STOP tax dodging

# Hidden profits:

## The EU's role in supporting an unjust global tax system 2014

**A report coordinated by Eurodad**

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# Glossary

### Automatic Exchange of Information
A system whereby relevant information about the wealth and income of a taxpayer - individual or company - is automatically passed by the country where the income is earned to the taxpayer's country of residence. As a result, the tax authority of a tax payer's country of residence can check its tax records to verify that the taxpayer has accurately reported their foreign-source income.

### Base Erosion and Profit Shifting
This term is used to describe the shifting of taxable income out of countries where the income was earned, usually to zero - or low-tax countries, which results in 'erosion' of the tax base of the countries affected, and therefore reduces their revenues.

### Beneficial ownership
A legal term used to describe anyone who has the benefit of ownership of an asset (for example, bank account, trust, property) and yet nominally does not own the asset because it is registered under another name.

### Country by country reporting
Country by country reporting would require transnational companies to provide a breakdown of profits earned and taxes paid and accrued, as well as an overview of their economic activity in every country where they have subsidiaries, including offshore jurisdictions. As a minimum, it would include disclosure of the following information by each transnational corporation in its annual financial statement:

- A global overview of the corporation (or group): The name of each country where it operates and the names of all its subsidiary companies trading in each country of operation.
- The financial performance of the group in every country where it operates, making the distinction between sales within the group and to other companies, including profits, sales and purchases.
- The number of employees in each country where the company operates.
- The assets: All the property the company owns in that country, its value and cost to maintain.
- Tax information i.e. full details of the amounts owed and actually paid for each specific tax.

### Harmful tax practices
Harmful tax practices are policies that have negative spillover effects on taxation in other countries, for example, by eroding tax bases or distorting investments.

### Illicit financial flows
There are two definitions of illicit financial flows. It can refer to unrecorded private financial outflows involving capital that is illegally earned, transferred or utilised. In a broader sense, illicit financial flows can also be used to describe artificial arrangements that have been put in place with the purpose of circumventing the law or its spirit.

### Offshore jurisdictions or centres
Usually known as low-tax jurisdictions specialising in providing corporate and commercial services to non-resident offshore companies and individuals, and for the investment of offshore funds. This is often combined with a certain degree of secrecy. 'Offshore' can be used as another word for tax havens or secrecy jurisdictions.

### Profit shifting
See 'Base erosion and profit shifting'.

### Special purpose entity
Special purpose entities, in some countries known as special purpose vehicles or special financial institutions, are legal entities constructed to fulfil a narrow and specific purpose. Special purpose entities are used to channel funds to and from third countries and are commonly established in countries that provide specific tax benefits for such entities.

### Tax avoidance
Technically legal activity that results in the minimisation of tax payments.

### Tax evasion
Illegal activity that results in not paying or under-paying taxes.

### Tax-related capital flight
For the purposes of this report, tax-related capital flight is defined as the process whereby wealth holders, both individuals and companies, perform activities to ensure the transfer of their funds and other assets offshore rather than into the banks of the country where the wealth is generated. The result is that assets and income are often not declared for tax purposes in the country where a person resides or where a company has generated its wealth. This report is not only concerned with illegal activities related to tax evasion, but also the overall moral obligation to pay taxes and governments' responsibility to regulate accordingly to ensure this happens. Therefore, this broad definition of tax-related capital flight is applied throughout the report.

### Tax treaty
A legal agreement between jurisdictions to determine the cross-border tax regulation and means of cooperation between the two jurisdictions. Tax treaties often revolve around questions about which of the jurisdictions has the right to tax cross-border activities and at what rate. Tax treaties can also include provisions for the exchange of tax information between the jurisdictions but for the purpose of this report, treaties that only relate to information exchange (so called Tax Information Exchange Agreements (TIEA)) are considered to be something separate from tax treaties that regulate cross-border taxation. TIEAs are therefore not included in the term tax treaty.

# Acronyms

| | |
|---|---|
| **AIE** | Automatic Information Exchange |
| **AFD** | French Development Agency |
| **AJPES** | Republic of Slovenia Agency for Public Legal Records and Related Services |
| **AMLD** | Anti-Money Laundering Directive |
| **ATR** | Advance Tax Ruling |
| **CBCR** | Country by country reporting |
| **CCCTB** | Common Consolidated Corporation Tax Base |
| **CDIS** | Consolidated Direct Investment Statistics |
| **CFC** | Controlled Foreign Companies |
| **CSD** | Central Securities Depository |
| **CSO** | Civil society organisation |
| **DTT** | Double Taxation Treaty |
| **EC** | European Commission |
| **EP** | European Parliament |
| **EPP** | European People's Party |
| **EU** | European Union |
| **FDI** | Foreign Direct Investment |
| **FfD** | Financing for Development |
| **FSI** | Financial Secrecy Index |
| **GDP** | Gross Domestic Product |
| **GNI** | Gross National Income |
| **IDA** | Irish Industrial Development Agency |
| **IFSC** | Irish Financial Services Centre |
| **IMF** | International Monetary Fund |
| **LDCs** | Least Developed Countries |
| **LLP** | Limited Liability Partnership |
| **MoF** | Ministry of Finance |
| **NFIA** | Netherlands Foreign Investment Agency |
| **ODA** | Official Development Assistance |
| **OECD** | Organisation for Economic Co-operation and Development |
| **OFCs** | Offshore Financial Centres |
| **PwC** | PricewaterhouseCoopers |
| **S&D** | Socialists and Democrats |
| **SEZ** | Special Economic Zone |
| **SFI** | Special Financial Institution |
| **SPE** | Special Purpose Entity |
| **SPV** | Special Purpose Vehicle |
| **TIEA** | Tax Information Exchange Agreement |
| **UN** | United Nations |
| **UNCTAD** | United Nations Conference on Trade and Development |
| **VAT** | Value Added Tax |

# Ireland

**'Ireland has been one of the frontrunners, and will be, in regard to building a new international consensus [on aggressive tax planning and profit shifting].'**

*Enda Kenny, Irish Prime Minister.*[251]

## General overview

Ireland came under serious criticism worldwide for facilitating corporate tax dodging during 2014. For instance, Apple's Irish operations have been the subject of an investigation both by the US Senate and more recently, as discussed below, by the European Commission.

A European Expert Group report shows that Apple paid just 3.7% tax on non-US profits of $31bn last year.[252] Recent media reports have suggested that the EC investigation may go beyond Apple.[253] Despite growing critiques of Ireland's tax regime, and negative media attention both internationally and domestically, the Irish Government has responded to the EC's preliminary view on the Apple case by strongly defending the country's tax practices with regard to the company. The government is also emphasising its commitment to international tax transparency, without seeming to recognise the two issues as contradictory.[254] To date, it seems Ireland is changing its corporation taxation policies only within collective EU or OECD actions, or when it comes under serious external pressure to do so.

## Tax policies

### Taxation of transnational corporations

The Industrial Development Agency (IDA) is responsible for the attraction of foreign investment to Ireland.[255] The IDA states that:

"thanks to our attractive tax, regulatory and legal regime, combined with our open and accommodating business environment, Ireland's status as a world-class location for international business is well established [...] In recent years Ireland has increasingly emerged as a favoured onshore location for [transnational corporations] establishing regional or global headquarters to manage their corporate structure and head office functions associated with their international businesses".[256]

Part of Ireland's attractiveness to transnational corporations is the Research and Development (R&D) tax credit - in place since 2004 - which allows companies to receive 25% tax credit for offset against a corporation tax rate of only 12.5%. All new companies setting up an R&D operation can receive the credit on all qualifying R&D expenditure.[257] Furthermore, Ireland has an intellectual property (IP) regime which provides a tax write-off for very broadly defined IP acquisitions.[258] In 2009, an incentive was introduced for expenditure incurred on the acquisition of intangible assets, such as patents, copyright or design right or invention.[259] In the international debate about corporate tax avoidance through profit shifting, such 'intangibles' are highlighted as one of the mechanisms corporations use to transfer profits from the countries where the real economic activity takes place into jurisdictions where the profits will be taxed less or not at all.[260]

There are no public estimates of foregone revenue due to these tax exemptions. Ireland has a general anti-abuse rule in national legislation - Section 811 of the Taxes Consolidation Act 1997.[261]

In October 2013, the Finance Bill included an amendment to Irish corporation tax residency rules to ensure that an Irish incorporated company (such as Apple) cannot be 'stateless' in terms of its place of tax residence.[262]

Ireland's much debated corporate tax rate, which is vigorously defended by the government[263], is 12.5% on active trading income (compared to the EU-28 average of 22.9%[264]); 25% on passive non-trading income, and currently 33% on capital gains.[265] Eurostat estimates that in 2012 the average effective tax rate for corporations in Ireland was as low as 6%[266], most likely due to Ireland's significant array of tax breaks and low levels of regulation.

The Irish Revenue Commissioners and the Irish Department of Finance state that they do not encourage transfer pricing abuse in any way. However, the Irish Revenue Commissioners leave the responsibility of proving any misconduct firmly with the country that may be losing revenue, despite the lack of capacity in the Global South to track tax avoidance or evasion.[267]

## Box 3: The "Double Irish"

The "Double Irish" is a scheme that is used by large companies to channel certain payments through Ireland and onward to lower tax jurisdictions, reducing their overall tax bills enormously. For example, according to the Irish Times, Google's Irish-based operation had revenues of around €15.5 billion during 2012, but ended up paying corporation tax of just €17 million. This was because it charged "administrative expenses" of almost €11 billion, including royalties paid to other Google entities abroad, partly to low tax jurisdictions such as Bermuda.[268] The government announced in its Budget for 2015 that the 'Double Irish' will be phased out by 2020. However, a new range of tax incentives will be introduced for companies, including in the areas of research and development, and intellectual property activity including a 'Knowledge Development Box'.[269]

## Potentially harmful tax practices

### Secret deals?

PricewaterhouseCoopers points out that the Irish tax authorities have, upon request, provided inward investors with Advance Tax Rulings (ATRs) on key issues relevant to the decision to establish operations in Ireland.[270] Indeed, the European Commission's investigation into Ireland's tax system is investigating advance opinions to three corporate groups in the Netherlands, Luxemburg and Ireland.[271] Ireland does not systematically publicly disclose either APAs or ATRs provided for transnational corporations, nor any analysis of potential revenue lost due to these rulings. However, the spectre of such 'secret deals' is very much in the limelight in 2014, with the Financial Times reporting that 'Apple rode to riches totalling $137.7bn in offshore cash with the help of the Irish taxpayer'.[272]

In September 2014, the European Commission (EC) concluded that two tax rulings granted by the Irish government in favour of Apple in 1991 and 2007 constitute state aid which may not be compatible with the internal market.[273] The EC's 'opening decision' letter on this matter shows that Ireland's tax rulings regarding Apple are contestable on a number of factors, including that: the rulings do not comply with the 'arm's length' principle in the transfer pricing methods used or do not seem to be based on any clear pricing methodology; the profit allocated by Apple to Ireland may be questionable and the tax advantages granted by Ireland were not periodically reviewed as per good practice.[274]

Indeed, the disclosure by the EC of notes of meetings between Irish Revenue and Apple at the time reveal a deeply inappropriate negotiation on the basis of job creation, rather than one based on clear accounting procedures and the tax obligations of the company. The Commission has requested that Ireland submit comments and provide any further information useful to the assessment of the situation by the end of October 2014.[275] This matter may continue into the next 18 months.

At the time of writing the Irish Prime Minister, Taoiseach Enda Kenny, has denied any special treatment for Apple despite the clear evidence to the contrary, revealed through the EC investigation[276], and continues to strongly defend Ireland's overall tax regime.

### Special Purpose Vehicles

The result of Ireland's favourable tax regime is that, according to law firm Arthur Cox: "Ireland has... firmly established itself as a location of choice for the establishment of special purpose vehicles (SPVs) for structured finance transactions,"[277] and a favourable tax regime is mentioned as an attractive factor.[278] Meanwhile, the Irish Industrial Development Agency tries to attract foreign direct investment by highlighting key characteristics of special purpose entities: namely a favourable tax regime, no withholding tax on dividends paid to or from relevant treaty countries, and the ability to minimise withholding tax on inbound and outbound royalties and interest payments.[279]

In 2013, one Irish academic reported that 742 Financial Vehicle Corporations (FVC) - a type of special purpose vehicle - are located in Ireland.[280] The Central Bank of Ireland reports that "total FVC assets values reported in Q1 2014 increased to €421.9 billion."[281]

The Irish Financial Services Centre (IFSC) in Dublin dominates foreign investment in the Irish economy, much of which is suspected to involve SPEs.[282] In 2011, IFSC investment was over 20 times the size of non-IFSC foreign direct investment and over 17 times the size of the gross national product (GNP) of Ireland.[283] Section 110 of the Taxes Consolidation Act 1997 is the cornerstone of Ireland's securitisation regime, which, according to Arthur Cox, permits qualifying Irish resident SPEs to engage in an extensive range of financial and leasing transactions in a 'tax neutral' manner.[284] In 2011, the Minister for Finance stated that as there was no specific statistical code for companies that use Section 110, it was not possible to provide information on any audits carried out on such companies, nor their tax yields. In 2014, the government maintains the position that Ireland does not have a specific definition for a "Special Purpose Entity" (SPEs), and therefore cannot provide a definitive response in respect to questions about SPEs.[285]

### Tax Treaties

Ireland has signed tax treaties with 71 countries, of which 25 are with developing countries.[286] At the time of writing the most recent treaties to come into effect are with Thailand and Botswana[287], while an agreement with Ukraine still has to go before the Parliament. These treaties cover direct taxes, which in the case of Ireland are income tax, corporation tax and capital gains tax.[288] In all new treaties, Ireland now includes an exchange of information clause.[289] However, it is unclear if any provisions are made to ensure that information can be exchanged on an automatic or spontaneous basis, or what information is available to be exchanged.

The government has stated that there is no general rule on whether Irish tax treaties with developing countries allow those countries to apply withholding tax on outgoing capital flows, but that each tax treaty negotiation is "based on meeting the needs of both sides, and that in some instances Ireland does have tax treaties that apply withholding taxes on royalty payments or… allow source taxation rights for other income arising in a contracting state."[290]

In general, however, the withholding tax rates applied in its treaties with developing countries have been significantly reduced. On average, the rates have been negotiated down by 3.2 percentage points which is more than the average for the 15 European countries covered in this report.[291]

Ireland's original tax treaty with Zambia - one of Ireland's nine key development cooperation partner countries – is a case in point of how Ireland's treaties can undermine development. According to estimates, this treaty may have deprived Zambia of revenues equivalent to €1 in every €14 of Irish development aid to Zambia, an issue of policy coherence for the Irish government.[292] There is hope, however, that the situation may improve as the Government of Zambia has asked for a renegotiation of its treaty with Ireland.[293] Experts have suggested that Ireland could prioritise the negotiation of transparent and fair treaties following the UN model[294], and the renegotiation with Zambia could present an opportunity to attempt this for the first time.

The Department of Finance has stated that a list of the developing countries with which treaty negotiations are planned is "not available".[295] However, data from the International Bureau of Fiscal Documentation (IBFD) shows that negotiations for new treaties are currently taking place with Jordan and Azerbaijan.[296] In its practice, Ireland largely favours the OECD model for tax treaty negotiations, even when they are agreed with developing countries, rather than the UN model.

### Impacts on developing countries

In relation to developing countries and policy coherence for development, the Irish government argues that it is working "both at an international level to combat illicit financial flows and capital flight, and at a national level to strengthen revenue collection and management that can allow them to eventually exit from a dependence on ODA."[297] In 2014, Ireland commissioned a spillover analysis with the objective of researching what impact, positive or negative, Ireland's tax system may have on the economies of developing countries.[298] The credibility of the spillover analysis, to be published in November 2014, and any action taken following it, will reveal whether Ireland intends to continue to be a part of a broken international tax system which currently works against the interests of countries in the Global South, or whether it will take a step towards policy coherence and working for global tax justice.

## Financial and corporate transparency

One reason why Ireland is an attractive location for special purpose entities is the lack of financial and company transparency. Ireland's position is that beneficial ownership of companies should be known and that provisions are already in place when authorities require this knowledge about companies and trusts which are subject to reporting requirements to authorities. However, the government has not committed to a publicly accessible register of this information. The government "is awaiting final agreement of the specific provisions in the text with the European Parliament before commencing with the cross-Departmental transposition work on the proposed 4th Anti-Money Laundering Directive."[299]

The Irish government does not require transnational corporations in any sector to provide an annual public account of the turnover, number of employees, subsidies received, profits made, and taxes paid. The government has stated support for the OECD's Action Plan on Base Erosion and Profit Shifting Action Point 13 on the development of rules on transfer pricing documentation to enhance transparency, which includes country by country reporting, and has stated that Ireland "will likely adopt this recommendation when it is finalised, but this will not happen before end of 2014".[300] It should be noted that the OECD governments have already decided that the information from country by country reporting under the BEPS Action Plan should not be available to the public and thus implementation of the OECD guidelines would be insufficient to ensure proper transparency.[301]

The government does not respond to questions on economic activities of a range of companies in Ireland, including Google, citing "taxpayer confidentiality". Information can be accessed via the Companies Registry Office, including details of a company's name and previous name, registered office, company type, incorporation and annual return details, charges secured against it, directors and secretary, but no detailed country by country information or shareholder registries are publicly available.

## Global solutions

### Automatic Information Exchange (AIE)

In relation to Automatic Information Exchange (AIE) on tax matters, the government has stated that data protection structures, confidentiality and data security are the critical elements in any automatic exchange of information, and that "these are typically, although not always, associated with maturity of a tax administration and will be key criteria for Ireland in deciding which partner jurisdictions with whom to exchange information".[302] The response indicates that the government is open to Automatic Information Exchange, but that it is cautious about exchanging tax information with countries with low levels of resources and weak tax administrations, in other words the poorest countries who are most in need of reliable information on the tax activities of the transnational firms operating within their borders.

### Inclusion of Global South countries

In 2013, the Irish government stated that 'While a proposal to establish an intergovernmental body on tax matters under the auspices of the United Nations may have merit, solutions need to be developed to BEPS and other issues and the OECD is well placed to develop these solutions'.[303] In 2014, the government did not directly answer this question on the role of the UN, but stated that the UN has a seat at the table of the OECD's Committee on Fiscal Affairs.[304] It is therefore clear that the Irish government supports the OECD as the leading negotiating forum for decision-making on global tax matters, rather than a more democratic and inclusive forum, such as the UN.

## Conclusion

Ireland's tax model facilitates a significant presence of Special Purpose Entities (SPEs) that lack real economic substance in the Irish economy. The Irish government sees its low corporate tax rate, set of tax incentives and light regulatory environment as a cornerstone of the country's economic policy, and a route to attracting high levels of FDI, which implicitly is assumed to have substance in real investments. However, as the significant presence of SPEs shows, this is not always the case. While real and valuable jobs have been created through some multinational companies' presence in Ireland, the Apple case exposed an instance of highly dubious procedure between it and Irish Revenue, a procedure which allowed Apple to avoid enormous tax payments at the expense of people in Ireland and in other countries. It raises the urgent question of how extensive this kind of practice has been, or continues to be, in the Irish tax system.

Despite international criticism, the Irish Government is unapologetic about promoting Ireland internationally as a low tax location for companies. The ongoing spillover analysis will be one opportunity for the government to analyse the impact of these tax policies on the economies of countries of the Global South and fulfil its commitment to policy coherence for development. As part of this work, the Irish government should follow up on its commitment to fight illicit financial flows at the international level by pro-actively supporting an intergovernmental process on tax matters under the UN. It should further support countries of the Global South by using the UN model treaty. And while the government states that it supports global tax transparency, this can only be proven through its actions. Namely by establishing a public register of beneficial owners of companies and trusts, adopting publicly accessible country by country reporting, and supporting AIE for all countries, including those of the Global South.

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[257] Ibid. p. 10.

[258] Ibid. p. 11.

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