Submission to the Department of Finance R&D Tax Credit Consultation
April 12th 2013

We joint civil society agencies – Christian Aid, TASC and Debt and Development Coalition Ireland - welcome the Department of Finance's invitation for submissions on the R&D Tax Credit. Policy coherence is a stated aim of the Irish government, while the Lisbon Treaty enshrines a commitment to greater policy coherence across government. In this context, all aspects of government policy, including that which relates to how we incentivise foreign direct investment, should be assessed against what impact those policy decisions may have on developing countries.

We acknowledge the strategic aims behind the R&D tax credit, namely fostering innovation and research in Ireland and driving future employment and growth. We also recognise the need for Ireland to remain competitive internationally in terms of attracting and retaining sustainable foreign direct investment.

However, we are concerned that the Terms of Reference for the Department of Finance's Review of the R&D Tax Credit do not include reference to the potential for the R&D credit to be used (or abused) in ways that may impact negatively on developing countries.

Profit shifting through activities such as transfer mispricing is a well-established feature of many, though not all, multinational companies' approach to their international tax obligations. Where developed countries offer minimal tax burdens on corporation profit, companies are incentivised to shift profits to such countries in order to reduce their overall tax liability. Where such companies have a presence in developing countries, such activities deprive these developing countries of badly-needed tax revenue.

Through locating intellectual property (IP) rights in developed countries such as Ireland, multinationals have the ability to declare these IP rights as a large share of their profits on products developed in other jurisdictions, including in developing countries. R&D tax credits, in reducing a company's effective tax rate, have the potential to incentivise multinationals to accumulate intellectual property rights in Ireland.[1] Group companies qualify for a group rate, whereby the credit may be allocated to other companies within the group, "if one is a 51 per cent subsidiary of the other, or both are 51 per cent subsidiaries of a third company, irrespective of the country of residence of each company".[2] As set out below, such group interactions are often the most difficult to monitor in terms of transfer mispricing, as they are more intangible.

While the Department of Finance has expressed confidence in the 'arms-length principle' as a tool to detect and prevent transfer mispricing, and while reference is made to the principle in the Finance Acts of 2009 and 2010, it is only a somewhat effective tool for the supply of goods between subsidiaries of a group company. When it comes to charges, e.g. for royalties for intellectual property, management fees, etc., it is much more difficult to detect the arms-length market price for such transactions. Thus tax expenditure such as R&D credits is more liable to manipulation for the purposes of tax avoidance. Consequently, there is an extra need for government to monitor such tax expenditure to ensure it is not an unintended vehicle for tax avoidance.

The patent income exemption was abolished in the 2011 Finance Act. Prior to this, it was part of a package of credits and exemptions in R&D and intellectual property. However, even without the patent income exemption, there remains a need to investigate the potential of the R&D tax credit as a means of avoiding tax bills in other countries, including developing countries.

The R&D credit reduces qualifying firms' tax rate significantly below the standard 12.5% corporation tax rate. In addition, the option of passing the R&D tax credit to key employees who are not owners or directors (and therefore not local SMEs) further increases the risk of making R&D a potential focus for tax avoidance by MNCs.

As reported in The Irish Times, as late as September 2012, the US Senate Homeland Security and Governmental Affairs Subcommittee on Investigations found that Microsoft used subsidiaries in Ireland and elsewhere to reduce its US tax bill for 2011 by €1.87bn.[3] This was done in part by using the architecture of R&D tax credits and intellectual property rights in Ireland:

> "Microsoft Corporation has used aggressive transfer pricing transactions to shift its intellectual property, a mobile asset, to subsidiaries in Puerto Rico, Ireland, and Singapore, which are low or no tax jurisdictions, in part to avoid or reduce its U.S. taxes on the profits generated by assets sold by its offshore entities."
> *Statement by Committee, 20 September 2012*

In 2011, Microsoft's subsidiary, Microsoft Ireland Research, paid 30% of Microsoft's overall research costs.[4] In the same year, MIR declared profits of $4.3bn, with 390 employees based in Ireland. Profit which is made by Microsoft through sales and production in developing countries and then booked in Ireland deprives these countries of tax revenue. This shift in profit is motivated in large part by the R&D tax credit, which along with intellectual property rights is especially vital for IT companies.

In 2001 Microsoft set up another Irish subsidiary, Round Island One, based in Dublin. By 2004 it controlled 22% of Microsoft's overall profits and $16bn of its assets. This subsidiary controls licensing rights to Microsoft software in Europe, the Middle East and Africa. Through Round Island One, Microsoft has moved much of its IP to Ireland from units located elsewhere.[5]

The recent OECD report on Base Erosion and Profit Shifting reinforces these concerns. The report was notable for the forthright language with which the organisation usually constrained in its statements by the language of international diplomacy- warned of the increasing problem of aggressive tax avoidance, which it said was damaging the global economy and represented a threat to democracy itself. It noted that the international tax system - created decades ago - has been unable to keep up with increasingly sophisticated tax planning by multinational corporations. Most significantly, international tax rules treat the different subsidiaries of multinationals as separate independent companies, whereas in many cases they are in effect a single entity. Given Ireland's membership of the OECD, we believe it would be reasonable to expect the Irish government to seriously consider the OECD's recommendations, and to expect that such aggressive tax avoidance and its development consequences be considered as key aspects of a review of elements of Irish tax policy - including the role played by R&D credits.

The OECD Report, released in February 2013, came on foot of a series of statements by G20 members: in June 2012 the G20 leaders' Final Declaration referred to the problem of base erosion and profit shifting, which was reiterated by G20 Finance Ministers in November 2012. In the same month, the Finance Ministers of UK and Germany released a Joint Statement calling for coordinated action, which was supported by the French Finance Minister. There is clearly momentum from European policymakers, not only from civil society, on the issue of tax avoidance. Ireland would do well to consider what action it can take at domestic level and how it can positively influence a determined effort at European and international level to tackle tax avoidance, which can have such disastrous consequences for badly-needed revenues of developing countries. Prolonging the status quo in which large multinationals continue to make huge profit in part through the legal but morally questionable practice of transfer pricing profit shifting while developing countries remain reliant on aid, damages public confidence in a fair taxation system and potentially damages Ireland's reputation as a jurisdiction with a transparent and accountable taxation system.

The period from 2005 to 2007 saw a €5.8bn capital flow into Ireland arising from transfer mispricing, of which €268m came from the poorest 49 countries in the world.[6] In a context where at least €160bn is lost annually by developing countries to tax dodging, there is a need for Ireland to examine its tax policy to consider its possible deleterious impact on developing countries, most notably those countries in which Ireland funds Irish Aid programmes.[7] A review of any aspect of our fiscal policy must take into account such a fundamental policy incoherence, studying in particular their impact from a development angle.

We would also urge the Department, as part of its public consultation to consider the following:

- Conduct a spill over analysis of Ireland's tax policy, as recommended by the 2011 joint report by the OECD/UN/IMF/World Bank on supporting more effective taxation systems. The report advised G-20 countries to undertake 'spill over analyses of any proposed changes to their tax systems that may have a significant impact on the fiscal circumstances of developing countries'.[8]

- The UN model of multi-lateral tax treaties would enable developing countries to apply withholding taxes, thus facilitating a better deal for such countries in negotiating tax treaties. The OECD model, by contrast, does not. Ireland should shift to adopting the UN model as a template for tax treaties with developing countries and support efforts to strengthen and upgrade the UN Committee of Experts on matters of international taxation.[9]

- Develop criteria for genuinely innovative R&D and limit the credit to this to ensure that Ireland is not used as a site for tax avoidance by MNCs, while genuinely supporting Ireland's commitment to becoming a centre for agenda-setting research and development. [10]

[1] S Killian "*Driving the Getaway Car? Ireland, Tax and Development*" March 2011 ; http://www.debtireland.org/download/pdf/driving_the_getaway.pdf

[2] Revenue Commissioners, *Revenue Guidelines for Research and Development Tax Credits,* December 2012. http://www.revenue.ie/en/tax/ct/leaflets/research-dev.pdf

[3] U.S. Senate Committee on Homeland Security & Governmental Affairs, *Subcommittee Hearing to Examine Billions of Dollars in U.S. Tax Avoidance By Multinational Corporations,* 20 September 2012. http://www.hsgac.senate.gov/subcommittees/investigations/media/subcommittee-hearing-to-examine_billions-of-dollars-in-us-tax-avoidance-by-multinational-corporations-

[4] C Keena "*Irish subsidiaries helped Microsoft reduce US tax bill by €1.87bn in 2011*" 22 September 2012, http://www.irishtimes.com/business/sectors/technology/irish-subsidiaries-helped-microsoft-reduce-us-tax-bill-by-1-87bn-in-2011-1.535939?page=2

[5] TASC, *Tax Injustice: Following the Tax Trail*, September 2012, http://www.tascnet.ie/upload/file/2055%20Tasc%20Booklet%20A4%2044pg_LR%20WEB.pdf

[6] McNair et al., "Tax Justice: The Impact of Global Tax Policy on Developing Countries and the Role Ireland Can Play" *Trocaire Development Review,* 77-96

[7] Christian Aid, *Death and Taxes: The True Toll of Tax Dodging,* 2008 http://www.christianaid.org.uk/images/deathandtaxes.pdf

[8] OECD, UN, IMF, World Bank, *Supporting the Development of More Effective Tax Systems,* 2011

[9] S Killian "*Driving the Getaway Car? Ireland, Tax and Development*" March 2011 ; http://www.debtireland.org/download/pdf/driving_the_getaway.pdf

[10] Revenue Commissioners, *Revenue Guidelines for Research and Development Tax Credits,* December 2012. http://www.revenue.ie/en/tax/ct/leaflets/research-dev.pdf