Tax and the next phase of Ireland's Economic Development

Pre-Budget 2008 Submission

September 2007

Table of Contents

1. Introduction 3
- 1.1 The Irish Taxation Institute 3
- 1.2 Contributing to Policy debate 3
- 1.3 Working in Partnership 3
- 1.4 The Programme for Government 4
- 1.5 The submission process 4
- 1.6 Our focus this year 5

2. Tax and the next phase of Ireland's Economic Development 5
- 2.1 Background and context 5
- 2.2 New challenges and opportunities 6
- 2.3 Moving to a truly incentivised model for R&D 7

3. Legislative issues 12
- 3.1 Relevant Contracts Tax (RCT) 12
- 3.2 Irish Tax Treatment of Foreign Dividends 14
- 3.3 Preliminary tax for Corporate Taxpayers 16
- 3.4 Balancing Allowances – assets bought and sold within an accounting period 17
- 3.5 Stamp Duty: Clawback of First-time buyer's relief for employees seconded abroad 19
- 3.6 Capital Acquisitions Tax (CAT) Dwelling-house exemption for co-habiting people 20
- 3.7 CAT/CGT overlap causing double taxation 21
- 3.8 VAT on Property 22
- 3.9 Close company rules 23

1. Introduction

1.1 The Irish Taxation Institute

The Irish Taxation Institute (ITI) is the leading representative body for taxation affairs in Ireland. Our membership comprises qualified tax advisers, accountants, barristers, lawyers, and other corporate and business professionals. Our mission is to support an efficient, fair and competitive tax system that promotes an understanding of and expertise in taxation and encourages economic and social progress.

Our 6,000 members work with corporate leaders, Government, State agencies, representative groups, professional organisations and the general public. Through our membership of the Confédération Fiscale Européenne, we monitor and influence legislation and tax policy developments in the EU and internationally.

For 40 years, ITI has been Ireland's foremost provider of qualified tax advisers through our three-year (AITI) and one-year (TMITI) tax qualification courses. Our professional development programme provides continued education, appropriate advice, specialist seminars and other support services for members. This ensures qualified tax advisers remain professionally competent throughout their working lives.

Through our nationwide branch network and comprehensive committee structure, our members are actively involved in developing and advancing research on taxation, economic and social policy. Drawing on this expert team, ITI produces a comprehensive suite of taxation publications covering the full range of tax topics.

1.2 Contributing to Policy debate

As part of our representational role, we engage regularly with key stakeholders in the policy formulation arena to give our members' perspective on key tax policy issues. In addition to the production of an annual pre-budget submission, we make submissions to the Department of Finance, the Revenue Commissioners and other relevant arms of the State on issues ranging from the administration of the tax system to overarching policy issues. In that context, we welcome the opportunity to make this submission and look forward to discussing the proposals contained therein with all key stakeholders as part of Budget and Finance Bill formulation process.

1.3 Working in Partnership

The ITI and its members are proud of the constructive and collaborative relationships enjoyed with key stakeholders in tax policy formulation in Ireland and in particular the Department of Finance and the Revenue Commissioners. The Taxes Administration Liaison Committee (TALC) continues to provide a robust forum for the exchange of views and the resolution of

both policy and practical administrative issues as they arise. Tax advisers have a key role to play in the smooth running of the tax administration system and we look forward to the continuation of this mutually beneficial approach in the future. Over the course of 2007, we have been delighted to work closely with the Department of Enterprise, Trade and Employment on the work of the Business Regulation Forum. The implementation of the recommendations of the group's report has the potential to significantly reduce the burden of compliance costs, particularly on small and medium-sized businesses. In addition, we have worked with the Expert Group on Future Skills Needs in the area of skills requirements for the future development of the financial services sector. This submission is presented within the context of such collaborative work and we are happy to provide expertise and assistance in the development of the proposals as required.

1.4 The Programme for Government

"If we are to compete effectively and in a sustainable way, we will have to do so through even greater competitiveness in knowledge –driven industries"
(Programme for Government, June 2007)

The programme for Government sets out a number of key measures to drive Ireland's future economic prosperity. Competitiveness and innovation coupled with an equitable tax system are central to these measures. We welcome, in particular, the commitment to support the Business Expansion and Seed Capital Schemes which recognise the key role played by small businesses in the economy. We also welcome the investment in Science, Technology and Innovation. In relation to a proposed carbon tax, there are a number of issues to be explored to ensure that any such tax does not become a cost of doing business in Ireland. However, there are many innovative approaches that could be taken to ensure that environmentally responsible employers are actively rewarded for their efforts and that any tax encourages a change in behaviour in a revenue neutral manner. This should be explored in detail by the proposed Commission on Taxation. A carbon levy deals only with one part of the issue and further incentivisation of the renewable energy industry should not be overlooked. We discuss this point further at 2.2 below as part of the broader incentivisation of research and development activity.

In addition, we welcome the establishment of the proposed Commission on Taxation. The Commission should be a key player in examining the role that taxation policy can play in the enhancement of competitiveness and economic efficiency as well as looking at ways to improve the equity of the impact of taxation and increase the overall transparency of the system. We look forward to engaging with the Commission in an appropriate manner for the benefit of all stakeholders.

1.5 The submission process

This submission is a result of extensive consultation within our membership as well as the wider business community and other representative bodies. As with all our work in the tax

policy area, it is guided by a set of principles, including our belief in a tax administration system that is simple, transparent, robust and stable and one that delivers low compliance costs for the taxpayer. In addition we provide support for the government on tax policy issues that improve the economic position of the country both domestically and internationally. In that context, we trust that the ideas put forward will prove useful in the overall debate on what we consider to be important issues for our members, for business and the economy in general.

1.6 Our focus this year

Our submission last year, *Tax Treaties in a Global Marketplace,* focused on the key role tax treaties play in the total package of measures required to make Ireland a truly global hub for business. The treaty network forms part of the overall framework within which international business across all sectors operates in Ireland. We remain convinced of the arguments set out in that document and re-iterate our view that it is time to consider short to medium-term pragmatic solutions to the issues it creates as well as putting a robust long-term strategy in place.

This year our focus remains in the area of sustaining and increasing Ireland's competitive position on the world economic stage. There is widespread buy-in to the importance of the knowledge economy as well as a commitment to the development of the fourth level education sector. We are therefore of the view that at this key juncture for the economy, it is time to prioritise the incentivising of **research and development** activity if we are to compete in a credible manner in that arena. This could have significant positive implications for Irish indigenous businesses as well as for foreign direct investment. We have set out our proposals in this regard in Chapter 2. In Chapter 3, we set out a range of **legislative issues** which we feel require attention in Finance Bill 2008. While they are technical in nature, they all contribute to our overall objective of a simple, transparent system with low compliance costs for all.

2. Tax and the next phase of Ireland's Economic Development

2.1 Background and context

By any measure, the Irish economy continues to perform strongly. Despite persistent negative media commentary, recent statistics provide more evidence of continued strong growth. For example, for the first quarter of 2007, total employment has risen by 3.8% and the numbers show signs of significant recovery in the manufacturing sector.[1] Growth rates are currently projected at 5% this year for both GDP and GNP with moderation to a rate of 4% for 2008. This continues to compare favourably with similar economies.[2]

---

[1] Reasons To be Cheerful, Dermot O'Brien, *NCB Economics weekly*, 17th May 2007
[2] Opening Statement, Governor John Hurley, launch of Annual Report of Central Bank and Financial Regulator 2006, 11 July 2007.

Such strong underlying economic fundamentals afford us the opportunity to think strategically about the next stage of development of the economy and the role that fiscal policy should play.

2.2 New challenges and opportunities

It has been noted by a number of commentators than apart from external macro-economic conditions, one of the greatest threats to our economic well-being is complacency.[3] The challenges posed by lower cost economies and global competition have been well documented and many of the key drivers of our initial economic success are no longer unique to Ireland as many other countries have learned much from our story. Having said that, the 12.5% rate of corporation tax remains a key component of the overall package for those doing business here. We therefore welcome the explicit commitment to its maintenance set out in the Programme for Government. In staying competitive, it is essential that Ireland retains the flexibility to set its own corporation tax policy without hindrance. For this reason, ITI strongly supports the government's position in opposing the concept of a Common Consolidated Corporate Tax Base as currently being developed by the European Commission.

In formulating tax policies to deal with the new challenges discussed above, it is important that we do not lose sight of our success in attracting large scale international industries such as financial services, information technology and pharmaceuticals to Ireland. This remains a core component of the economy that cannot be simply dismissed, despite the negative media commentary on the future of manufacture here. What is common to all of these industries is the threat posed by lower cost economies. It is worth remembering that these industries were attracted here by a package of measures including taxation, our young educated workforce, our legal and regulatory framework and our location as an entry point into the EU. Many of these fundamentals still remain and, while recognising that we may lose elements of these businesses' activities to lower cost locations, the challenge now is to ensure that we attract and retain the high value added activities, and in particular, knowledge-driven industries.

In recent years, Government policy has been focused on developing a knowledge economy, a key component of which is research and development activity.[4] The potential benefits, however, are not reserved for large foreign multi-nationals locating here. Indigenous Irish businesses of all sizes continue to compete effectively in world markets and can only continue to do so if they invest in leading edge technology and processes. This activity also has the potential to generate sustainable employment in smaller local industries such as the organic food industry and specialist manufacturing sectors. In that regard, we welcome the recent simplification of the procedures for very small R&D claims which have already been approved for grant assistance[5] Another possible area of opportunity is that of renewable energy where further R&D activity is now essential. While there are some renewable energy

---

[3] Statement of the Chairman and Chief Executive, Forfas Annual Report 2006
[4] Review of the Exemption from Taxation of Patent Income, Goodbody Economic Consultants, February 2007.
[5] Revenue eBrief, No.42/2007

tax incentives in place, the area now demands real focus if the Government is to meet the targets for the proportion of our total energy needs to be produced from renewable sources.

2.3 Moving to a truly incentivised model for R&D

2.3.1 Overview

A number of key reports have driven policy in the area of research and development over the past number of years including ***Building Ireland's Knowledge Economy***[6] and the ***Strategy for Science, Technology and Innovation 2006- 2013***[7]**.** The strategy document deals with many of the supports required to build research excellence with a strong focus on fourth level education and an increased number of doctoral awards. In addition, the plan sets ambitious targets for the proportion of sales from indigenous enterprises from innovative products and processes.

An important tool in this overall strategy is the R&D tax credit introduced in Finance Act 2004, which has been modified in subsequent years including Finance Act 2007. Essentially the provision allows for a 20% tax credit for incremental expenditure on R&D incurred by trading companies. While widely welcomed at the time, there are a number of problems with the current provisions and while R&D expenditure has increased significantly in recent years, the total amount remains low by international standards.[8] Again, most of our competitor jurisdictions have similar credit systems in place and it is therefore time to review our model and make the required changes so that the case for undertaking R&D activities in Ireland becomes a compelling one. It is worth noting the success that has been achieved in the UK since the introduction of their regime in 2000 and its extension to large companies in 2002. An OECD comparison shows that after Canada, the UK offers the most generous tax credits in the world. The result has been a steady increase in R&D investment with growth of 7% between 2003 and 2006[9]. It is also worth noting that of the 5,500 companies that claimed the R&D tax credit in the UK in 2004, over 80% of the claimants were SMEs[10].

2.3.2 Problems with current regime

Awareness and statistics

While the credit has been available since 2004, evidence of the low levels of take up of the credit shows that there is a relatively low awareness of the credit, as well as the possible areas of activity to which it may be applied. In 2004, 73 claims for the credit were made totalling €70.4 million. The latest figures for the following year indicate that 135 claims were made totalling €65.2 million. While the industries that would be more traditionally focused on such activities are aware of it, to really generate the levels of activity that could yield lasting economic results would require a significant information

[6] Forfas, January 2005
[7] Forfas, June 2006
[8] As 4 above
[9] Information and statistics from www.innovation.gov.UK/randd
[10] Supporting Growth in Innovation, HMRC, July 2005.

and promotion campaign in conjunction with a range of industry groups. This would be greatly assisted by the availability of more timely and reliable statistics on the take up of the credit.

Narrow focus

The credit has obvious application for industries such as pharmaceuticals and IT which are research-driven. However, there are many industries which Ireland has strength in that could benefit from incentivising new processes, products, technologies, etc. Such industries include financial services, food processing and manufacturing. The legislation does not exclude such industries from consideration. The guidance notes and other administrative elements of the regime are, however, firmly focused on the more obvious targets. Consideration could be given to more extensive guidance notes for different industries such as those in the Canadian regime which would lead to better understanding and lower costs in computing the R&D credits. There needs to be more recognition that R&D is not just done in laboratories; it is also done in financial services houses and on the factory floor. A prime example of this reality is the decision by Merrill Lynch to establish a new, €30 million Research, Development & Innovation (RDI) Centre at its offices in Leopardstown, Dublin. The centre will focus on the development of technological applications to support Merrill Lynch's business worldwide and will create up to 40 new, high-value, research-based jobs. This is exactly the type of activity that the R&D tax credit should incentivise. We need to encourage all stakeholders to be much more open in their thinking on R&D and to actively engage with a broad range of industries on the possibilities available.

Rate of credit

While the 20% rate for the tax credit in Ireland compares well with other jurisdictions, we are mindful of the fact that some other jurisdictions (e.g. Singapore, Czech Republic) increase the attractiveness of their rate through tax holidays and additional grant structures. As of now we are just on a par with other jurisdictions, rather than leading the way. However, the rate is only one element of the overall mechanism, and should be looked at in the context of other issues including the base year.

Base year

The credit operates on the principle of a base year from which incremental expenditure on R&D is measured. The original base year of 2003 was due to roll forward in 2006 but was frozen as part of Finance Act 2007 for a further three years in recognition of the fact that most large scale projects run for an average of five to seven years. However, the use of an incremental rather than a volume-based approach remains a significant weakness of the Irish system with many other jurisdictions adopting a volume-based approach. The incremental approach is a blunt instrument and discriminates between companies depending on their overall pattern of expenditure rather than the total amount. The volume-based approach is clearer for industry, simpler to administer and alleviates the need to roll forward the base year. The UK system, introduced in 2000, has adopted a volume based approach.

Sub-contracted activities

Due to the complexity involved in many research projects, companies outsource elements of the project to other experts in the field. In recognition of this market reality, Finance Act 2007 introduced changes to allow a company to outsource up to 15% of their eligible R&D activity and still qualify for the credit. This percentage remains extremely low and does not recognise the reality that even very large companies operating here will need to outsource very significant proportions of their R&D activity to specialist operators in the field.

Companies in start up situations
The credit is of little or no value to start up companies with no tax liability. These are the very companies where R&D should be promoted and encouraged.

Administrative complexity for small businesses
While we welcome the recent simplification of procedures for small R&D claims that have already been approved for grant assistance, the current regime adopts the same approach for an SME company applying for a relatively small credit and a large multinational undertaking significant R&D activity here. The cost and time involved in working through the process acts as a disincentive, particularly for very small companies.

2.3.3 Proposed solutions

Based on our discussions with our members and other stakeholders and a high level review of some of the regimes in operation in other jurisdictions, we have set out below a range of proposals that we feel should be considered in the context of the upcoming budget discussions.

- **Awareness and statistics**
    - Launch of awareness campaign on a collaborative basis across a wide range of industries.
    - Compilation of regular statistics on the number of companies claiming the credit, amounts claimed, types of research conducted, etc.

- **Narrow focus**

  Drafting of promotional material to clarify that all types of research and development could potentially qualify for the credit, assuming the basic criteria set out in the legislation have been fulfilled. We believe there is a wide variety of businesses whose research activities could qualify but for whom the options have never been explained and explored. Considering our very solid foundations in areas such as financial services, software, food processing and specialist manufacturing, there are many opportunities to encourage enterprise and innovation in these sectors.

- **Rate of credit**

  Evaluation of our regime against those of our competitors to ensure we are remaining competitive and with the objective of leading the field. This may well necessitate the consideration of an increased rate of credit although that would be

heavily influenced by any decision to move from a base year to a volume-based approach.

- **Base year**
  We would advocate moving to a volume-based system which would be simpler to both market and administer than the current incremental approach. It recognises the long term nature of the investment process and sends the right signals to business as it would benefit companies with sustained research activity, those starting from a very low base and those with growing levels of expenditure. A volume-based system would act as an incentive to continue research and development activity even if levels of expenditure are reduced in tighter economic times. Crucially, it would not penalise companies who reduce their expenditure for a year after a period of very significant investment. The manner in which a volume basis is rolled out needs to be addressed as currently different business operations within, say, a multinational pharmaceutical, may have different R&D policies and each business operation is unable to control its own R&D credit claims as the group's expenditure is taken into account in deciding whether there is an increment in spending as opposed to the relevant business operations. The same issue will arise in a volume-based system unless legislation is introduced to allow companies to elect to have segmented business operations, which are assessed separately, based on the fact they control their own spend and thus are entitled to determine their own credits by reference to that spend and in accordance with the law. We fully recognise that certain other safeguards may be needed, such as a tiered system to protect from excessive annual fluctuations. However, it is an area that needs to be addressed to ensure the credit is a real tool in our total competitiveness package.

- **Sub-contracted activities**
  In recognition of the significant amounts of R&D that need to be outsourced, we would advocate increasing the % allowed to 25% over the life of the project. This would go some way to recognising the commercial realities of such activity.

- **Companies in start up situations**
  We would advocate a form of surrender system as allowed in other jurisdictions, whereby the start-up company could get some immediate benefit. For example, the credit could be set off against some other non- corporation tax liability. Alternatively, some form of "BES" type solution could be explored whereby the credits could be passed onto the investor group for as long as the entity has no tax liability. The UK regime allows for cash refunds for small businesses engaged in R&D.

- **Simplification of administrative procedures**
  In line with our comments in relation to awareness and promotion, it is essential that the administration of the regime itself does not discourage companies from claiming the credit. This is particularly crucial for small entrepreneurial businesses where senior management time is at a premium. We would recommend

the adoption of a more streamlined process for smaller entities, particularly once they have come though the process once and many of their credentials will already have been verified.

- **Allied Issues**

  A further issue of relevance to this agenda includes the requirement for a pooling system for credits for overseas tax on royalties received, akin to that in place for dividends.

3. Legislative issues

As well as the tax policy proposals that we believe will be instrumental in the next phase of Ireland’s economic development, the ITI believes a number of key legislative changes are necessary to ensure certainty and simplification of the tax system as well as supporting entrepreneurship and reducing compliance costs. They are detailed in the following section.

3.1 Relevant Contracts Tax (RCT)

Impacted Group: Individual or Corporate Taxpayers involved in Construction Industry or Construction/Property based investments

As Ireland’s economy has become and continues to be heavily dependent on the construction and property sectors, RCT remains a key consideration for all stakeholders in these sectors. The scope of the RCT legislation is considerable and there can be serious consequences for taxpayers in the event of failing to meet its administrative and payment obligations. We understand that a significant review of RCT, and electronic options for the tax, is being carried out by Revenue’s Operations Policy and Evaluation Division (OPED) and we ask that the following legislative changes be considered as part of this review.

3.1.1 RCT and connected persons

Issue
Over the past year we have discussed the significant administrative difficulties being caused by the current scope of the RCT legislation at the TALC Direct Taxes Technical Sub-Committee. Many of these difficulties arise as a result of the “connected persons” rules. While this area has been the subject of discussion at this forum, and indeed formed part of our 2007 pre-Finance Bill submission, the ITI believes that legislative changes are required to resolve the unwarranted difficulties with the system.

Under the provisions of Section 531(1)(c) Taxes Consolidation Act 1997 (“TCA”) a person connected with a company carrying on a construction business is a deemed principal contractor with all the accompanying RCT administrative requirements that attach to that position.

Consequences
While ITI accepts the clear intention to bring connected party transactions within the RCT provisions, the outcome of the current definition has been to bring those with very limited connections with principal contractors into the RCT regime. This is hampering bona fide business by adding significant complexity to standard business operations. Some examples of these scenarios are:

- A group of investors come together and buy a site on which they are going to contract to have a hotel built. If one member of the investor group is "connected" to a building company, the entire group is brought within RCT and has to go through the administrative burdens of registering, etc. It can often be difficult to establish if there is a connection if there are, for example, 20 participants in the investor group.
- A taxpayer owns a construction company and builds a new principal private residence (PPR). Due to the connected party rules, the taxpayer director would have to operate RCT on all payments in respect of the PPR.
- A person connected with a building company buys a new building for rental purposes and has to deduct 35% on closing of the deal with the builder. The builder will probably not have a C2 as he is not a subcontractor.
- A partnership/co-ownership wishes to construct a building with a view to letting it on a long-term basis. The partnership comprises 3 individuals, one of whom is the majority shareholder of a company which is a principal contractor for RCT. Due to the connected persons rules, the partnership would have to operate RCT on every relevant contract to do with the construction of the new building which it intends to let, not sell.

Proposed solution
Section 531(2) TCA includes a provision that an individual carrying on a business will not be regarded as a principal contractor of the type specified in Section 531(1)(b)* by reason only of the fact that in the course of that business they erect buildings for their own use or occupation, or for the occupation of their employees.

The ITI asks that the above provision be extended to include individuals referred to in Section 531(1)(c) TCA so that Section 531(2) TCA would read as follows:

"A person carrying on a business shall not be deemed to be a person of a kind specified in subsection (1)(b) or (1)(c), only where the connection in (1)(c) is to a person referred to in (1)(b)(i), by reason only of the fact that in the course of that business such person erects buildings for the use or occupation of such person or employees of such person."

*Section 531(1)(b)(i) reads as follows:
(b) a person -

(i) carrying on a business which includes the erection of buildings or the manufacture, treatment or extraction of materials for use, whether used or not, in construction operations

This would avoid situations where a person is deemed a principal only by virtue of being connected to somebody involved in the construction industry.

3.2 Irish Tax Treatment of Foreign Dividends

Impacted Group: Inward investment, namely Irish subsidiaries of foreign companies and Irish parent companies in receipt of dividend income

Issue
As it currently stands, Irish legislation provides that dividends received from Irish resident companies are taxed as FII ("Franked Investment Income") and not normally liable to Irish corporation tax. Dividends received from foreign companies are fully liable to Irish corporation tax, at a rate of 25%, subject to a credit for underlying taxes paid by the foreign companies on the profits used to pay the dividend.

The Chancery Division of the UK High Court referred the case of Test Claimants in the FII Group Litigation ("FII case") to the ECJ for consideration in 2004. The matter to be decided was whether the UK tax treatment of dividends received from foreign companies resident in other EU Member States was in breach of certain provisions of the EU Treaty when compared to the taxation of recipients of dividends from UK companies (the latter referred to as "FII").

The ECJ decided that: *"Articles 43 EC and 56 EC must be interpreted as meaning that, where a Member State has a system for preventing or mitigating the imposition of a series of charges to tax or economic double taxation as regards dividends paid to residents by resident companies, it must treat dividends paid to residents by non-resident companies in the same way."*

Her Majesty's Revenue and Customs ("HMRC") issued a public consultation proposal entitled "Taxation of the foreign profits of companies" in June 2007 to examine the area of the taxation of foreign dividends as well as the UK Controlled Foreign Corporation (CFC) regime.

Consequence
As summarised above, the Irish system for taxing dividend income includes an exemption system for domestic dividends and a credit system for foreign dividends, which is similar to the system that applies in the UK. However, the situation in Ireland is complicated by the fact that certain profits earned by companies are taxed at different rates. As discussed in the FII case, the Irish system for taxing dividend income could result in situations where domestic and foreign dividends are not treated in the same way in the context of the tax burden they bear. In particular, dividends from trading profits earned outside of Ireland received by an Irish resident company are taxed at a higher rate than dividends received from an Irish company which are paid out of its trading profits.

Proposed Solution
As detailed above, the Irish system for the taxation of dividends could result in situations that are at odds with the ECJ's decision in the FII case and accordingly needs to be reviewed and amended.

One of the possible mechanisms for relieving the disparity in treatment between domestic and foreign dividends would be to introduce a participation exemption for dividends. Such a participation exemption would greatly complement Ireland’s existing holding company regime and boost its attractiveness as a holding company location. The ITI looks forward to reviewing the legislative changes that we believe need to be introduced to bring Irish tax law in line with the ECJ’s decision in the FII case.

The ITI believes that it may be opportune to use the above recommended review of the Irish system for the taxation of dividends to examine whether or not Ireland’s dividend withholding tax (DWT) regime is keeping pace with other jurisdictions. This examination could be said to be necessary in the context of the use of private equity vehicles to purchase Irish companies or Irish subsidiaries of foreign companies, which has become the modern commercial norm. Certain aspects of the taxation regimes of other jurisdictions, e.g., Luxembourg, make them more attractive as holding and management company locations in private equity-funded mergers or acquisitions.

3.3 Preliminary tax for Corporate Taxpayers

Impacted Group: Corporate taxpayers that do not fall within the "small company" regime for payment of preliminary corporation tax

Issue
As stated a number of times, including in our pre-Finance Bill 2007 submission, the ITI welcomes the changes announced for "small companies" in the context of preliminary tax in the Budget 2007 speech. As a result of these changes "small companies" (with a corporation tax liability of less than €150,000) can base their preliminary tax payment on 100% of the preceding year's liability where the liability threshold was previously €50,000. We also welcomed the assurance that start-up companies will not have to pay preliminary tax in respect of their first accounting period.

One of the fundamental tenets of any modern, well-functioning tax system is the principle of certainty.

While the positive changes introduced in 2007 remove the uncertainties surrounding preliminary tax for some 97% of corporate taxpayers, the largest corporate taxpayers in the country are still left with exposures and ambiguity with regard to their Irish corporate tax position. These uncertainties associated with the payment of what, by definition, are large amounts of tax, are at odds with the principle of certainty.

Consequences
A preliminary tax payment regime which requires certain companies to compute their tax liability prior to the relevant period's end is at odds with the principle of equity of treatment for taxpayers. For many large businesses, it is extremely difficult to accurately forecast the last two months of the year, even if sophisticated forecasting and budgetary processes are employed. In practice, it means that such companies are forced to calculate their liability twice and, in order to avoid possible penalties and interest, they generally tend to significantly overpay their preliminary tax bill. The tendency to overpay so as to avoid what can be significant interest charges, can cause cash-flow problems for companies.

Proposed solution
The ITI asks that the current self-assessment preliminary tax regime for companies which are currently not within the "small companies" rules be reviewed. Our preference is that all companies be entitled to avail of the prior year basis, as detailed above. With a view to ensuring certainty for Exchequer returns, in the case of larger companies, the taxpayers could pay 100% of the full prior year liability inflated by a % to allow for growth and inflation.

3.4 Balancing Allowances – assets bought and sold within an accounting period

Impacted Group: All taxpayers with fixed assets, especially leasing businesses or those acquiring and disposing of information technology hardware and software

Issue

Section 288 (1) TCA, provides for balancing allowances and charges on the occurrence of certain events, such as the disposal of a fixed asset. A prerequisite for claiming a balancing allowance on the disposal of an asset is that a wear-and-tear allowance has been claimed in respect of that asset. Section 284 TCA provides that a wear-and-tear allowance can be claimed where the qualifying asset has been in use at the year end. Notwithstanding long years of Revenue practice, Revenue have noted accordingly that where an asset is disposed of during a year, and therefore no wear-and-tear allowance has been claimed, a balancing allowance cannot be claimed. ITI believes that the combined effect of these pieces of legislation is very negative for business and does not reflect their commercial realities, especially in a number of sectors.

Consequences

The practical implications of the inability to claim balancing allowances can be seriously disadvantageous for business, being most pronounced in a number of sectors. Any depreciation on these assets is not deductible for tax purposes so, where a balancing allowance is also unavailable, there is no relief of any sort for the investment made in these assets. This can be financially significant for any business with modern information technology requirements. By definition, computer hardware and software becomes obsolete very quickly, resulting in the need for business to replace assets frequently in order to stay up-to-date. The inability to claim balancing allowances in respect of these assets, bought entirely for the purposes of the business, can be financially damaging.

The specific sectors most affected by the inability to claim balancing allowances on qualifying assets bought and sold within an accounting period are aircraft leasing and motor leasing. Both of these sectors are significant contributors to Ireland's economy, both directly and indirectly. The Irish capital allowances legislation does not take account of their commercial reality, making it less attractive for them to do business here.

Proposed Solution

While the ITI fully appreciates the need for a comprehensive set of rules governing capital allowances, we believe the reversion to Revenue practice in the area of balancing allowances needs to be re-examined in light of the negative consequences detailed above. To this end we ask that consideration be given to establishing a set of conditions which, if satisfied, would allow for the claiming of balancing allowances on assets bought and sold within an accounting period. These conditions could include, for example:

- Proof that the asset was in use during the accounting period
- The asset was bought for and used for bona fide commercial reasons

- The asset was bought and used wholly and exclusively for the purposes of the business
- There was a bona fide business reason for its replacement and the timing thereof

3.5 Stamp Duty: Clawback of First-time buyer's relief for employees seconded abroad

Impacted Group: First time buyers seconded abroad who are owner/occupiers

Issue

The ITI has welcomed the changes introduced by Finance (No. 2) Act 2007 exempting first-time buyer owner/occupiers of second-hand property from stamp duty. This very positive measure will provide support for an economically important group of Ireland's working population. Notwithstanding these positive changes, difficulties remain for Irish individuals who have benefited from either the old first-time buyer regime or the new exemption in circumstances where they are seconded abroad by their employers.

Consequence

Under either the new or old first-time buyers' regime the relevant relief is clawed back if within the 5 years commencing with the date of execution of the deed, the property ceases to be occupied as the principal place of residence of the purchaser and rent is received. The cost of this clawback can be extremely high. It is causing difficulties for employees who are required by their employers to work abroad for an extended period of time with the result that they no longer occupy the property as their principal residence and rent it out. This legislation is bringing about unnecessary resource issues and is significantly increasing the cost of sending employees abroad to work as many employers have no option but to reimburse their employees for the cost of the stamp duty clawback.

Proposed solution

In the same work-related circumstances, for the purpose of principal private residence relief from CGT, which is governed by Section 604 TCA, employees are not penalised for work-related periods of absence. ITI asks that similar relieving provisions be introduced for Stamp Duty in the circumstances detailed above with appropriate certification being provided to support the absence due to employment abroad.

3.6 Capital Acquisitions Tax (CAT) Dwelling-house exemption for co-habiting people

Impacted Group: Co-habiting individuals wishing to gift a dwelling-house between them

Issue

Finance Act 2007 introduced restrictions to the dwelling house exemption from CAT. One of the main requirements for dwelling-house relief is that the donee be living in the house for the 3 years prior to the gift or inheritance. The new restrictions now exclude a beneficiary from claiming dwelling-house relief on a gift where the recipient of the benefit was living with the donor at any time in the 3 years pre-transfer. (This exclusion does not apply if the donor is dependent upon the co-habiting donee by reason of old age and/or infirmity.) A further restriction introduced in 2007 is that the property occupied by the donee in the 3 year period must have been owned by the disponer throughout that entire period.

Consequence

The effects of disallowing a period of co-habitation by the donor and recipient from the 3-year requirement that the recipient be living in the house are two-fold. Firstly, the restriction makes it impossible for co-habiting siblings to gift the house from one to another without suffering a significant CAT charge. Secondly, the same is true in the case of unmarried individuals who are co-habiting.

The dwelling-house exemption was originally introduced as "brother/sister" relief to cover a situation where two elderly siblings live together and one receives the property from the other but did not have resources to pay CAT on the inheritance. The relief was later extended to cover all dwelling-houses and we understand that part of the rational for this extension was to aid one unmarried partner who received a gift of the dwelling-house from the other. The fact that dwelling-house relief from CAT is now not available to any of these people is causing serious hardship in circumstances which have become a modern, social norm in Ireland.

Aside from the personal reasons for people wishing to co-habit, a gift is often a desirable tool for protecting an individual's estate against claims from persons other than, for example, their surviving partner. Such gifts are already subject to tax in the form of stamp duty but the fact that the gift is no longer exempt from CAT in the most frequently occurring circumstances makes it prohibitive.

Proposed solution

We understand that the Finance Act 2007 changes were introduced to deal with certain situations that could have been interpreted as being structured for the purposes of avoiding tax. However, the individuals and circumstances that are actually being affected by the new legislation are not, we believe, the group to whom it was intended the changes would apply. For this reason we ask that the 2007 restriction be revisited and that the exclusion from the dwelling-house relief of individuals who had been co-habiting during the 3-years pre-transfer be reconsidered.

3.7 CAT/CGT overlap causing double taxation

Impacted Group: Beneficiaries of Inheritances

Issue

Section 573 TCA provides that where an asset is taken from an estate, the base cost for a later disposal of that asset, e.g., by personal representatives or a legatee, is the market value at date of death. In contrast, the Capital Acquisitions Tax (CAT) legislation provides that where a beneficiary inherits an asset, the value of the asset will be established as at the valuation date, as defined by Section 30 CAT Consolidation Act (CATCA) 2003.

The focus of the definition in Section 30 is that the valuation date will be the date the beneficiary becomes beneficially entitled to the asset or to call for it. In some cases this will be the date of death, though for most assets passing through an estate the valuation date will be the date of Grant of Probate. The date of Grant of Probate can typically be several months after the date of death.

Consequence

If a rise in value occurs between the date of death and the date of the Grant of Probate, the beneficiary can be subject to double taxation on a subsequent sale of this inherited asset. This can be best illustrated by way of an example:

A property is inherited with a value in date of death of 15 December 2006 of €1 million. At the valuation date, the Grant of Probate, it is valued at €1.1 million. The beneficiary pays CAT on the €1.1 million, meaning the €100,000 is subject to CAT. On a subsequent sale of the property the base cost, which is allowable, is the €1 million value at the date of death. Accordingly, the beneficiary is also subject to CGT on the €100,000 increase in value.

This issue arises not only in relation to property but in any market with volatile assets, e.g., share dealings. The above situation is at odds with the fundamental tenet of any good tax system namely that a taxpayer will not suffer double taxation on a single rise in value.

Proposed Solution

This inequitable situation would not arise if the base cost of an asset for CGT purposes was the value at the date of death or the value as at the valuation date, whichever is greater. We ask that consideration be given to amending the legislation to remove this unjust double taxation.

3.8 VAT on Property

The ITI has been engaged in the Consultation Process carried out by the VAT on Property Review group and has made submissions on the subject under the auspices of the group. We look forward to engaging further with the Department of Finance and the Office of the Revenue Commissioners as the consultation process continues.

3.8.1 Legal services connected with property

Impacted Group: Taxpayers involved in property transactions

We refer to our Finance Bill 2007 submission which also included a representation on this issue. Article 9(2)(e) of the Sixth Council Directive (77/388/EEC), now Article 56(1)(c) Council Directive 2006/112/EC, provides that the place of supply of:

"… the services of consultants … lawyers … and other similar services"

shall be the place where the customer has established his business if the customer is either established outside the EU or is established in another EU country and is a taxable person.

This provision is not currently reflected correctly in Irish law as the Fourth Schedule to the VAT Act 1972 contains an exclusion from this place of supply rule for "services connected with immovable goods". The effect is to render such services as supplied where the property is situated. Such a fundamental variation from EU law is not permitted and ITI requests that this anomaly be removed.

3.9 Close company rules

Impacted group: Knowledge economy

Issue
Section 441 TCA 1997 imposes a surcharge on the undistributed income of service companies. A service company includes a "close company whose business consists of or includes the carrying on of a profession or the provision of professional services". Revenue Tax Briefing Issue 48 lists a number of activities as being professions which fall within the provisions of Section 441. This list includes a Computer Programmer and a Management Consultant. The ITI understands the reason behind the creation of the close company rules and indeed the professional services surcharge. We do, however, question whether or not the need for this type of legislation remains in the current economic climate in Ireland.

Consequences
Where a newly formed close company carries on a trade consisting of, for example, computer programming and management consulting, the income from its activities will be brought within the surcharge legislation. When a new company is in the growth stage of its life cycle a capital-reinvestment need exists in order to further the company's growth and generate further business and employment. As already mentioned in this submission, the government has made it clear in its "Programme for Government" that it is committed to supporting knowledge-driven industries. Accordingly, it seems absurd that a new enterprise would be penalised by a close company surcharge for the retention of profits when the reason for retaining profits in the company is for the purpose of growing the business and not for the avoidance of tax.

Proposed solution
The ITI would greatly appreciate the opportunity to discuss the justification for the close company rules remaining as they are given the current economic climate. We believe that through this discussion, an alternative to the professional services surcharge, and perhaps other aspects of the close company rules, may emerge to the mutual satisfaction of Department of Finance, Revenue and taxpayers alike. Perhaps some research could be carried out into establishing approved reinvestment mechanisms into which a company could place profits in order to expand the business in the future. Such a solution would satisfy any need to curb tax "avoidance" while supporting enterprise.