

Mr Brian Cowen T.D.
Tánaiste and Minister for Finance
Department of Finance
Upper Merrion Street
Dublin 2

19 February 2008

Dear Tánaiste,

Subject: Finance Bill 2008

The Irish Taxation Institute (ITI) welcomes Finance Bill 2008 and its creative use of tax policy in maintaining Ireland's competitive position and sustaining economic growth.

We are writing to you with a number of observations on the Bill as initiated and the list of Committee Stage amendments published on 15 February 2008. We hope that the matters raised might be given consideration during Committee Stage discussions.

Taxation of foreign dividends – section 39

Ireland has an attractive holding company regime which has been bolstered by the abolition of capital duty and the introduction of substantial shareholding relief in recent years. As regards foreign dividends, Section 39 is seeking to bring the Irish tax rules relating to such dividends in line with the recent ECJ decision in the *FII* case. Hopes had been raised that the requirement to change the Irish rules might be used as an opportunity to improve the attraction of Ireland as a holding company regime and in this regard the further enhancement of this regime which the above section provides goes some way to meeting this goal. Notwithstanding this, the consistent view expressed by our members at the forefront of liaising with potential FDI investors to Ireland is that the proposed new regime is very complex and difficult to explain to overseas companies.

While we welcome the reduction in the headline rate of tax on foreign dividends from 25% to 12.5%, the change falls short of the attractiveness of a participation exemption which the Irish business community, and other stakeholders, has been repeatedly calling for in order to stay in front in an increasingly competitive international market.

The application of the new regime involves having to apply Irish tax concepts, such as what constitutes profits earned from trading activities, to profits generated by non-Irish companies in situations where the Irish company may not have the information required. It imposes a requirement to gather large amounts of data to track overseas profits which must then be retained until dividends are paid and the new rules come to be applied. There may also be difficulties with dealing with Revenue audit enquiries, especially where overseas companies involved in a group may have been sold.

Perhaps the complexity of administering and explaining the proposed system for taxing foreign dividends can be best demonstrated by means of the decision tree diagram included in the Appendix to this letter. This can be contrasted with other countries where dividends received from companies in treaty countries are tax exempt without the application of a complex qualification requirement.

Retirement relief – section 48

We refer to Section 48 of the Bill and the proposed introduction of a bona fides test for retirement relief from Capital Gains Tax. The relevant proposed subsection reads as follows:

“This section shall not apply...unless it is shown that the disposal is made for bona fide commercial reasons and does not form part of any arrangement or scheme of which the main purpose or one of the main purposes is the avoidance of liability to tax”

This is one of several occasions in the Bill where a bona fides test has been introduced but it is perhaps the one most likely to give rise to difficulties in practice given the extent to which this important relief is used.

We understand from Revenue that the test is being introduced to combat some limited instances of “misuse”. However, these cases are in the minority and we feel that the blanket introduction of a bona fides test will disproportionately add to the administrative burden associated with claiming this relief. It will not be possible for a taxpayer to validly claim the relief unless they show that the claim is not being made for the purposes of avoiding tax. The fact that the relief itself is a genuine and long established measure to minimise the tax impact in transferring or selling a family business only adds to the confusion and uncertainty. Our concern is that this change will necessitate automatic and in most cases unwarranted contact with Revenue, tying up resources and adding to administrative costs on both sides.

We ask that these comments be considered at Committee Stage.

Relevant contracts tax (RCT) – section 32

We refer to the various issues concerning RCT and connected persons detailed in our pre-Budget 2008 submission to you in September 2007. As detailed in that submission, the

breadth of the definition of “connected” persons as it applies to RCT has brought many individuals within the charge to RCT in unintended circumstances.

We welcome the change introduced in Section 32 of the Bill which resolves some of the issues regarding groups of companies being brought within the charge to RCT by virtue of being deemed a principal contractor due to a connection with a construction company. We do however ask that, as the Bill progresses, further consideration be given to addressing the significant issues that the current rules are causing for individuals who are being deemed principal contractors and for connected companies with letting income.

The consequences for individuals are all the more harsh when one considers the complexity of RCT legislation, the severe consequences of failing to operate RCT and the lack of understanding of this area of the tax code amongst ordinary individuals.

Capital allowances and business cars – section 28

The ITI understands the need for and appropriateness of incentivising environmentally sustainable behaviour through the tax code and we believe this should be done in as simple a fashion as possible. We refer to the above section which proposes to link capital allowances and deductions for leasing costs associated with business cars to their CO2 emissions. While this is to be welcomed as a policy initiative, the proposed legislation is very lengthy and will lead to very complex record-keeping for each individual car in order to claim the relief, running contrary to the simplification agenda. The complexity will be disproportionate to the value of the relief in many cases and our concern is that taxpayers may no longer claim it as a result.

Crèches, hospitals, mental health centres and the mid-Shannon corridor – section 26

The restrictions proposed in the Bill on the claiming of capital allowances under the above schemes are such that parties connected with property developers will no longer be eligible for relief. We understand that these changes may have been introduced as a result of EU State Aid concerns. We would welcome consideration at Committee Stage of whether the State Aid concerns could be addressed in a way that does not unnecessarily limit the use of these important reliefs in practice due to the broad definition of “connected” that is proposed.

Convertible securities – section 16

The Bill as initiated introduces a new charge to income tax on the occurrence of a number of events associated with convertible securities, including conversion and disposal. We welcome the Committee Stage amendment that has been tabled to alleviate the potential double tax charge which the section as initiated brought about.

Taxation of UK income - section 18

We refer to the above section which extends the same basis of assessment to certain UK source income which applies to income from other EU/EEA States. We ask that consideration be given to extending this to UK capital gains also.

Revenue Powers

We note that the Bill confers a number of new powers on the Revenue Commissioners. We refer to previous submissions made by ITI in this area, including our submission following the publication of the Report by the Revenue Powers Group in 2003. Since the work of the Revenue Powers Group a number of new powers have been introduced without the introduction of consequent safeguards for taxpayers. Accordingly we ask that a full review of this area be carried out so as to ensure that legislative and administrative safeguards are in place for taxpayers.

VAT – section 85

The Institute is very supportive of the inclusive and collaborative consultation process that has led to the introduction of the new VAT on Property regime and both your Department and Revenue are to be commended for the approach adopted.

One of the issues that has arisen since publication of the Finance Bill is the blanket prohibition on opting to tax lettings between connected parties which we believe is inappropriate given the very wide definition of “connected parties” and the restrictions on VAT group registrations in these circumstances. We have brought this to the attention of Revenue through the appropriate channels and we ask that consideration be given to amending the blanket prohibition at Committee Stage.

Ireland as a Knowledge Economy

We refer again to our pre-Budget 2008 submission to you which called for review and reform of Ireland’s Research & Development (R&D) tax credit system.

We welcome the enhancements to the R&D tax credit system that have been introduced in recent months. We do however believe that significant enhancements to the relief are required (e.g. a move to a volume-based approach) in order to maintain Ireland’s attractiveness as a knowledge-based economy and the location of choice for R&D activity.

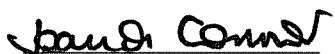
On a related matter, we refer to Section 37 of the Bill which introduces several significant changes to the know-how regime. The substantive issue is that relief will not now be available under Section 768 where one company buys the “know-how” of a business and a connected company buys the “non-know-how” assets of the trade. We are concerned that this disincentive to the separate purchase of know-how when buying a business will ultimately result in such know-how not being purchased by Irish companies

for exploitation to the benefit of the Irish knowledge economy and exchequer.. Such movement in this direction could seriously jeopardise the overall strategic objective of enhancing our knowledge economy and we request reconsideration of same.

Section 37 also allows Revenue to consult with experts to assist them in the evaluation of expenditure on know-how where tax relief for such expenditure is sought. We note that similar provisions currently exist for Revenue to consult with experts with regard to R&D tax credit claims. We understand that these provisions are used in exceptional cases within the field of R&D and that confidentiality and secrecy concerns remain to the fore at all times. We understand that this too will be the case in the application of the new consultative powers for know-how claims.

Please do not hesitate to contact me at the Institute should you wish to discuss any of the issues raised in this letter.

Yours truly


Joan O'Connor
President
Irish Taxation Institute

Appendix 1

Dividends

