THE FUTURE OF IRELAND AS A PLACE TO CARRY ON BUSINESS IN LIGHT OF RECENT E.U. & O.E.C.D. INITIATIVES

Author
Martin Phelan

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INTRODUCTION

Ireland has long been established as the onshore location of choice for the world's leading multinational enterprises ("M.N.E.'s"). Although Ireland's attractiveness as a location for foreign direct investment is based on a number of factors, the low corporate tax rate of 12.5% is crucial.

Ireland's corporate tax regime has received persistent and pervasive scrutiny from international media in recent times, focusing on topics such as the "Double Irish," the O.E.C.D. B.E.P.S. initiative, and the Apple investigation. What must not be forgotten in the midst of such coverage is that Ireland has nothing to hide and nothing to fear from any of the above issues. Ireland is a small jurisdiction, and as far back as the 1950's, the cornerstone of the economy has been foreign direct investment ("F.D.I.").

Ireland makes no secret of its wish to compete with other jurisdictions for F.D.I., and its highly competitive corporate tax regime, including the 12.5% tax rate, forms part of a broader strategy that allows Ireland to "play to win."

This article will discuss some of the main O.E.C.D. and E.U. initiatives impacting Ireland and the effects such initiatives are likely to have on Ireland and the M.N.E.'s which are based here.

E.U. INVESTIGATION INTO APPLE IN IRELAND – ALL SMOKE AND NO FIRE

Content & Scope of the Investigation

The European Commission (the "Commission") has made an initial finding that Ireland conferred an unfair tax advantage on Apple in relation to tax arrangements reached with the multinational on the amount of corporate tax payable in Ireland. The Commission's investigation focuses on tax rulings given by the Irish tax authorities in 1991 and 2007 that validated transfer pricing arrangements of two Irish-incorporated, non-Irish tax resident branches of Apple Inc. On this basis, the Commission launched an in-depth investigation into whether the arrangements constituted illegal State aid that is contrary to E.U. law. This investigation is by no means isolated. The Commission is examining tax ruling practices across the E.U. Similar investigations have been launched in the Netherlands and Luxembourg in relation to Starbucks and Fiat Finance & Trade, respectively. The opening of the in-depth investigation allows third parties to provide comments and is not a final judgment on the matter. The Irish Government has stated that the Commission has a weak case and if the investigation results in a determination against Ireland, it will appeal to the European Court of Justice (the "E.C.J.").

Martin Phelan is a Partner and Head of William Fry Tax Advisors, Ireland. He is former President of the Irish Taxation Institute. Mr. Phelan acts for a large portfolio of multinational clients on various taxation matters and is a representative of the profession on taxation committees with industry, government, and Revenue. He is a frequent author and speaker on topics of international taxation.

Ireland has an open and transparent tax system and does not generally provide tax rulings to companies operating in Ireland. Although it is the Commission's position that there is nothing illegal about the provision of tax rulings, an issue arises if the rulings provide unfair tax advantages for recipient companies. Tax rulings are particularly prevalent in the area of transfer pricing, *i.e.*, the appropriate price that should be charged for commercial transactions between group companies. Although Ireland did not have transfer pricing rules at the time of the tax rulings in question, the Commission's investigation is based on what it refers to as "transfer pricing rulings."

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Apple Operations Europe ("AOE") has been described by the Irish tax authorities as essentially being a contract manufacturer and provider of shared services for related Apple entities. In the 1991 ruling, it was agreed that the net profit attributable to AOE would be the lower of (i) the overall profits of the Irish operations or (ii) an amount equal to 65% of the operating expenses up to the value of $60-$70 million and 20% thereafter. In 2007, this agreement was revised so that the branch profits would be a 10%-20% margin on branch operating expenses.

Apple Sales International ("ASI") was considered by Irish tax authorities to carry out routine, albeit important, functions in the procurement and onward sale and supply of goods for Apple. It would therefore have no special valuable assets. In the 1991 ruling, it was agreed that 12.5% tax would be charged on all branch operating costs excluding material for resale. In 2007, this agreement was revised and a modified basis for determining net profit was agreed to with an 8%-18% margin on branch operating costs excluding those not attributable to the Irish branch (such as material costs).

The Commission's preliminary finding is that these rulings conferred an unfair and selective tax advantage on Apple on the following basis:

- The rulings did not consistently apply the transfer pricing method chosen by the Irish tax authorities when determining the profit allocation for AOE and ASI and, therefore, did not comply with the arm's length principle.
- The rulings appeared to have been negotiated, rather than substantiated by comparable transactions. The Commission noted that no transfer pricing report was submitted by Apple regarding its proposals. It should be noted that Ireland did not have transfer pricing legislation at the time of the ruling, and therefore, the absence of such a report may well be explained by this simple fact.
- The rulings do not adequately explain the selection of the appropriate transfer pricing method used to calculate the allocation of the profit.

The Commission further concluded that the State aid could not be justified and therefore, constituted illegal State aid.

Ireland's Response

Ireland's Minister for Finance has indicated that he believes the investigation will cease at the conclusion of the in-depth examination. However, if the final conclusion of the Commission remains unchanged, the Irish Government has indicated that it will challenge the finding before the E.C.J. and has stated that it has been legally advised that Ireland would win the case easily, as the Commission's case against Ireland is weak. It must be hoped that proceedings will not reach that stage, as one would have to conclude that such a drawn out legal challenge would ultimately inflict damage on Ireland's reputation, even if such damage is unjustified and Ireland ultimately succeeds before the E.C.J. Ireland has an extremely open and transparent tax system – the rate is clear and straightforward, and no rulings are provided in relation to deductions or deemed deductions as in other jurisdictions. Therefore, a timely resolution to the E.U. investigation must be hoped for lest any damage be caused by a lengthy legal battle.

Comparison with the U.S. Senate Investigation

An interesting anomaly has arisen in the interaction between the Commission's investigation and the U.S. Senate investigation into Apple's tax affairs in Ireland. The Senate was aggrieved by Apple allegedly syphoning billions of dollars of profits away from the U.S. and into Ireland, whereas the Commission's investigation is premised upon not enough profits being taxed in Ireland. This exemplifies the complex area of international tax arrangements.

THE DOUBLE IRISH - THE GRADUAL PHASING OUT BEGINS

Ireland's position is that the ability of a company to structure its tax affairs in such a manner is primarily derived from U.S. tax law, not solely from Irish tax law. However, in response to increasing criticism of the use of the so-called "Double Irish" structure, Ireland has introduced changes to its corporate tax residency rules.

To allow companies ample time to restructure their affairs (and some would say to allow the newly announced patent box time to be fully operational and successful) a very extensive grandfathering period of six years will apply, whereby the previous tax residency rules remain applicable. Therefore, it is not envisaged that the changes will adversely impact M.N.E.s' current operations in Ireland.

THE O.E.C.D.'S B.E.P.S. INITIATIVE – CHALLENGES & OPPORTUNITIES

The O.E.C.D.'s B.E.P.S. initiative presents as many opportunities as it does challenges for Ireland. The B.E.P.S. project is about two things; aligning taxing rights with substance and preventing double non-taxation. This alignment of taxing rights and substance is in line with Ireland's own tax policy, which seeks to attract substantive investment to the country. Ireland's F.D.I. strategy has always focused on substance in Ireland and attracting companies that bring employment and valuable economic activities to Ireland. The Irish Government has stated that it welcomes the O.E.C.D. initiative. As a small country, Ireland believes it is advantageous for discussions to take place on tax reform and the prevention of aggressive tax planning at O.E.C.D. level. Ireland wants to have a voice in the discussions and to contribute to negotiations. It believes that a multi-lateral approach to dealing with aggressive tax planning is superior to the unwelcome alternative, which would be uncoordinated and unrestrained unilateral actions.

Challenges

The B.E.P.S. project certainly presents challenges for Ireland. In a paper prepared by the Irish Government on the impact of the project for Ireland, the introduction of C.F.C. rules and potential restrictions on interest deductions were cited as areas of concern.

The introduction of C.F.C. rules to all countries poses an issue for Ireland, as it does not currently have C.F.C. rules for taxing international profits of foreign subsidiaries. Instead, such income is taxed once it is remitted to Ireland.

It is also proposed to introduce a Limitation of Benefits Clause, which would mean that countries could only rely on the provisions of a double taxation agreement where a certain list of criteria is satisfied. This is seen as potentially problematic for smaller jurisdictions, such as Ireland, particularly if the criteria are restrictively drafted. The U.S., on the other hand, is strongly in favor of the introduction of Limitation of Benefits Clause.

Opportunities

The B.E.P.S. project is not focused on the applicable tax rate in a country; therefore, it poses no threat to Ireland's 12.5% rate. The Irish government again confirmed its steadfast commitment to the 12.5% rate at the speech announcing the 2015 Budget and launching the *Road Map for Ireland's Tax Competitiveness*.

Preferential I.P. Regimes

Ireland was not mentioned in the interim report on harmful tax practices; this should have an immediate positive effect for Ireland.

This Action on preferential tax regimes will deal largely with patent boxes and preferential I.P. regimes. Ireland announced the introduction of its own patent box regime known as the "Knowledge Development Box" as part of the Government's *Road Map for Ireland's Tax Competitiveness*. It will be legislated for at the end of 2015 and will be in keeping with O.E.C.D./E.U. agreed guidelines while aiming to be best in class. The Knowledge Development Box encourages investment in the development of I.P. by allowing a preferential tax regime for income derived from such development. It will allow a lower effective corporate tax rate in order to encourage companies to locate high-value employment related to the development of I.P. in Ireland. The precise guidelines for patent boxes are yet to be agreed at E.U. and O.E.C.D. level.

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Ireland's new Knowledge Development Box will be complemented by pre-existing I.P. regimes, such as our research & development tax credit and capital allowances regime for intangibles. It is hoped that the combination of this I.P. tax offering, in addition to the 12.5% rate, will make Ireland the location of choice for F.D.I.

Transfer Pricing

The work being carried out in relation to transfer pricing offers a significant opportunity for Ireland to establish itself as the optimal location for M.N.E.'s needing to relocate their offshore intangible assets on shore. The focus of the work on transfer pricing in the B.E.P.S. project is to align the location of profits with value creation. This will clearly impede current structures in which all the valuable I.P. of a company is kept in an offshore jurisdiction in which little or no tax is payable. In a post-B.E.P.S. world, this will no longer be possible and M.N.E.'s will be faced with two options:

- Move the value creation and substantial operations to the offshore location; or
- Move the valuable I.P. rights to an onshore location.

Given the lack of infrastructure in many prominent offshore locations, the former option is not seen as a likely choice. The question therefore becomes to which onshore location should the I.P. be moved and where should substance be developed. Many of the world's leading M.N.E.'s already have headquarters and substantial operations in Ireland. Critically, much of the I.P. housed offshore is already owned by Irish registered companies; therefore, Ireland is, if nothing else, the most straightforward and obvious choice.

WHY IRELAND IS A PRIME A LOCATION FOR F.D.I.

Whether or not M.N.E.'s already have operations in Ireland, a combination of both tax and non-tax related reasons means Ireland will be at the forefront of many M.N.E.'s minds when deciding where to focus their substantive operations. Ireland's F.D.I. agency (the "I.D.A.") specifies the "4 T's" as making Ireland the destination of choice for foreign direct investors: Talent, Track Record, Taxation, and Technology.

Taxation

The tax-related reasons have been largely discussed above and include:

- A 12.5% corporate tax rate on trading income;
- An extensive double tax treaty network (currently Ireland is a signatory to 72 treaties, with 68 in effect);
- A best in class I.P. regime, including a 25% research & development tax credit, intangible asset capital allowances regime, and the introduction of the Knowledge Development Box;
- An attractive holding company regime; and
- An effective zero tax rate for foreign dividends.

However, the non-tax issues are also compelling.

Track Record – History of F.D.I. in Ireland

Ireland's major competitive advantage over other jurisdictions competing for F.D.I. is experience; F.D.I.'s history in Ireland goes back as far as 1917, when the Ford Motor Company set up manufacturing operations here. In the 1950's, the government of the time developed an economic plan with F.D.I. as the cornerstone; it acknowledged that, as a small jurisdiction, Ireland had to be outward looking and encourage inward investments from foreign companies. In 1956, tax relief was introduced, which granted relief from tax for companies that manufactured their output; and in 1981, Ireland introduced an effective 10% corporate tax rate for manufacturing activities, which was extended to financial services in 1987. These were all predecessors to the 12.5% corporate tax rate on trading income, which was announced in 1998.

From the humble beginning of the Ford Motor Factory, Ireland is today home to:

- Nine of the top 10 pharmaceutical companies;
- Nine out of the top 10 software companies,
- Nine out of the top 10 internet companies,
- Twelve of the top 15 medical tech companies;
- Fifteen of the top 20 financial services companies; and
- Nine out of the top 10 aircraft leasing companies.

With the arrival of Google, Facebook, and eBay, Dublin's so-called "Silicon Docks" have become a leading location for established and start-up technology companies to set up non-U.S. operations. In addition, owing largely to Ireland's moderate climate, Ireland has become a very popular destination for the location of data centers.

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This reflects the success of Dublin's International Financial Services Centre, which has been a leading international hub for the funds sector and aircraft finance leasing companies since the 1980's. Although the economic downturn had hugely negative effects on individuals in Ireland, the downturn also reduced the cost of doing business in Ireland and streamlined costs, with the result that Ireland is now a much more affordable place to do business than it was during the so-called "Celtic tiger" era.

It is therefore not surprising that Forbes recently announced that Ireland was the best country in the world in which to do business and Ireland topped the table in the Euro Zone for ease of doing business.

Ireland is well ahead of the curve in attracting F.D.I. and is accustomed to the presence of M.N.E.'s and their international workforces.

Talent

Ireland has a highly educated and skilled workforce with a higher percentage of third level (university) graduates than the U.K., U.S., or the O.E.C.D. average. In addition, Ireland has a predominantly young, ambitious, and mobile workforce, with the median population age being 35 – the lowest in the E.U.

Because Ireland has been a hub for certain sectors (such as the pharmaceutical industry, and the aircraft leasing and funds industries), there is a highly skilled and experienced talent pool from which to draw employees. This is in addition to an extensive selection of highly specialized firms to provide legal, tax, and administrative support. For example, since the establishment of the IFSC in 1987, Ireland has established itself as a leading jurisdiction for alternative investment funds. Over 50 licensed fund administrators are established here, including not just the big names but also more bespoke and niche operations; this has contributed to Ireland being a global leader for the servicing of alternative investments, with over 40% of global hedge funds being serviced in Ireland, and making it the largest hedge fund administration center in the world.

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Similarly, aircraft financing has a very long history in Ireland, going back almost 40 years. Owing to Ireland’s focused attention on creating the optimal legal and tax environment for the development of this industry, it has remained a world leader, with nine out of the top ten global lessors located here and 50% of the world’s commercial aircraft fleet being managed from Ireland.

Therefore, for any new entrant setting up operations in Ireland in such sectors all of the economic, technical, and human resources are already in place, resulting in a much more streamlined and straightforward process than in jurisdictions with less experience and expertise.

Other Factors

In addition to the 4 T’s, Ireland’s strong education system, easy access to the European market, and the fact that English is the country’s first language all contribute to its success in attracting F.D.I.

LIVING IN IRELAND

Personal Taxation Regime

In a post-B.E.P.S. environment, if companies choose Ireland as a location for developing their operations, what does it mean for the staff that may be moved here? What can they expect from life in Ireland?

To start with, unfortunately, Ireland’s personal tax regime is not as attractive as the corporate tax regime. The marginal tax rate is currently 51%, which is obviously higher than what one may be accustomed to in the U.S. It compares unfavorably to the O.E.C.D. average of 46%, and the situation is compounded by the fact that the rate applies at a low level of income (€32,800 for a single person). Therefore, companies would need to make up the difference for any employees relocated to Ireland in order to ensure that the tax rates here do not act as a deterrent for those being relocated; this would be an additional cost to the company for relocating staff to Ireland.

In a bid to alleviate this problem, the Irish Government introduced the Special Assignee Relief Programme in 2009 (the “S.A.R.P.”). The S.A.R.P. is relief aimed at facilitating foreign employers who wish to relocate their executives to their Irish operations. It allows a reduction in the taxable employment earnings of an individual assigned to work in Ireland of up to 30%. It therefore reduces the cost to the employer of relocating its executives to Ireland. The program, which dates back to 2009, came into effect in its current form in 2012. Due to a number of onerous requirements and a limit of €500,000 being applied on the amount of salary which could be reduced, the up-take on the S.A.R.P. was very low. In 2012, only 15 employees applied for the S.A.R.P. In light of this, major improvements were announced as part of the 2015 Budget and became effective from January 2015. The improvements will enable a broader scope of people to qualify by removing previous restrictions. The upper salary threshold of €500,000 has being removed; this will make the S.A.R.P. attractive for executives moving to Ireland, as they will be entitled to reduce their taxable income by 30% once certain conditions are met.

Non-tax Factors – Society & Environment

Ireland is a small island with a population of approximately 4.6 million people. Despite some problems in the past in Northern Ireland, modern Ireland is peaceful and has a stable political system. It is a long standing member of the European Union and is a member of the Euro currency. Although much of the island is rural, the majority of the population density is in the cities, with 60% residing in cities and 40% in rural areas. The capital city, Dublin, is home to over 1 million people and is the main financial and business district in Ireland. Galway, on the west coast, and Cork, in the south, are much smaller cities but are surrounded by some of the most beautiful scenery and beaches in Ireland and are home to many of the medical/tech companies and pharmaceutical firms in Ireland.

Ireland's education system is made up of primary level, (5-12 years of age), secondary level (13-18 years of age) and third level (university) education. It was recently ranked ninth in the world in a global league table which looked at 40 countries and compared performances in skills such as reading, math, and science, in addition to graduation rates from second and third level. The vast majority of primary and secondary students are in public schools; however, in Dublin, private schools exist and are popular. Third level education in Ireland is also free. The main universities are located in the major cities, Dublin, Cork, Galway and Limerick. Although the universities do not rank as high as their U.K. contemporaries (such as Oxford or Cambridge) in many of the international polls, world class universities exist, and Trinity College Dublin is an example. In any event, the close proximity to the U.K. means that university age children of a foreign executive assigned to Ireland may conveniently attend university in the U.K.

The health system in Ireland could certainly not be described as a jewel in its crown; although a public system exists, waiting lists to see consultants are extremely long, emergency departments are often over-crowded, and people regularly have to wait on trolleys for days before getting a bed in a public hospital. In 2014, Ireland dropped eight places to 22nd in the Euro Health Consumer Index. A private system of health care also exists but at a cost, which renders it inaccessible to many families. In comparison to the cost of health care in the U.S. it is, however, relatively inexpensive.

Ireland has a moderate climate owing to the influence of the Atlantic Ocean and does not experience the same range of temperatures throughout the year as continental European countries. Air temperatures in the summer generally reach approximately 68 degrees (Fahrenheit) and 46 degrees in winter. Most Irish winters are free from snowfall, with only small falls on higher ground. However, this does mean that when infrequent snowfalls occur, they result in serious disruptions, particularly to public transportation. Because of its geographical location, Ireland does not experience major natural events such as earthquakes, hurricanes or tsunamis nor does it have any poisonous animals. Despite the high levels of rainfall in both summer and winter, Ireland is a haven for outdoor enthusiasts. As an island, one is never far from a beach; Dublin is on the coast, and coastal walks and beaches are reachable on public city transport. Ireland has innumerable championship golf courses around the country, most notably the Royal Dublin, the Island, the European, and (home to the 2006 Ryder Cup) the K Club.

CONCLUSION

Ireland's future as a place to carry on business in light of recent E.U. and O.E.C.D. initiatives is mixed. Whilst the E.U. investigation and B.E.P.S. initiative pose challenges, they are certainly not insurmountable. The Irish Government is strongly committed to maintaining the 12.5% corporate tax rate and to creating an optimal business environment to attract F.D.I. In a post-B.E.P.S. world, M.N.E.'s will have to ensure profits and substance are aligned; therefore, it will be necessary to relocate executives and persons involved in decision making to the jurisdiction where the profits of an entity arise. Ireland is a modern jurisdiction with advanced infrastructure, technology, and expertise to facilitate the establishment and ongoing development of operations; and therefore, it is hoped that M.N.E.'s will choose Ireland as the location to center operations post-B.E.P.S.

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