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# Commission on Taxation

Dissecting the detail...  
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## Contact

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# Business & employment

## In this section...

- Commitment to low taxes
- Research and development (R&D) tax credit
- Patent income exemption
- Reform of capital allowances
- Zero-rating stamp duty on shares
- Taxation of dividends
- Taxation of gains on the disposal of trading assets
- Preliminary tax for companies
- Unilateral credit relief (UCR)
- Start-up businesses
- Close company provisions
- Business expansion scheme (BES) and Seed capital scheme (SCS) reliefs
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- Professional services withholding tax (PSWT)



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## Commitment to low taxes

There is a clear theme which emerges from the report that, broadly speaking, low tax on enterprise works for Ireland. This applies to both sides of the equation in a strong commitment to a “low stable rate” of corporation tax as a core aspect of Irish tax policy to support economic activity in the long term, but also recognising “the need to keep taxation on labour low and marginal rates competitive”. The commitment to corporation tax does send out yet another strong message to the foreign direct investment and indigenous sectors that the 12.5% rate of tax is here to stay.

## Research and development (R&D) tax credit

In its review of the R&D credit regime, the Commission recognised that a competitive system for attracting R&D is an integral part of the development of the knowledge based economy. The Commission considered whether further enhancements to the R&D regime were warranted. Their recommendation is to allow companies, at their option, to offset their R&D credit against their employer PRSI costs. If introduced, this facility would enable companies to take account of the total R&D tax credit ‘above the line’, thereby immediately impacting on the unit cost of R&D. This is particularly relevant in a multinational context, where investment decisions are often made on a plant by plant basis by reference to the pre-tax cost comparisons between the investment locations in different jurisdictions.

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## Patent income exemption

Section 234 TCA 1997 provides for an exemption from tax on certain income derived from patent royalties. Section 141 TCA 1997 extends that exemption from tax to certain distributions from exempted patent income. While the patent income exemption has been enshrined in legislation since 1976, its end has been much anticipated since the introduction of the R&D tax credit as the preferred fiscal tool to encourage innovation in the knowledge economy. The end of the exemption is now almost certain with the Commission's recommendation that the patent income exemption be discontinued. While the Report is not prescriptive as to how the exemption should be withdrawn, it would be prudent for those companies who avail of the exemption to accelerate any 2009 payments to ensure they are made before the next Budget date.

## Reform of capital allowances

The Report makes a number of recommendations to amend the legislation relating to capital

allowances. The most radical recommendation would see the alignment of the tax treatment of capital expenditure with the accounting treatment. The Commission points to a key difficulty with the current capital allowance regime in that it generally does not apply allowances to a time period which fits with the economic life of the business asset. If this recommendation is adopted it would certainly represent a simplification of the capital allowance rules which would be welcomed. It would mean that companies would need to carefully consider the accounts classification of some high value capital items. However, there are likely to be a number of sectors which would be negatively impacted by the proposed changes, aircraft leasing immediately comes to mind as a sector which would require a particular carve-out.

As part of the above recommendation, the Commission were conscious that because capital allowances are not available on many buildings, permitting a deduction for depreciation on all buildings would significantly reduce

the tax base on business income. To reflect that point, the Report is clear that the accounts depreciation should only replace capital allowances for buildings that qualify under the existing system, but depreciation should not be deductible for other buildings. As a separate recommendation, the Commission suggests that the definition of 'industrial buildings' be reviewed with a view to extending the classes of building that qualify. The example given is that of call centres, which are 'modern industrial buildings'. This in itself would be a significant change if implemented.

The other recommendations relating to capital allowances are summarised below:

- It is recommended that balancing charges should apply on industrial buildings regardless of the life of the building. This would be the case for any future acquisitions.
- Capital allowances for childcare facilities should be discontinued.
- The arrangements for the scheme of accelerated capital allowances

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for palliative care units should be modified by the introduction of a termination date for the scheme.

- The accelerated capital allowances for energy efficient equipment should continue.
- The investment allowance for machinery and plant and for exploration expenditure should be discontinued.

### Zero-rating stamp duty on shares

The Report recommends the reduction of stamp duty on transfers of shares from 1% to 0%. The Commission found that the 1% stamp duty on share transfers increases the cost of capital for Irish companies and has a negative impact on competitiveness and economic activity. The Report highlights the disadvantage that purchasers of Irish shares face compared to the UK where the rate is 0.5% and France, Germany, Italy, the Netherlands and Luxembourg, where duty on share transfers has been abolished.

The Commission initially considered reducing the rate of duty to 0.5% but decided a 0% rate would be more appropriate as:

- Due to current market conditions the cost of removal of the duty would be low.
- If the rate is reduced to 0.5% there may be temptation extend the charge to stamp duty to securities that are currently not stampable, e.g. unit trusts, investment undertakings, etc.
- The removal of the duty should encourage internationally mobile capital to locate and incorporate in Ireland

As the key rationale for the removal of this duty is to stimulate trading in quoted shares, the Report states that the retention of the duty on transfers of unquoted shares could be considered. Stamp duty on transfers of unquoted shares currently accounts for 12% of total stamp duty revenues on shares.

## Taxation of dividends

In the context of supporting economic activity, the Commission recommends that it is not appropriate for Irish-resident individuals to be paying a higher rate of tax on dividends than on deposit interest. Currently Irish-resident individuals pay tax at the marginal rate on dividend income, while the rate of tax on deposit interest income is 25%. The contention is that equalising the tax rate on dividend income and deposit interest would encourage investment in the productive sectors of the economy. Combined with proposals to eliminate stamp duty on shares, the recommendation would make this form of capital much more attractive to investors.

## Taxation of gains on the disposal of trading assets

The Report recommends that capital gains on the disposal of trading assets by companies should be taxed at the applicable corporation tax rate rather than, as is currently the case, at the capital gains tax rate of 25%. This

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would be a welcome move which would encourage companies to invest in their business for future growth.

### Preliminary tax for companies

'Large' companies, defined as companies with a corporation tax liability exceeding €200,000 in the preceding year, must pay preliminary tax based on an estimate of their current year's liability. The conclusion of the Commission is that the preliminary tax rules for 'large' companies impose a disproportionate compliance burden and cause significant uncertainty to business. The recommendation is to allow 'large' companies to base their preliminary tax payment on 100% of the previous year's figure rather than 90% of the estimated current year's liability.

### Unilateral credit relief (UCR)

The Report recommends that UCR be extended to all companies. UCR is a mechanism for Irish companies to get some credit against Irish tax for withholding taxes suffered in non-treaty countries. However, under

existing rules the relief is only available to companies subject to the 10% corporate tax rate (i.e. manufacturing companies). The issue is particularly relevant to the Irish software sector where many Irish companies face an incremental tax cost through the inability to relieve withholding taxes on royalty income deducted in non-treaty countries.

Extending the relief will improve the position of Irish companies expanding into foreign markets which are not yet covered by our treaty network. However, the Commission recognises that this measure alone will have limited impact. Typically the withholding tax is calculated on the gross amount of the payment, yet a credit would only be available against the Irish tax on the relevant profit. Accordingly, the Report also recommends that an overall foreign pooling system be introduced to allow any 'unused' credits to be offset against Irish tax on other foreign royalty income. Pooling arrangements for foreign tax paid on profits of overseas branches and on interest and dividend payments coming

into Ireland are already in place so this recommendation could be easily implemented, and would be welcome.

### Start-up businesses

Finance (No. 2) Act 2008 introduced a relief from corporation tax for companies commencing a new trade in 2009. Full relief from tax is granted where the total amount of corporation tax payable by a company for an accounting period does not exceed €40,000 (marginal relief is available where the tax payable does not exceed €60,000). The exemption is available for a period of three years from the commencement of the new trade.

The Commission recommends that this relief be extended within the existing three year timeframe to companies starting a trade in 2010 (for a two year period) and 2011 (for a one year period). In addition to this extension, the Commission recommends that the exclusion currently contained in the legislation in relation to service companies availing of the relief should be removed.

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The Commission has further recommended that a new scheme similar to that introduced for companies should be introduced for unincorporated businesses.

### Close company provisions

The Commission recommends that the close company surcharge which currently applies on the undistributed income of professional services companies be abolished.

The report also suggests that the surcharge which applies to undistributed investment and estate income be retained but that the current de minimis amount of €635 should be increased substantially to ease the regulatory burden on companies in such cases.

### Business expansion scheme (BES) and Seed capital scheme (SCS) reliefs

The current BES and SCS reliefs are due to expire at the end of 2013. The Commission recommends that these reliefs should remain in place until the expiry date of 31 December 2013, but that they should be reviewed to evaluate their effectiveness. In addition

it is suggested that the administrative burden on companies in relation to these schemes is onerous and should be reviewed.

### Transfers of business and farming assets

The Report recommends that capital gains tax (CGT) relief on transfers to family members should be continued but should be limited to transfers of assets with a value of up to €3m. CGT would apply as normal to any excess over €3m.

The Commission recommends that the current CGT retirement relief for disposal of a business or farm to non-family members be retained.

The Commission suggests that for gift and inheritance the tax purposes (CAT), the reduction applied to the market value to determine the taxable value of business or agricultural assets should be reduced to 75% (currently 90%) and that the total value eligible for the reduction should be capped at €3m.

### Venture fund managers

Finance (No. 2) Act 2008 provided a new incentive for venture fund

managers that invest in businesses that carry on research, development or innovation activities. The relief provides that the carried interest or return is taxed as a chargeable gain. The Report suggests that this should be amended as follows:

- Where the investment return on the carried interest represents income, it should be taxed at the marginal rate of income tax
- Where the investment return on the carried interest represents capital, it should be taxed as a chargeable gain

### Professional services withholding tax (PSWT)

The Commission recommends that in the case of compliant taxpayers who have the appropriate certification from Revenue, no professional services withholding tax should be deducted on payments made to those taxpayers by the various Government Departments, State Bodies, local authorities etc.

This would be a very welcome measure to improve cashflow for those businesses supplying the relevant professional services.

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