ireland.

The Chamber will continue to provide input and feedback on the design of the KDB under separate cover over the coming months as we receive further feedback from our Members on the operation of this regime.

Understanding the necessity for reviewing tax expenditures requires an "end date" for the KDB, it would be important for investor certainty that the Minister make a positive statement in Budget 2017 that the intention would be to evaluate the incentive at that point for its ’fit-for-purpose’ .

(iii) Double Taxation / Withholding Tax Regime

It is vitally important that Ireland can offer a competitive regime for dealing with withholding taxes suffered on inbound royalty payments. It is also important to at least maintain our current regime for granting relief for withholding tax on outbound royalty payments. Both are critical to ensuring that Ireland can compete internationally and be a hub for highly mobile, IP rich global operations.

While Ireland has implemented various attractive measures to compete for international business, its current withholding tax regime for inbound royalties is not competitive compared with other jurisdictions. This significantly impacts upon our members decisions to do business from Ireland with certain countries. The ***Irish Measure of Income*** regime is now extremely complex and burdensome for companies, despite efforts to simplify it the opposite is in fact the case for a lot of tax payers.

Furthermore, the view that a deduction cannot be claimed for withholding tax under general trading principles is very unsatisfactory. All withholding tax should be deductible as a business expense on the basis it is incurred wholly and exclusively for the purposes of the company’s trade and Ireland falls behind several other competitor jurisdictions that allow this. The lack of clarity in this area is of concern for taxpayers, and creates uncertainty. The Chamber recommends that consideration be given to simplifying and streamlining the regime.

In order to address the concerns outlined above, and ensure Ireland competes effectively for mobile IP rich foreign direct investment, we strongly urge consideration be given to improving the double taxation relief afforded on tax suffered on inbound royalty payments. Improvements to this area are key to ensuring Ireland is competitive internationally to win global mandates:

1. With effect from 1 January 2017 there should be a removal of the requirement for Irish taxpayers to estimate the Irish measure of income limitation for foreign withholding taxes on a formula based approach – one size simply does not fit all. For example, consideration could be given to enable the taxpayer, particularly with different margins on products in different markets, to calculate based on actual net income from each foreign source. It should also be clarified that a full deduction for unrelieved or excess foreign withholding tax (WHT) should be permitted where credit is unavailable or limited.

2. Unrelieved or excess foreign WHT should be deductible under general tax principles (on the basis withholding tax is an expense of business incurred "wholly and exclusively" for the purposes of a company's trade), if it is not otherwise deductible under specific WHT provisions.

3. Clarification needs to be provided such that unilateral relief for withholding taxes under paragraph 9DB, Schedule 24, applies to income which under Irish tax rules would not typically be considered to be royalty income, but which certain foreign jurisdictions view it as being subject to withholding tax. For example, companies suffer withholding tax on certain service fees including payments for software services / technical services, which are currently not included under the provisions of 9DB creating additional complexities to calculate the deduction for WHT. Therefore, extending the provisions of 9DB to include such services would be welcomed by the Members.

It will be important to consider the interaction of withholding tax credit relief rules with capital allowances available on certain intangible property (under Section 291A Taxes Consolidation Act 1997) where intellectual property is on-shored in Ireland. Relief for withholding taxes on income arising from the exploitation of assets eligible for relief under Section 291A is currently ring-fenced against tax on income from those assets. As the operation of the allowances regime reduces the taxable measure of income and the amount of current tax payable, companies which invest in assets in Ireland face a further limitation on their ability to utilise withholding tax credits. This could potentially impact any decision to move intellectual property to Ireland. Ideally an enhanced regime would facilitate use of credits against tax on other income in order to minimise any loss of credit or deduction relief.

A key feature of a competitive offering in terms of tax relief for withholding taxes is the ability to pool surplus tax credits. Currently, in contrast to other areas of the Irish tax legislation (for example dividends, foreign taxes suffered on branch profits), no pooling is available for withholding taxes suffered on royalty income. This is a significant disadvantage and renders Ireland uncompetitive in this area. However recognising that there may be cost implications to the introduction of the full scope pooling of credits, it may make sense to introduce this on a phased bases over the next 2/3 years.

If it was determined to phase it in (as opposed to making the bold move in FA 2014), this would need to be clearly expressed and delivered within an appropriate timeline.

(iv) Developing Ireland's Tax Treaty Network

The Chamber would stress the importance of continuing to develop Ireland's Tax Treaty network. As noted, Ireland has made positive steps in this area but we urge continued efforts with countries such as China and Japan as noted in past submissions. It is crucial for Ireland to continually improve on its competitiveness to attract and retain business into the future.

In this regard, the Chamber would draw attention to other countries (e.g. the Netherlands and the UK) which have succeeded in developing very extensive treaty networks while also offering broad-based withholding tax relief. As noted, Ireland is lacking treaties with many key trading partners, and in many instances where treaties are in place the level of withholding taxes remains high

(iv) Resourcing the Competent Authority within Revenue

One of the many consequences of the OECD BEPS process has been a focus by Revenue Authorities around the world on increasing the tax yield from Revenue audits. One element of such audits in a cross border group situation is to examine the supply of goods and services between group companies and in particular the transfer pricing arrangements that are in place to ensure these are at arm's length and thus fair to the Exchequers of both countries.

The Chamber greatly welcomed the Government's actions over the last 2 years to strengthen the capacity of the Revenue Commissioners to enable them to deal with any queries raised by other jurisdictions in a speedy and comprehensive manner. This is not just dealing with the speed of such responses, but also with pushing back on the demands of other countries and to preserve, as far as possible, Ireland's corporation tax position and its tax base.

Given the importance of this issue, **the Chamber strongly encourages Government to continue to invest to have a well-resourced competent authority team within Revenue to engage with Ireland's treaty partner jurisdictions.**

Concluding Remarks

The American Chamber of Commerce Ireland promotes policies that enhance Ireland's competitiveness to be the location of choice for US foreign direct investment into Europe. Competition for FDI remains intense as investment, rather than trade, emerges as the key driver of the global economy in this century.

We believe that if the measures and strategy suggested in this submission are embraced they will help drive growth by making Ireland more attractive for future inward investment.