

The Commission on Taxation

Observations by CCAB-I on foot of the Commission's invitation to make submission.

May 2008

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1. Introduction

1.1 About CCAB-I

The Consultative Committee of Accountancy Bodies – Ireland is the representative committee for the main accountancy bodies in Ireland. It comprises the Institute of Chartered Accountants in Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland, and the Chartered Institute of Management Accountants. With a combined membership of 23,000 professionals working in every aspect of industry, business and tax practice, we are uniquely placed to offer expert comment and analysis on the structure, efficiency and appropriateness of the Irish tax system.

We welcome the establishment of the Tax Commission and endorse its terms of reference as a vehicle for making a meaningful and necessary contribution to Irish tax policy.

1.2 Continuous appraisal of tax expenditures

CCAB-I notes that one of the Commission's terms of reference is to review all tax expenditure with a view to assessing the economic and social benefits they deliver. We feel that the need to review tax expenditures/tax incentives is an ongoing process and that continuous appraisal by Irish tax policy makers is necessary to ensure that tax expenditure remains an effective tool for the stimulation and growth of target areas of the Irish economy.

As such, this form of review should not be within the remit of the Tax Commission alone and we hope that tax policy makers will

continue to build on the work of the Commission and assess tax expenditures/tax incentives regularly.

As a corresponding point, we would encourage the Commission to review existing tax measures which do not yield tax revenues, particularly in the international context. We refer in particular to the treatment of tax credits on foreign dividends, and to the application of Professional Services Withholding Tax on non-resident service providers. These matters are amplified further later in our submission.

1.3 Reward and encourage an enterprise society

A number of the issues we will raise in this submission endorse the use of tax incentives such as BES relief and R&D investment as a reward for long term investment in high risk projects. Irish tax policy is currently more favourably disposed towards low risk investments which ultimately generate low income and gains such as deposits, savings bonds/certs, treasury bonds, and domestic collective funds.

CCAB-I recommends that Irish tax policy makers shift their focus away from rewarding low risk investment and instead offer tax incentives as a reward for high risk and potentially high return investments and thereby support an enterprise society. In the long term, returns from these investments will generate larger income and gains leading to larger exchequer tax contributions.

The ethos of rewarding high risk investment and encouragement of entrepreneurship is equally relevant to the strategic need to develop Ireland as a strong IP base which attracts and retains high end IP intensive business. The tax system should be used in a decisive

manner to achieve a future for Ireland as a knowledge base economy.

1.4 Recognition of tax policy successes

While our submission focuses on the areas of the Irish tax system in need of improvement, CCAB-I recognises that many aspects of the system are working well. In particular we acknowledge that the right balance has been struck on exchequer returns between direct taxes and more consumer driven taxes such as VAT, excise and customs. ¹Using the latest published statistics, in 2007 indirect tax payments to the Exchequer were over €20billion while direct tax payments to the exchequer amounted to approximately €26billion. We hope that this balance is actively maintained going forward.

We also welcome the introduction of measures to promote energy efficiency and the use of the tax code with an environmental focus. We have every confidence that this focus will be developed in future tax legislation for the long term benefit of our environment. We do caution that tax policy for the future should be based up on to date information and studies. For example, on first contemplation, the use of plant based biofuels to replace mineral oil for commercial and domestic heating seemed a valid substitution. Any tax policy proposed to encourage such a substitution must be firmly grounded in up to date cost/benefit analysis assessing the long term impact the use of tillage land for bio-fuel production has on food prices.

We would encourage the Commission to focus on the consideration of tax policies which might promote economic activity in furtherance of carefully identified environmental aims, rather than the contemplation of those aims in themselves.

¹ Revenue Annual Report 2007 p.11

1.5 Term of reference for our submission

In accordance with the Commission of Taxation Guidelines on making submissions (at Paragraph 6) our focus in this submission is most appropriate to the first term of reference of the Tax Commission to "***Consider how best the tax system can support economic activity and promote increased employment and prosperity while providing the resources necessary to meet the cost of public services and other Government outlays in the medium and longer term***".

We must emphasise that the issues we will identify in the following submission are the product of real difficulties in the operation of the tax system as experienced by our 23,000 members in their capacity as tax advisors working with clients functioning on the full spectrum of the tax system and in their capacity as progressive professionals involved on all aspects of industry and business. Likewise the proposed solutions to the identified deficiencies are focused on offering practical amendments without reducing the revenue take arising from the tax base.

2. Methodology

As outlined above, we have a substantial membership base working in all aspects of practice and industry. The collective experience of this membership has been our foundation in compiling this submission and assessing areas of tax policy in most need of review. We have also reviewed statistical information available from Government bodies such as the Revenue Commissioners, Department of Finance, Forfás, Department of Trade and Enterprise along with statistical information available from HM Revenue & Customs and data commissioned by the EU. Therefore our analysis of the identified areas in need of reform and the recommended solutions are grounded in front line experience and statistical comparatives which all goes towards producing what we believe to be a balanced and solutions focused submission to the Commission on Taxation.

3. Using The Tax System To Retain International Competitiveness

Key Recommendation – Refine a series of aspects of our tax code to make Ireland an even more attractive locale for innovators

The BES relief and R&D tax credit reliefs form part of the strategic need to cultivate Ireland as a location to develop, hold and exploit intellectual property. More specifically, the IP sector needs significant improvement in order to add tax 'teeth' to the stated national policy objectives of transforming to a knowledge based economy and 'moving up the value chain' in high end employment.

Our tax regime in this broader sense is not at all coherent. We have completely separate and different incentives/allowances/reliefs for acquisition of certain types of intellectual property such as software, know how, scientific research, research and development, but for certain other forms of intellectual property such as goodwill, trademarks, and brands, we have nothing on offer from a tax perspective. Our competitors Spain, Luxembourg, Belgium and the Netherlands all offer very attractive regimes.

The need for a coherent tax policy which encourages developing, holding, and exploiting IP from Ireland is critical as R&D in particular is very difficult to shift from a HQ location for control reasons. A very strong package of consistent tax measures is therefore vital to encourage the growth and retention of IP in Ireland. Fundamental to this is the retention of the 12.5% CT rate.

3.1 Full participation exemption

Policy makers have to some extent recognised the power of tax as a tool to support the efforts of national agencies such as the IDA by introducing the CGT exemption on gains arising from the sale of a subsidiary, pooling of tax credits on foreign dividends and most recently, the availability of the 12.5% tax rate on dividends paid out of trading income received by Irish holding companies from subsidiaries located in the EU and countries with which Ireland holds a Double Tax Treaty.

At present only the making of distributions from an Irish subsidiary to an Irish parent is exempt from tax. While the pooling of tax credits and the introduction of the 12.5% tax rate in its limited application may result in the effective exemption of distributions from tax, these measures can be unwieldy in a competitive tax environment, and often fail to persuade international groups that Ireland is an attractive location for holding companies. On this basis, we would strongly recommend that all distributions from foreign subsidiaries be exempt from tax in Ireland. The substitution of what is frequently an effective exemption with an actual exemption as suggested would have little or no negative Exchequer impact – in fact we would expect a positive impact overall as more multinationals would decide to locate in Ireland (or for that matter, not leave Ireland) by virtue of a clear exemption policy.

3.2 Expand scope of tax reliefs across all IP assets

Currently there are different capital allowances regimes available for software and patents; there are also different reliefs available for know how, scientific research, and a tax credit system for R&D spend. There is no relief available for goodwill and other IP assets such as trademarks, brands, etc.

In the context of promoting the knowledge based economy and making Ireland attractive for IP intensive inward investors, we recommend the overhauling this collection of reliefs in such a way as to provide real incentive, expansion of scope and consistency of treatment. This would not preclude tailored allowances towards activities deemed more favourable to the Irish economy.

3.3 Withholding Tax on annual interest and other payments

Section 246(2) TCA 1997 provides for a withholding tax at the standard rate on a yearly interest payment. Section 246(3)(h) TCA 1997 provides relief from the withholding tax where the interest is paid to a person resident in an EU Member State or in a country with which Ireland has concluded a tax treaty.

There is no relief where the interest payment is made to a person resident in a non-EU/non-treaty country. This may result in double taxation as there is no treaty to provide relief from the withholding tax paid in Ireland.

We suggest that withholding tax should not be applied on any payment of yearly interest as the current rules leave Ireland in a non-competitive position, where foreign direct investment may choose another location.

To compound this situation, there is no specific relief from the deduction of withholding tax in relation to royalties and other payments in respect of patents. At present there is only relief where the two companies are in a group. If Ireland is serious about becoming a knowledge-based economy, then the position of withholding tax on royalties must echo the position in respect of

interest. We are calling for the complete abolition of withholding tax on royalty payments.

3.4 Double Taxation Agreements

The role of Double Taxation Agreements in securing Ireland's position as an excellent tax environment cannot be doubted, and good progress has been made in increasing Ireland's portfolio of such arrangements.

However in an increasingly global marketplace, Ireland's capacity to trade can be hampered if such arrangements are not in place. We suggest that we cannot wait to have such arrangements concluded with all the countries, particularly rapidly developing economies, with which we would wish to develop strong trade links.

We advocate that unilateral credit relief be extended to withholding taxes on interest and on royalties applied by ALL countries, irrespective of EU or other trading bloc status. This will unquestionably foster income flows to Ireland as we become the country of choice for capital and intellectual property holdings. The latter is of enormous significance in positioning Ireland as a knowledge economy.

4. The Business Expansion Scheme

Key Recommendation - minimise qualification procedures & remove restrictions on investors to encourage greater use of BES

4.1 Relax grant aid qualification requirement

The extension to the Business Expansion Scheme (BES) in Finance Act 2007 will serve developing industry well. We also welcome the extension of BES relief to Recycling Businesses without prior grant aid as introduced in the Finance Bill 2008. The CCAB-I feels it is now opportune to further extend the types of business which are eligible for the relief.

In addition to specified industries, BES has traditionally been available to companies which would have been regarded as manufacturing under the "old" 10% rate rules provided that those companies had received employment grant aid.

Employment grant aid has become a less prevalent element of the industrial environment in recent years. For example, in 2006, IDA Ireland extended such grants to a value of some €25m. However in 2005, the comparable figure was €42m which closely paralleled the 2004 figure. The employment grant criterion may be excluding worthy businesses, which would qualify in all other respects, from the relief.

We also note that from the experience with the enhancements to the scheme in 2007, grant aid can be restricted under the EU State

Aid approvals process, as outlined in the ¹Vademecum Community Rules on State Aid, where the scheme is availed of. These additional conditions create another hurdle for Irish businesses in attempting to avail of BES. We therefore urge removing the grant aid criterion more generally in favour of a certification process which does not necessarily entitle the company to the receipt of grants.

4.2 Target high end software/computer sectors, internationally traded services & IP Intensive business

The Department of Finance in conjunction with the Department of Enterprise, Trade and Employment and the Revenue Commissioners conducted a ²review of the BES scheme in 2006. As part of the review, almost 1,400 companies who had availed of the scheme were surveyed. 58% of the respondents to the survey categorized their qualifying trade as that of manufacturing.

While manufacturing is a good job generating sector, it is somewhat at odds with the general national policy for job creation and sector growth in high end computer services, software development, IP intensive business and international services. These very services only make up 42% of the qualifying trades profiled under the Department of Finance's 2006 survey. The requirement that internationally traded services and computer services must also qualify for grant approval for BES relief vetting process is inconsistent with the emphasis placed on the need for growth in these sectors by national policy. We recommend that these sectors should have access to BES relief with minimal impediments to qualification.

¹ ec.europa.eu/comm/competition/state_aid/studies_reports/vademecum_on_rules_2007_en.pdf

² Department of Finance Publications "2006 Review of Business Expansion Scheme & Seed Capital Relief"

Our closest European neighbour, the UK, offers tax relief under the¹ Enterprise Investment Scheme (EIS). Similar to BES relief, EIS is designed to help small higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

However the success of EIS relief is more pronounced with on average €528,979 (£361,980) raised in funds per application in the year 2006/07 compared to average funds raised of €268,947 per BES application to the Revenue in 2007. The success of EIS is due to its flexibility in the types of trade that qualify for the scheme and it allows relief for the investor up to a maximum of £400,000 invested in such shares, giving a maximum tax reduction in any one year of £80,000. In addition, where income tax relief has been obtained and has not been withdrawn, any gain realised is exempt from CGT.

4.3 Limitations imposed on investors

As noted in our introduction, Irish tax policy favors low income yielding personal investments structures which lead to low returns and low taxable income and gains. High risk investments which have the potential to generate greater tax revenue on higher taxable income and gains are treated with suspicion by the tax policy makers. In the FA of 2006, restrictions on the amount of allowances that may be claimed by high-income individuals were introduced. Qualifying allowances including BES are capped at €250,000. Therefore, the increase of the BES investment limit to €150,000 as introduced by the FA 2007 will be inhibited by the cap on high-income earning investors despite the fact that BES investment is a risk capital investment. On a broader analysis, the

¹ HMRC Enterprise Investment Scheme www.hmrc.gov.uk/stats/ent_invest_scheme/menu.htm. Further information on this scheme is provided in the Appendix.

qualifying reliefs restriction introduced in the FA 2006 apply primarily to asset-backed property type tax schemes. It is clear the BES does not fall in to this category and should therefore be excluded. The inclusion of BES relief in the list of tax reliefs restricted in use for high-income taxpayers ultimately will leave investment in BES companies at a severe disadvantage.

5. Research and Development Relief

Key Recommendation - Bring national spending on R&D and innovation infrastructure up to international standards by allowing tax credit refunds and wider definition of processes qualifying for R&D tax credit.

5.1 Refund R&D tax credit in start up phase

Many companies who incur R&D costs in their early years are not making profits and hence are not able to get the benefit of the R&D tax credit until they become profitable. In the UK, there is a provision which allows the tax credit to be refunded to unprofitable SME's. Consideration should be given to allowing a refund of the R&D Tax Credit up to a maximum annual cap which, for the SME market might be €500,000.

¹Forfás produced a study titled "Review of International Assessments of Ireland's Competitiveness" which consolidates four measures of Ireland's competitiveness conducted by WEF Global Competitiveness Report, IMD World Competitiveness Yearbook, EU Lisbon Growth and Jobs Strategy and Huggins Associates European Competitiveness Index. All four measurements to competitiveness in the study conclude that Ireland's weak innovation and R&D infrastructure is a real threat to sustained economic growth. The study identifies low levels of Government expenditure in innovation and R&D as the driver for the low rating in this area. The scope for further national investment in establishing a solid and internationally acceptable standard of R&D and innovation infrastructure could take the form of tax refunds of R&D expenditure by companies in the setup phase of business.

¹ Forfás Publications <http://www.forfas.ie/publications/show/pub289.html>

5.2 Restrictive definitions turn away good businesses

The definition of qualifying Research and Development under the current legislation is very narrow and can deter multinationals from establishing high end job generating businesses in Ireland. In particular, the application of the R&D credit to software development is restrictive. The development of new software using existing tools or knowledge does not come within the definition of qualifying R&D. Serious consideration should be given to broadening the definition of qualifying research and development activities for R&D credit relief for the purposes of encouraging more software and computer development businesses to establish in Ireland in keeping with national policy.

We do accept that EU approval would be necessary on amendments we propose in respect of Research and Development tax incentives by virtue of our participation within the European Union.

6. Preliminary Corporation Tax

Key Recommendation - Tax payment threshold of €200,000 should be removed to allow all companies pay preliminary tax on prior year's liability

6.1 Discrimination against the larger taxpayer

Companies of any significant size are facing difficulties in meeting their preliminary corporation tax obligations because of the lack of a rule permitting them to base preliminary corporation tax payments on earlier years' results. Some progress was made by the 2007 and 2008 Budgets by increasing the small company's relief from €50,000 to €200,000. However, a significant number of companies pay tax in excess of €200,000 in any given year. Time and interest based penalties arising on shortfalls in payments of preliminary corporation tax affect these companies even more because of the large sums involved.

On review of the¹Revenue Commissioners Statistical Reports for 2006 we calculate that approximately 95% of all companies making corporation tax payments fell within the €200,000 tax threshold allowing such companies to base preliminary tax on the previous year's tax liability. Companies in the 5% range not allowed under current rules to base preliminary tax on the previous year's tax bill paid approximately 85% of the total corporate tax take. On first consideration of this information it may appear that Revenue has achieved its goal to maximise the cashflow of the payment of corporate tax without putting pressure on small companies. However the company paying the lion's share of the corporation tax

¹ Statistical Report for the year ended 31 December 2006 – Corporation Tax Distribution Statistics

bill is being discriminated against and is exposed to interest for differences in the tax liability which can reasonably occur between one month before the year end and the date it prepares its financial statements after the year end. Invariably this is the company employing the larger workforce and paying the lion's share of employer taxes.

Given the timing of payments and the fact that the payment is due by the 21st of the month, in reality, the estimate has to be based on management accounts for the first ten months of the year. This is not realistic for the following reasons:

- ***Application of generally accepted accounting principles (GAAP)***

The 2005 Finance Act introduced the production of accounts to GAAP standards for corporation tax purposes. The majority businesses would not necessarily follow GAAP in the preparation of their management accounts. It is on the management accounts that estimates before the end of an accounting period must be based – there is no other information to hand.

- ***Adjustments for Exchange Gains and Losses***

Such gains and losses will of course impact on a company's results. No company can know, or precisely anticipate, what the impact of exchange differences will be forty days in advance of the period end.

- ***Mark to Market Adjustments – financial services companies***

It is not possible to provide accurately for such adjustments at the Preliminary Corporation Tax payment date.

In the interest of fairness and equity, all companies, wherever reasonably possible should be subject to the same tax rules and to

take this one step further, the companies contributing 85% of the corporate tax revenue should, at the very least, not be subject to a less favorable tax rule than the companies making a lesser contribution to the exchequer.

The matter is further complicated because many of the companies paying tax in excess of €200,000 per annum are multinational entities. As such, these companies will be sensitive to comparable arrangements in other jurisdictions and are suspicious of a tax payment system which appears to set up the larger company for a significant fall in the guise of an interest exposure on an underpayment outside of its control.

6.2 Unreasonable application of interest on underpayment

Even with the best systems in place, many companies cannot estimate their final tax liability 5 weeks before the year end. The rate of interest of 0.0273% is applied on the full liability rather than the underpayment and runs from the due date of the preliminary tax payment to the date the full liability is discharged. The penal application of interest on the full liability up to the date of full payment is intended to discourage late payment but this is not appropriate where the taxpayer is not in a position to accurately determine its final liability due to the timing differences between the due date of payment and the accounting year end.

6.3 Inconsistency with tax payment rules for other tax heads

In addition to the obvious discrimination within the corporation tax system, the treatment of the large corporate is also at odds with the system for calculating preliminary income tax for individuals. The option to base preliminary income tax on 100% of an individual's tax liability for the previous year of assessment or on 90% of the

liability for the current year of assessment has not given rise to any cashflow problems for the exchequer and we submit that the same premise for corporation tax will apply if the current preliminary tax rules are repealed.

A universal rule permitting preliminary tax to be based on the previous year's tax liability would yield more accurate estimations of corporation tax outturns to the Exchequer on a year to year basis.

We strongly urge therefore that the €200,000 previous year liability 'limit' be removed entirely so that all companies can base their preliminary tax obligations on prior year results.

7. Surcharge on the Undistributed Income of Professional Services Close Companies

Key Recommendation – Owner managed companies are not exploiting tax advantages & should not be penalised with Close Company Surcharge Rules

7.1 The relevance of the Surcharge in 2008?

CCAB-I has consistently argued that the regimes applicable to professional services and investment companies are discriminatory.

Since we moved from the imputation system of tax credits on dividends, there is no correlation between the tax suffered on dividends and the underlying results of a company. It is discriminatory to promote a system which mitigates one form of taxation (the Corporation Tax surcharge) by attracting Income Taxation (Dividend Withholding Tax along with any marginal balance) which are not directly related.

The effective rate of tax on investment income for companies (25%) is higher than that which applies to individuals, thereby making redundant an anti-avoidance measure for most types of investment income earned through companies.

A company's after tax profits are taxed on their ultimate extraction to the shareholder normally under standard income tax rules. By obliging the payment of a dividend to avoid the surcharge, the only result is to accelerate the payment of tax. Where income has suffered tax at 25% and is then distributed; taking account of income tax on the shareholder, the tax burden can be up to 55% (ignoring levies).

The tax context in which the surcharge was introduced some thirty years ago is now very different. The justification for extending the surcharge regime in 1976 to include retained profits of close companies was based on concerns of leakage of income tax from the self-employed sector as well as concerns about the equity of a corporation tax system that permits very low-taxed profits.

However the introduction of self assessment for companies, the introduction of dividend withholding tax, and the bringing forward of preliminary Corporation Tax payments has achieved the acceleration of payment of tax on the profits of companies generally. Therefore we recommend that Irish Tax Policy makers should move away from the premise that private owner managed companies are solely established to exploit tax advantages because the Irish economy is now driven by sophisticated owner managed companies with commercial objectives.

7.2 Surcharge and Revenue policy

In its Budget 2000 – Tax Strategy Group Paper, the Department of Finance’s case for retaining the close company surcharge was based on concerns that the significant drop to 12.5% tax rate on corporate trading profits would mean that company structures would be increasingly used to shelter income at low rates of CT while postponing distributions to shareholders and would lead to a loss of income tax revenue.

However the income tax paid by company directors is significant and has not lead to an erosion of the income tax revenue as the 2004 ¹Revenue Statistics reveal. Over 16% of total income tax receipts were made by Proprietary Directors in 2004 compared with

¹ Statistical Report for the year ended 31 December 2004 – Income Tax Distribution Statistics

10.5% paid by individuals under Case I /II Schedule D - the self employed person's tax classification. It is clear that the proprietary director is making a sizable contribution to the tax system and the tax leakage feared by the removal of the close company surcharge does is not a threat as reflected in these statistics.

7.3 Commercial requirement to incorporate

From a commercial standpoint, many professionals are obliged to operate through a corporate structure. This can be for insurance or professional indemnity reasons, for example engineers and financial consultants. It can also reflect industry practice. There should be no particular tax penalty attaching to following best commercial practice.

8. Professional Services Withholding Tax

Key Recommendation - Introduce clearance mechanism for non-residents to ease administrative burden on accessing PSWT refunds

At present, certain foreign professional services providers can claim a refund of PSWT provided they are resident in either an EU country or in a country with which Ireland has a DTA (and are not operating as a branch). The administrative process would be greatly simplified if foreign based service providers could avail of an exemption from withholding tax on provision of appropriate certificates of residency. A procedure with close analogies already operates for Tax Treaty clearance.

There would be significant commercial advantages for Semi-State companies if such a procedure were to be adopted, as there is evidence that the cash-flow and administrative costs of the tax are passed on by foreign providers in the overall cost of contracts.

9. Maintain the Integrity of the Irish Tax System as an Instrument of Fiscal Policy

Key recommendation - Maintain the integrity of the Irish tax system by concentrating Revenue resources on tax collection rather than using the tax system as tool for enforcing other Government agencies rules.

The Irish Tax System is recognized as being one of the most advanced systems in the world. However in order to retain this status the Irish Revenue Commissioners should not be used as a form of social police to give impetus to other Government policies. We view such a development as erosion to the integrity of our tax system and strenuously warn against using the tax system for any other purpose other than to collect tax as a source of public finance and encouraging economic growth.

The lesson in “sticking to the knitting” was emphasised in HM Revenue & Customs recent public relations disaster on losing 25 million child benefit records. In addition to the obvious questions on data protection, the question of why the UK’s tax authority held social welfare records also came under scrutiny. The consequences of using the Irish Revenue as a tool for the purposes of other Government agencies should also be seriously considered before the Irish Revenue also falls foul of high profile problems as experienced by the HMRC.

We outline specific cases where Revenue is compromised and distracted from its function of tax collection and fair application.

9.1 Registration with the Private Residential Tenancies Board

The FA06 introduces a tax sanction for failure to register with the Private Residential Tenancies Board. It should be repealed because:

- FA06 s11 introduced a significant additional administrative burden on taxpayers, concerning rental income deductions and the operation of evidential requirements of registration with the PRTB.
- It is not clear that the changes to the Returns of Income required to implement FA06 s11 are in accordance with the provisions of TCA97 s879(1).

The requirement for landlords to register residential tenancies is governed by Part 7 of the Residential Tenancies Act 2004, and has been in force for some time. There are sanctions for failing to comply with Part 7. If that sanction is deemed inappropriate, it should be remedied there, not in the tax code.

9.2 Tax Relief for Holiday Cottages

Holiday cottages, holiday apartments or other self-catering accommodation, usually registered under provisions of the Tourist Traffic Acts may not be let long term if the tax relief is not to be denied. Longer winter or other off season lettings are thus impossible in practice. As a consequence:

- Property not occupied for long periods particularly when weather conditions are hostile is subject to deterioration through lack of ventilation, damp interior conditions and so on. This can lead to derelict and unsightly residential property in resort areas, making them unattractive and thus defeating the object of the legislation in the first place.

- There is an increasing demand for short term letting within certain construction developments, a demand occasioned by increasing levels of flexible and mobile immigrant workers. The shortage of rental accommodation in turn increases inflationary pressures on the housing market.

We suggest that the rules governing the letting of holiday accommodation be relaxed for the off-season, while retaining the conditions regarding short term summer season letting. This would deal with the problems of deterioration and will also have the advantage of increasing the availability of rented accommodation, so reducing localised inflationary effects on rents.

In order to preserve the intention of the restrictions set out in the legislation, we would propose that rental income from “non-holiday” rentals would not be sheltered by capital allowances, but would not of itself prejudice the availability of capital allowances for holiday lettings.

The source of the rule prohibiting long term letting is essentially a Fáilte Ireland regulation and should not have been linked to availability of tax relief in the first place as it serves no commercial rationale.

9.3 Tax Relief on Donations

The unified system of relief for charitable donations introduced in FA01 (now TCA97 s848A) has recognised the ethos of charitable giving in our population, and realised significant benefit to the charities sector. One of the key benefits of the relief has been to encourage donations to worthy causes, on the promise of the tax relief. However, our members advise that in very many cases, the

relief is not in actual fact claimed. In particular, donations made by employees are not always followed up with the tax certification required under the CHY2 procedure.

The relief granted under TCA97 s848A is not being used as a tax planning device. Further, because of the stringent controls exercised by Revenue in determining the “approved bodies” for the purposes of the relief, and the transparent manner in which these bodies are publicly identified, there can be little or no abuse of the scheme. In our view, it would be both positive and progressive to now re-evaluate the arrangements with a view to:

- Reducing the minimum contribution level
- Simplifying the administrative requirements associated with the CHY2 procedure

With regard to the latter, we suggest that a lower level of certification might be operated. For example, where donations are made by an employee to a charity by way of standing order which tends to be renewed from year to year, a note from the charity concerned to Revenue confirming the arrangement should be sufficient. It should not be necessary to operate the CHY2 procedure every year. For one-off donations, a written assertion by the donor of employee status along with their PPS number should be sufficient to allow the charity to reclaim the tax credit under the principles of self assessment.

The administration role assumed by Revenue in assessing charitable status and donation qualification should in any event be controlled by a separate dedicated Government body.

9.4 Relief for fees paid for third level education

TCA97 s473A provides for a generous form of tax relief for individuals on fees paid for undertaking third level education. It is entirely appropriate to provide for such reliefs given the emphasis on developing skills in our economy. The key criteria for the relief are that:

- Fees be paid for an approved course
- The course must be conducted in an approved college

In most instances, these criteria do not give rise to difficulty. Course accreditation is usually granted by the Higher Education and Training Awards Council, and its work in this area is well respected both at home and abroad. However, a separate approval process is required in respect of the course provider. It seems anomalous that one taxpayer attending a HETAC accredited course can obtain tax relief, while another attending a similarly accredited course but at a different educational establishment would be denied it.

As the tax legislation pre-dates the significant reform and advances in the third level sector since the formation of HETAC in 2001, it may be appropriate to review the requirement that the college, as well as the course, be approved.

10. Pension Provision

Key recommendation – Extend tax relief to encourage OECD recommended pension funding levels

The ¹OECD April 2008 Economic Survey of Ireland emphasised the need for Ireland to “develop a long term framework now to ensure the sustainability of public finances and adequate retirement income”. The Report also noted that “the current system will become unsustainable as the population ages, even with the resources in the National Pension Reserve Fund”. The OECD Report specifically identifies that substantial changes are required in public spending, in taxation and in the pension system. The CCAB-I recommends a review of key taxation incentives as a means of encouraging the necessary substantial increase in pension funding as identified in the OECD report. The aspects of tax incentives in terms of pension funding in urgent need of review are as follows:

10.1 Pension contribution limits

TCA97 s787 provides for a limit on the allowable contribution that can be made to an approved pension scheme as a percentage of the net relevant earnings of the person. This is further restricted by a cap on the earnings of €254,000 as provided in TCA97 s790A.

While we welcome the provision in FA06 for this cap to be increased in accordance with inflation, we believe that the cap of €254,000 is too restrictive. For example, an individual aged between 50 yrs and 55 yrs cannot deduct a pension contribution of more than €76,200 in calculating their taxable income.

¹ Policy Brief April 2008 www.oecd.org/dataoecd/38/12/40448199.pdf

It is our members' experience that income tends to increase in the later years of an individual's working life. The earnings cap does not recognise this fact. In addition, the Minister for Social and Family Affairs is actively encouraging those workers who do not contribute to a pension scheme to do so. The restriction on the earnings limit seems to be at odds with public policy.

On this basis we would strongly suggest that the overall limit on pension contributions which attract tax relief be set at €250,000, all other criteria being met.

10.2 ARFs

FA06 introduced a measure to impute a 3% distribution to the value of assets in an ARF on 31 December each year, with no credit being given for the imputed tax when the money is eventually drawn down. This is a form of double taxation. This is further compounded if the investment return is less than inflation.

Our members have expressed concern in relation to this measure which is seen as forcing them to receive actual distributions from their ARFs. The concern surrounds the main purpose of an ARF for those members – to provide for their extreme old age, where nursing home care may be required. If they receive distributions from their ARFs, their fund is reducing. If they do not receive distributions from their ARFs, their fund is still reducing as a result of the tax on the imputed distribution. Therefore, this imputed distribution may reduce the capital value of the fund.

In this era of aging population, where more and more people will be relying on the State in later life, it seems unreasonable to penalise those people who have provided for their retirement. We would recommend that this measure be repealed.

10.3 Encourage the young to pension fund earlier in life

There is a very real need to indoctrinate pension funding in the young as early in life as possible. Tax relief on pension contributions should be tailored to specifically target the young on first entry to the workforce and thereby establish a pattern of ongoing pension saving over the individual's entire work life. These specific measures could take the form of a double tax deduction for pension contributions in the first years of commencing to work and a PRSI holiday in total or partially for those who make voluntary contributions to a pension scheme.

It should always be borne in mind that up-front Exchequer costs of any form of pensions incentive have a considerable long term yield, both in terms of reducing the requirement for State support of the elderly, and in terms of the tax yield from the pensions when they are ultimately paid.

10.4 Refunds of PRSI to self employed persons on foot of pension contributions

CCAB-I wishes to highlight a significant anomaly in the treatment of self employed persons as against employed persons in the matter of pension contributions.

Where a payment is made either to a Personal Retirement Savings Account, an occupational scheme or a qualifying premium under an annuity contract approved by the Revenue Commissioners, a refund of PRSI is generally available to taxpayers. The legislation governing the repayment mechanism, ss 21(1)(c) and 38 of the Social Welfare Consolidation Act 2005 operate as to prevent a PRSI

refund in respect of “reckonable income” (trading income) as opposed to earnings which are subject to PAYE under Schedule E.

In short, an employed taxpayer can claim a PRSI refund where he or she makes a pension contribution, but a self employed person can not. This is inequitable and counterproductive in an environment where all citizens are being asked to make proper provision for their retirement.

10.5 PRSI – reinstate employer ceiling

Employers must pay PRSI in respect of their employees without limit. This has resulted in considerable additional costs for employers. However, the additional funds generated by the PRSI contributions paid by employers do not appear to have made any significant impact on increasing the National Pension Fund and so its usefulness for pension funding purposes is questionable.

The unlimited employer PRSI burden has been effective in increasing salary and wages costs, however in this challenging time for the Irish economy, it is important to incentivise employers so that employment figures remain in the very high range that we have become used to. On this basis, we would recommend that the employer ceiling be reinstated with immediate effect.

10.6 Inequity in PRSI payable by self employed compared to employees

The self employed individual is liable to higher rates of PRSI compared to employed individuals. Self employed individuals make PRSI contributions at a rate of 3% on all of their reckonable income where an employed contributor makes PRSI contributions at a rate

of 4% subject to a ceiling of €50,700 and an exemption of €6,604 per annum.

For example, an individual self employed with reckonable income of €100,000 pays PRSI of €3,000 compared to an employed contributor's PRSI of €1,764 on a salary of €100,000. In addition, the self employed contributor must pay PRSI at 3% on unearned income such as rental income whereas an employed PRSI Class A contributor does not make PRSI contributions on unearned income. There is a clear discrimination in operation of PRSI which should be amended to offer the same PRSI contribution structure to the self employed as available to employees for the purposes of encouraging the continued growth of an enterprise society.

11. Corrections to simplify the Tax System

The consistent and fair operation of a national tax system is vital for the smooth and efficient running of a modern economy. It is in everyone's interests to ensure that compliance with Revenue law and practice can be achieved at a reasonable cost to all tax payers. Otherwise the fairness of the overall tax take will be as distorted. Self assessment has been in place for almost twenty years. It has its advantages. One of the downsides however of self assessment for taxpayers and their agents is that it has permitted the introduction of limits, restrictions and deadlines which would not been countenanced if Revenue were still fully responsible for the assessment of tax.

CCAB-I has already identified particular areas of difficulty through the TALC process. Some of these, which are based on our experience of the tax system, require legislative change to implement, and these are as follows.

11.1 Payment dates

Key Recommendation – Capital taxes return dates and payment dates should coincide

Capital Gains Tax

At present Capital Gains Tax (CGT) must be paid in two installments:

- on or before 31 October in relation to gains incurred in the initial period (1 January to 30 September);
- on or before 31 January in the following year in relation to gains incurred in the secondary period (1 October to 31 December).

In addition, returns must be submitted on or before 31 October in the following year.

For simplification purposes, we recommend that the CGT return applicable to the CGT payable in respect of the initial period of a year of assessment should be made at the payment date (by 31 October of that year). Conversely, the payment and return for the secondary period should be both made at the following return date (by 31 October of the following year).

CCAB-I recognises that there could be concerns as to Exchequer cash-flows arising from this amendment. We suggest that the balance between cash-flow considerations and administrative simplification could be met through making the simplified arrangement available where the aggregate consideration from disposals in the three month period does not exceed €1,000,000.

Capital Acquisitions Tax

A similar logic should be applied to Capital Acquisitions Tax. CAT is generally accounted for by reference a date four months after the Valuation date.

To enhance CAT compliance and administration, we suggest that CAT returns and payments for gifts and inheritances under a specified value should coincide with Income Tax returns. The CAT Return and payment would be made on 31 October, by reference to valuation dates falling in the previous year. A useful threshold might be €1,000,000.

11.2 Base Cost

Key Recommendation – allow option to use base cost of 31 December 1991 or 5 April 1974 as base cost for CGT purposes on sales of assets held long term

There are enormous administration difficulties both for Revenue and for taxpayers in determining 30 year old values as well as addressing the significant inflation problem in taxing gains derived from the disposal of such assets. The need to re-base becomes more acute with each passing year. We recommend that there be an option to determine market value for assets held long term by reference to 5 April 1974 or 31 December 1991, the latter date being the commencement date for CAT aggregation purposes.

11.3 Relevant Contract Tax Simplification

Key Recommendation – repeal requirement to complete RCT1 & capture required information at C2 tax clearance application stage

The RCT Form 1 was recently updated for relevant contract tax purposes. Unfortunately the form is very onerous and complicated and duplicates information requested at the stage when a subcontractor applies for tax clearance card (C2). The additional administration burden imposed by the new RCT1 is not fair because generally it is the tax compliant principal contractor and subcontractor who actually complete the form in the first place. Therefore we recommend that the requirement to complete the new Form RCT1 be repealed.

12. Summary Recommendations

- 12.1 Refine a series of aspects of our tax code to make Ireland an even more attractive locale for innovators.
- 12.2 Minimise BES qualification procedures & remove restrictions on investors to encourage greater use of BES relief.
- 12.3 Bring national spending on R&D and innovation infrastructure up to international standards by allowing tax credit refunds and wider definition of processes qualifying for R&D tax credit.
- 12.4 Corporation tax payment threshold of €200,000 should be removed to allow all companies pay preliminary tax on prior year's liability.
- 12.5 Owner managed companies are not exploiting tax advantages and should not be penalised with Close Company Surcharge Rules.
- 12.6 Introduce clearance mechanism for non-residents to ease administrative burden on accessing PSWT refunds.
- 12.7 Maintain the integrity of the Irish tax system by concentrating Revenue resources on tax collection rather than using tax as a tool for enforcing other Government agencies rules.
- 12.8 Extend tax relief to encourage OECD recommended pension funding levels.

12.9 Amend necessary technical corrections to the tax system to encourage compliance and reduce administration burden on taxpayer

Appendix

The Enterprise Investment Scheme

The EIS was introduced in January 1994 as the natural successor to the Business Expansion Scheme (BES), which operated from 1983 until the end of 1993. It is one of three tax-based venture capital schemes (the others being Venture Capital Trusts, VCTs, and the Corporate Venturing Scheme, CVS), designed to address an acknowledged capital market failure in the UK, by helping small firms (who suffer it most acutely) to obtain the finance they need in order to grow their businesses into sustainable, profitable enterprises. The scheme does this by using fiscal incentives (tax reliefs), to lever additional private investment (risk capital) into smaller, higher- risk, unquoted trading companies that would otherwise struggle to obtain appropriate levels of finance due to this market failure

In summary, the reliefs available to investors are:

- 20 per cent income tax relief on up to £400,000 investment in any one tax year (giving up to an £80,000 reduction of income tax liabilities). Subject to State aid approval, this limit will be raised to £500,000 (giving up to a £100,000 reduction on income tax liabilities) for the tax year 2008/09 onwards;
- a capital gains tax (CGT) charge can be deferred on a capital gain that is reinvested in an EIS qualifying company; and
- CGT exemption on gains arising on disposal of EIS-qualifying shares.

The Enterprise Investment Scheme In Operation

The Enterprise Investment Scheme (EIS) offers a variety of tax reliefs to individual investors in smaller, higher-risk, unquoted trading companies. The investor can either subscribe for full-risk, ordinary shares in the company directly, or can put money into an EIS fund that subscribes for shares in a range of qualifying companies on behalf of investors.

Both the company and the investor must meet various conditions in order to obtain, and retain, EIS-qualifying status and the accompanying tax reliefs. HM Revenue & Customs (HMRC) has responsibility for administering the scheme, and ensuring that these qualifying conditions are met.

In order for an issue of shares to qualify for EIS investment, there are two main tests that a company must meet:

- Gross assets test – the gross assets of the company (or of the whole group if it is the parent of a group) cannot exceed £7 million immediately before any share issue and £8 million immediately after that issue; and
- Employees – the company (or the whole group if it is the parent of a group) must have fewer than 50 full-time employees (or their equivalents) at the time the shares are issued.

Besides carrying out a qualifying activity, the company must also be an unquoted company when the shares are issued. That means that it cannot be listed on the London Stock Exchange or any other recognised stock exchange. The Alternative Investment Market (AIM) and the PLUS Quoted and PLUS Traded Markets are not considered to be recognised exchanges for this purpose.

The following reliefs are available to investors under the EIS:

- Income tax relief. This is based on the amount invested in the company. The relief given is 20 per cent of the amount invested, with a minimum investment of £500 per company per tax year. The maximum total investment in any tax year on which income tax relief is available is currently £400,000. Subject to State aid approval, this limit will be raised to £500,000 for the tax year 2008/09 onwards.

Income tax relief can only be claimed by individuals who are not “connected” with the company.

- Capital gains tax (CGT) deferral relief. If a capital gain (from any asset) is invested in shares of a company that qualifies under the EIS rules, then CGT on the gain is deferred until the EIS shares are disposed of. The EIS investment must be made no earlier than one year before, and no later than three years after, the gain arises.
- CGT exemption. Provided income tax relief has been granted (and not withdrawn), any gain from the disposal of the shares in an EIS company is exempt from CGT.

An investor is entitled to these reliefs provided that the shares are held in a company that remains an EIS-qualifying company for a period of three years after the issue (or three years after the commencement of the trade if that followed the share issue).

Conditions for relief

The company must meet several conditions before an EIS investment can be made, and must continue to meet these conditions throughout the qualifying three year period.

- The company (or group) must have gross assets of less than £7 million, fewer than 50 employees, and be unquoted when the shares are issued.
- The company must either carry on a qualifying trade, or be the parent company of a trading group that carries on a qualifying trade. The qualifying trade must be carried on by either the company issuing the shares or by a subsidiary (which must be at least a 90 per cent subsidiary).
- A qualifying trade is one that consists mainly of activities not on a list of excluded activities and which is conducted on a commercial basis with the intention of making a profit.
- The list of excluded activities is designed to target the scheme effectively on those companies facing the most severe barriers to accessing finance. In many cases the excluded activities are asset-backed trades that do not suffer the same degree of market failure as those companies without assets (that can be used, for example, as collateral to secure a loan).

