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Transfer: European Review of Labour and Research 2010 16: 55
DOI: 10.1177/1024258909357875

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Transfer
16(1) 55–69

DOI: 10.1177/1024258909357875
trs.sagepub.com
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Ireland's low corporation tax: the case for tax coordination in the Union

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Summary

Ireland has been an innovator in using taxation as a tool for industrial policy, by attracting foreign direct investment (FDI) with low taxes on corporate profits. This article outlines the background to how this policy evolved and the advantage it was to building up Ireland's industrial base during the 1990s as well as how it contributed to building the 'Celtic Tiger' economy from 1994 to 2000. It argues that, since EU enlargement in 2004, the advantages of using low corporate tax rates to attract FDI have diminished, even though 'official' and 'corporate' Ireland continue to promote this policy and to obstruct any EU-level moves to coordinate corporate tax. The room for manoeuvre is closing and it is argued that Ireland needs to develop alternative strategies and to engage seriously with its EU partners in finding agreement on a common corporate tax base.

Résumé

L'Irlande a fait preuve d'innovation dans l'utilisation de la fiscalité comme instrument de politique industrielle, en attirant l'investissement étranger direct (IED) avec des impôts peu élevés sur les bénéfices des sociétés. Cet article décrit le contexte qui a amené le développement de cette politique et l'avantage qu'il y avait de développer la base industrielle de l'Irlande durant les années 90, ainsi que la façon dont cette politique a permis de mettre en place l'économie du ≪ Tigre celtique ≫ entre 1994 et 2000. Il soutient que, depuis l'élargissement de l'UE en 2004, les avantages à utiliser de faibles taux d'impôt sur les sociétés pour attirer les IED ont diminué, même si le gouvernement irlandais et les entreprises irlandaises continuent à promouvoir cette politique et à entraver toute mesure au niveau de l'UE de coordination de l'imposition des entreprises. La marge de manœuvre est à l'arrêt et l'article met en avant le besoin de l'Irlande de développer des stratégies alternatives et de s'engager sérieusement avec ses partenaires européens pour trouver un accord sur une assiette d'imposition commune consolidée pour l'impôt des sociétés.

Zusammenfassung

Irland hat als erstes Land Steuern als industriepolitisches Instrument eingesetzt und ausländische Direktinvestitionen durch niedrige Steuern auf Unternehmensgewinne angezogen. Dieser

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Beitrag beschreibt den Hintergrund, vor dem sich diese Politik entwickelt hat und wie sie geholfen hat, in den 90er Jahren Irlands industrielle Basis sowie, zwischen 1994 und 2000, die Wirtschaft des "keltischen Tigers" aufzubauen. Hier wird argumentiert, dass es seit der EU-Erweiterung 2004 weniger vorteilhaft ist, niedrige Körperschaftssteuern anzuwenden, um ausländische Direktinvestitionen anzuziehen, obgleich diese Politik von offizieller Seite und von den Unternehmen in Irland weiter gefördert und jeder Schritt auf EU-Ebene zur Koordinierung der Körperschaftssteuer behindert wird. Der Handlungsspielraum wird kleiner, und Irland müsste alternative Strategien entwickeln und sich ernsthaft mit seinen EU-Partnern darum bemühen, sich über eine gemeinsame Körperschaftssteuer-Bemessungsgrundlage zu einigen.

Keywords
Corporation tax, taxation, tax competition, tax harmonisation, foreign direct investment, transfer pricing

Introduction

Ireland, a small open economy, has long been a tax innovator. While its initial low corporation tax regime played a role in attracting foreign direct investment (FDI), on the establishment of the single market in 1992, a modified regime greatly assisted in its attraction, especially with regard to FDI from the US. Ireland gained substantial additional corporation tax revenue even with lower rates, through transfer price fixing[1] by multinational corporations (MNCs), where companies located taxable profits in Ireland to avail themselves of the low rates of corporation tax. Low rates of corporation tax do assist in attracting FDI, but, with increasing tax competition by countries to attract investment from multinational corporations, Ireland's corporate tax advantage is being eroded. Yet low corporation tax remains a key industrial policy of the government, all opposition parties and the beneficiaries: business interests,[2] who are opposed to the coordination of corporate taxes and appear oblivious to the decreasing impact of low corporate taxes as other countries reduce their rates of corporation tax also in order to attract FDI, in what is likely to be ultimately a zero-sum-game.

Ireland's low corporation tax is a policy instrument which is not within Ireland's control; it takes tax from other jurisdictions; has generated hostility towards Ireland, especially from other EU Member States; and has contributed to a race towards the bottom,[3] where corporations play

1 Transfer pricing or transfer price fixing is where prices in transactions are not set at 'arm's length' within a large multinational firm. A goal of transfer pricing may be to maximise after-tax profits by setting transfer prices that reduce the total tax paid. The company ensures that the profit is located in the lowest taxed country, like Ireland. Ireland gets the benefit of some revenue even with the low tax rate, the company pays less tax and the second or third country may lose tax revenue.

2 Not just companies, but tax planners, lawyers, accountants, and other 'experts'. These form a formidable lobby, allied with some public servants who may occasionally confuse the wider public interest with corporate interests. The corporate sector has now been rebranded in official Ireland as the 'enterprise sector'. This is particularly untimely and ironic because the collapse of the Irish economy was largely due to the lack of real enterprise in recent years (after some important successes). Ireland's 'enterprise sector', aided by some in official Ireland, fell prey to property speculation since 2001. The cream of the 'enterprise sector' – around 60 of the leaders of the top Irish firms – sat on the boards of Irish banks, lending to property developers without due care or responsibility. The edifice crashed and brought the state itself to near collapse.

3 A race towards the bottom, not to the bottom. There are important differences – first, the race towards the bottom is well underway; secondly, it would take a long time to reach bottom in most Member States and, thirdly, it is unlikely that corporate taxation, *per se*, will be abandoned in most EU countries. In fact, there is likely to be a conscious reversal of the pro-market leniency towards companies after the crash.

off countries against each other in order to pay less tax. Ireland's staunch opposition to tax coordination in the EU is an obstacle to national governments asserting their authority over corporations and exacting a reasonable contribution in tax from them to provide the services which corporations also make use of.

The Irish tax innovators

Irish governments and policy-makers have been tax innovators in the pursuit of economic development since they abandoned protectionism in the late 1950s. The first example of tax innovation by Irish officials was the concept of 'duty free tax zones' in the 1950s. It was very successful in attracting foreign direct investment into the Shannon Free Area. Also called 'free trade zones', this was an idea that has been copied all over the world.

In the 1950s, Ireland was a poor country with very high unemployment and high emigration, under a failing system of protectionism. After the government belatedly abandoned protectionism, policy-makers were prepared to do almost anything to attract investment.

As its next tax innovation, Ireland introduced a zero rate tax on profits from exports for all companies. At that time, companies paid up to a nominal tax rate of 50% on profits. Under this scheme, they would pay no tax on profits from their exports. Professor Frances Ruane, Director of the Economic and Social Research Institute (ESRI), a think tank, was critical of the zero rate on export profits. She held that had a lower rate, even at 5%, been introduced earlier, in the 1970s or 1980s, it would have generated substantial revenue over the years (Sweeney, 2008a).

Another major tax innovation was introduced 'accidentally' by one of the big accountancy firms and tolerated by governments until public pressure demanded its termination. Section 84 (Leasing), a major tax avoidance scheme, was of particular benefit to the banks, many of which paid no corporation tax due to this loophole (Sweeney, 1992). It was based around leasing plant and machinery from their clients in return for reduced interest payments on loans.

Section 84 was a section of a counter-evasion tax law curbing directors' loans that was turned on its head by one of the big accountancy firms. It cost the Irish state some €1 137m (in current prices) over 11 years to 1990/91, according to the Revenue Commissioners' data researched by this author at that time (Sweeney, 1992). Most were taxes foregone from the banks. It was actively supported and promoted by the government's own Industrial Development Agency (IDA Ireland) as an industrial policy instrument for many years. The government was forced to introduce a Bank Levy as the banks had successfully used the loophole to reduce their corporation tax rate to zero. The government was reluctant to close this loophole, under pressure from the beneficiaries, business interests and the IDA. However, in time it bowed to public pressure and abolished Section 84.

The impact of EU reforms

The European Union was unhappy with Ireland's low corporation tax rate of only 10% for manufacturing, while the standard rate of corporation tax for companies in other sectors was much higher. The 10% rate was extended to export service companies later. The European Commission ruled that this was discriminatory and the government responded by proposing to cut the standard rate for all companies to just 12.5%, at a time when the standard rate was 38%. This reduction was

Table 1. The reductions in Irish corporation tax rate*

1976	50
1977-81	45
1982-88	50
1988-89	47
1989-91	43
1991-95	40
1995-97	38
1997	36
1998	32
1999	28
2000	24
2001	20
2002	16
2003 et seq.	12.5

* Standard rate.
Source: Revenue Commissioners.

recommended by a Forfas advisory board[4] but was opposed by the Department of Finance which believed the proposed 12.5% rate was too low. The so-called Rainbow government (1994-97) decided to bring down the rate of corporation tax progressively. This was implemented by the next government and the rate reached 12.5% in 2003,[5] (see Table 1).

The reduction in this particular tax was an unusual example of forward planning in tax 'reform' for Ireland. Yet it was not an evidence-based strategy but more a 'clever', pragmatic response to the EU rules on competition policy and state aid. It was a huge, unexpected tax subsidy to non-trading businesses, especially the financial institutions.[6] Some members of the government had hoped to impose a higher rate of tax on banks, but were unable to do so, under EU rules.[7]

The government did not seek a quid pro quo for the major cuts in corporation tax from the beneficiaries. It was argued by proponents that it was a rise for those on the 10% rate, but this increase was delayed until 2005 for services and 2010 for all existing manufacturers.

Ireland did benefit from low tax rates

Ireland has benefited from the low rates of corporation tax. It has had 'first mover advantage' in the area and it made Ireland a more attractive place for FDI, especially US investment. Low company tax has become a key government industrial policy, but what is surprising is that it remains so central for policy, as its impact diminishes.

4 Forfas is the government's research policy advisory body for business and science. The author was a member of the Forfas Finance and Taxation Advisory Group, which was largely composed of industry representatives. The group was not unanimous in this recommendation.

5 There is a corporation tax rate of 25% on non-trading income and higher rates on mining and oil and gas companies (royalties on production were abolished some years ago).

6 The Irish Congress of Trade Unions opposed this corporate tax-cutting regime, opposed the Section 84 leasing, opposed the pro-cyclical tax policies, opposed the increases in tax expenditures, sought a greater social wage through increased social expenditures, and was unhappy with the income tax reductions. It directly criticised these income tax cuts in 2004 in its publication *Tax Cuts did not Create the Tiger*.

7 A government minister's statement to a group of advisors, including the author, in 1995.

Table 2. Percentage increase in profit required to achieve the same distributable income available in Ireland

Netherlands	17.45%
UK	21.53%
China	16.67%
Belgium	32.56%
France	33.45%
Germany	25.00%
USA	44.63%
Japan	48.31%

Source: Deloitte & Touche May 2009, quoted on website of IDA Ireland.

The IDA Ireland, the body charged with attracting FDI to Ireland, naturally sees the low tax rate as a competitive advantage. It points out that the low rate means that to get the same return as in Ireland, profits in other countries have to be substantially higher (see the 2009 figures in Table 2).

Professor Ruane, Director of the Economic and Social Research Institute, has pointed out that US firms are particularly sensitive to tax which they see as a business cost (which it is not, being a payment from profit). 'I would see the low tax, given our peripheral location, as a necessary but not sufficient condition to attract FDI' (Sweeney, 2008a). She made the interesting point that US firms 'are very driven by tax', as the US corporate culture sees tax as an avoidable cost and not as a payment for public services, for roads, education, etc.

Professor Ruane is also critical of the previous zero rate – 'we moved from the zero tax rate and it is now very evident that we should have done so much earlier. Had we had a tax rate of even 5% for much of the 1970s and 1980s, we would have enjoyed considerable revenue gain.' Indeed, it is well known that a high proportion of US profits earned abroad are in low-tax jurisdictions. For 2005, six low-tax countries (Bermuda, Luxembourg, Ireland, Netherlands, Netherlands Antilles and Switzerland) accounted for 45% of the net income and for just 5% of total tax paid abroad of US majority-owned affiliates (Stewart, 2008).

Peter Sutherland, former EU Competition Commissioner and founding director-general of the World Trade Organisation, argued that, while Ireland did have low company taxes, foreign firms did not invest substantially in Ireland until the EU single market was established in 1992. Many US firms had been planning to invest in Europe, prior to the establishment of the single market but the new single market competition laws and enforcement meant that they would not be discriminated against if they operated from anywhere within the EU.

He argued that once the single market was working in practice, from 1992 on, Ireland was the place to invest for access to European markets, being English-speaking. US firms like to control communication and Ireland and the UK were the only two English-speaking countries in the EU. However, Ireland had an advantage, as it was unequivocally pro-EU, unlike the UK. Sutherland said 'I have no doubt that foreign direct investment would not have happened without the lower corporation tax rate. It was the vital cause of inward investment' (Sweeney, 2008a).

Joe Macri, Head of Microsoft Europe, saw the low-tax regimes as being one of the three main factors in Ireland's success and Gary McGann, head of one of Ireland's largest multinational corporations (MNCs), Smurfit Kappa, said 'Low tax was a huge factor for Ireland. If you go to any international marketplace low tax is a factor'. He also believes that 'certainty, no matter which party was in power' was important around tax ... 'it was consistent over time. This is extremely important for companies' planning' (Sweeney, 2008a).

McGann supported the low-tax regime, but also argued that the other EU Member States are reducing their company tax rates and our competitive tax advantage will be reduced. Sutherland also warned that Ireland's low corporation tax advantage could be under threat from Europe or 'there is the possibility of the US changing its laws – but on the other side, if the British turned on this issue and decided that they were in favour of tax harmonisation in Europe rather than being opposed'. Ruane thinks Ireland should defend its company tax regime but 'we need to be conscious that the impact of our present low rate is being continuously eroded by the low tax rates in the new Member States' (Sweeney, 2008a).

Thus a number of business people and academics, while staunchly defending the low tax rate, are conscious of the need to consider alternative policies.

In 2004, I argued that a low-tax regime did little to assist in Ireland's economic development. Since then I have been persuaded that the commencement of the single market after 1992, combined with the low tax rate, did contribute to a major boost in FDI in Ireland, especially from the US. This contributed to what was called the 'Celtic Tiger' economy in Ireland, between 1994 and 2000 (Sweeney, 2008, 1998). This was a period of real sustained economic progress by every criterion. This was a one-off economic boost, where average GDP rose by 8.7% in each of the eight years.

The boost was extremely timely and fortunate for Ireland, but many other necessary ingredients for economic success were also in place at that time. However, I also argued that the policy had limited time left and state agencies, instead of promoting it, should be planning its replacement with policies based on real competitive advantage. This remains even more pertinent today as time runs out.

Transfer price fixing (TPF), lower rates and more tax revenue[8]

The reduction in the nominal rate of corporation tax did not mean that revenue from this tax declined. In fact, the amount of revenue increased. Thus there was no inequity imposed on other taxpayers in Ireland through higher taxes due to the imposition of this lower tax rate on the corporate sector.

There were two reasons for this outcome. First, the effective rate of tax (cash tax paid) by companies was already very low due to extraordinarily generous deductions which were far in excess of the usual legitimate capital allowances. Indeed, at one time, companies in the west of Ireland could write-off 110% of capital investment. The government did attempt to bring the nominal and effective tax rates closer together by reducing many of these allowances. Secondly, through transfer pricing multinational corporations could, and increasingly did, transfer profits, which had not been made in the country, to Ireland.

However, the low corporation tax regime, which, it will be seen, was imposed as a one-size-fits-all approach, generated windfall tax gains for non-trading firms, such as banks, wholesalers, retailers and incorporated professionals.

Low corporation tax was one of several attractions until 1992 and the single market. Then it became more important as many firms, especially US MNCs, established subsidiaries in Ireland, which then gained substantially from its low-taxation regime in attracting FDI. Ireland also gained tax revenue through the transfer of profits, which were not earned in Ireland, into Ireland.

The Common Consolidated Corporate Tax Base

The move by the European Commission in 2006/07 to introduce what it calls a 'Common Consolidated Corporate Tax Base' (CCCTB) for assessing the profits of companies is strongly opposed by both business and government in Ireland. It is seen as a way to introduce tax rate harmonisation

8 See Footnote 1 above.

and it is feared that it would pave the way to change or increase Ireland's low rate of company tax. It is feared that because the CCCTB would harmonise the corporate tax base – the base on which a company's taxable earnings are calculated – it could lead to a harmonisation of the rates.

The Commission argues that it would increase transparency in comparing national tax regimes and, as is the case in the US, individual Member States would be free to set their own tax rates. The proposal to harmonise the corporate tax base is designed to reduce compliance costs for companies but could ultimately reduce the scope for multinationals to take advantage of low-tax jurisdictions if Member States decided to make it compulsory.

However, a mechanism proposed is to share tax revenues between countries, by applying tax where the business transaction takes place, not where the business is headquartered. For multinationals based in Ireland, this would mean that a company selling goods to the EU would pay part of its tax in the state in which the goods were being sold. Thus as little product/services is sold in Ireland, which has less than 1% of the EU population, Irish tax revenue would collapse. Furthermore, and this is not addressed by official Ireland and business, it might also eliminate the opportunity for transfer pricing and so undermine much of the corporate tax base in the country. There is a legitimate case against basing taxation of companies on where goods are sold, due to a major loss of revenue, but there is no case for protecting transfer pricing.

It is clear that Ireland should not rely as heavily as it does on low company taxes for competitive advantage if a change in the US law could wipe this advantage out overnight. Yet the low-tax regime has been to Ireland's advantage. It has gained much investment from it and a great deal of tax revenue. It is obvious that the Irish government or its agencies cannot change the tax regime as it would cause uncertainty, but the day will come when a change in the law elsewhere might wipe out that advantage. This uncertainty undermines what is declared to be a major government industrial policy lever.

In the meantime, every day sees further tax competition with reductions in company taxes that diminish the Irish tax advantage.[9] There is also a dilemma for EU Member State governments – do they wish to see companies not paying taxes in the future? This is where the EU appears to be going as governments compete with each other with incentives and corporate tax reduction (just as they did before the rules were established under the single market) to attract FDI.

Peripheral countries and tax coordination

It has been seen above that businessmen argue that peripheral countries have certain disadvantages compared to those in the heart of Europe and that the lower corporation tax rates help mitigate these.

Many of the Irish supporters of the low tax rate are quite conservative adherents of efficient market theory. Thus it is not surprising that they support low taxes, nor is it surprising that they believe that competition between Member States for FDI is good. They will argue that peripheral countries offer most in low taxes and in subsidies, because they need FDI. However, too often it is these countries that are poorer and least able to pay for such subsidies and incentives. They generally have fewer indigenous, self-sustaining enterprises, are further from the markets, etc.

In an empirical analysis of 19 OECD countries Garretsen and Peeters found that the increased mobility of capital 'implies a lower corporate tax rate' (Garretsen and Peeters, 2007). Thus, it may be argued that this confirms that there is 'a race to the bottom', but they found that the core countries, with greater agglomeration, tend to maintain higher corporate tax rates. However, peripheral countries, such as Ireland, generally tend to have lower rates.

9 Germany announced a reduction on 1 October 2009.

A case can be made, therefore, for peripheral and small countries to attempt to compete for FDI with lower company taxes. The problem is that if trends continue, all countries, in time, will have very little revenue-raising powers over the corporate sector. Consequently, there is a strong case for tax coordination in the EU that allows Member States some discretion, within a certain band of tax rates, and on an agreed tax base.

No coordination means a policy vacuum

The Irish government's continued opposition to tax coordination is an obstacle to clear legal direction at the EU level and it contributes to the situation where future tax policy for all Member States could be increasingly determined by the European Court of Justice (ECJ). Thus EU policy-makers are ceding policy-making powers to the ECJ. While courts interpret laws, where there is a vacuum, they will determine policy in complex areas which are best determined by politicians and administrations. The ECJ judgments includes cases such as that taken by the British government against the retail chain Marks and Spencer, when the ECJ ruled that that company could offset losses incurred by foreign affiliates against their domestic tax bill.[10] There are implications here for revenue from corporation tax as companies headquartered in Ireland could offset losses incurred by overseas affiliates against their domestic tax bill.

It is possible that, over time, successive ECJ rulings in such cases would result in a difficult EU tax regime which takes little or no account of broad policy issues such as raising revenue, redistribution and incentives. Without tax coordination, Member State governments are ceding power on taxation policy to the ECJ.

In a paper on treasury management companies, Stewart argues that 'two European Court of Justice cases dealing with treasury management companies located at the IFSC in Dublin, are significant in terms of providing a legal basis for the operation of companies with little operational substance in low tax rate regimes'. He found that 'recent European Court of Justice cases have supported the existence of both low-tax regimes and treasury management type operations within the EU, but their continued existence is opposed by many EU and non-EU countries as being at variance with legislation to counteract tax avoidance' (Stewart, 2008).

King Canute and the tides

In 2008, the Irish government established a Commission on Taxation to review the structure, efficiency and appropriateness of the Irish taxation system.[11] It set the maintenance of

10 Judgment OJ C 36, 11.02.2006, p. 5.

11 The Commission on Taxation Report, September 2009. Its terms of reference were highly restrictive, in contrast with the last review of the taxation system by the Tax Commission in the 1980s. Highly ideological, the terms of reference were based on low (direct) taxes and no increase in the 'burden', as taxation was called, pejoratively. In effect, it recommends a major shift in the burden from business to citizens, but with some progressive reforms. Its composition was not reflective of society as a whole, dominated by tax planners. The social partners were not invited to nominate members. The one trade unionist of the 16 Commission members, Brendan Hayes, Vice-President, SIPTU, chosen by the Minister for Finance (now the Taoiseach (Prime Minister)), refused to sign the final report as it did not address inequality and redistribution of income and wealth, as it was not required to do so under its terms of reference.

Ireland's low-tax economy (sic) and the retention of the low rate of corporate tax as key terms of reference. Even as it set the terms of reference, the tide was going out for low taxes. Most observers would have seen the beginning of the economic crash and the consequent need to raise taxes. Low direct taxes did exist for incomes and on profits, but Ireland's taxes on consumption are amongst the highest in the world, contributing to Ireland having the second highest price levels globally.

The Commission recommended the retention of low taxes on incomes and low taxes on profits, as instructed by its terms of reference. It also recommended even lower taxes on unearned income, savings and dividends, while simultaneously arguing in favour of a tax system that 'rewarded work and enterprise'. It came close to recommending the abolition of corporation tax, but probably did not do so as that would mean that US MNCs would be liable for the full US rate on repatriation of profits, in the absence of some kind of a corporate tax regime elsewhere. The Commission, confined by dated and ideological terms of reference, produced a report that was detailed and scarcely evidence-based. It confirmed that official Ireland has no new thinking on the role of low corporation tax in industrial policy and on developing real competitive advantage.

The timing of tax cuts and the crash

When Ireland enjoyed high economic growth and was at close to full employment, between 1999 and early 2008, the government still pursued pro-cyclical economic policies of tax cutting (mainly on direct taxes, i.e. on companies and incomes) and deregulation and it gave substantial tax subsidies to property investors. Interest rates, set by the European Central Bank, were very low for Ireland while its own bank regulator, mesmerised by the apparent efficacy of the market, did not intervene during a prolonged, soaring credit boom.

The Celtic Tiger years, 1994 to 2001, was a period of rapid economic growth which was based on real achievements of increased productivity, strong FDI, etc., but it was followed by the false boom from 2001 to 2007, which was a domestically-induced, overheated economy, which ended with a major crash in 2008 when the global economy slowed.

The impact of the economic crash could have been greatly reduced had there been: a) regulation of bank credit; b) no reduction of direct taxes on incomes and on profits; and c) curbing, rather than expansion, of tax subsidies to property investors and others. While there was opposition to these policies, it was from few organisations and was muted.[12]

Unintended beneficiaries

The reduced rate of corporation tax in Ireland has been of immense benefit to the once highly profitable banks, other financial institutions and non-trading sectors where there is limited domestic competition. Yet even lowly taxed, large profits did not prevent the Irish banking system from collapse in 2008/09, necessitating a massive taxpayer bailout.

The low taxes on profits gave the opportunity for high bank profits that were available for retention for building up capital reserves, or paying out in dividends. The two biggest banks in Ireland,

12 For example, the Irish Congress of Trade Unions, as was stated in footnote 6 above, strongly opposed the pro-cyclical, tax-cutting policies and also deregulation and privatisation. As a social partnership body, some commentators assumed it was supportive of the government's economic policies, but the record shows strong opposition to 'growth for growth's sake' and much more.

AIB Bank and Bank of Ireland, made very large profits and paid out large dividends in recent years.[13] While these banks' dividend payouts were not out of line with those in the UK, US and continental Europe, the profits on which they were based were made on reckless lending by the boards and executives of the banks. The boards of these two banks were made up of the elite in Irish business who are the strongest defenders and the key beneficiaries of the low corporation tax regime.

Low corporation tax did not result in entrepreneurship that would add long-term value within the economy. It could be argued that low taxes allowed the banks to keep most of their profits and so the high after-tax profits acted as a disincentive to the boards to act responsibly and to be prudent in their lending. Thus, the low-tax regime may have contributed, in some not insubstantial way, to the near destruction of the banks and to the immense harm done to the Irish economy by the boards of these Irish banks.

The bailout of the Irish banks has been at the expense of the Irish taxpayer. The banks did immense damage to the Irish economy and to Irish citizens who will now underwrite a new national 'bad bank', the National Assets Management Agency (NAMA). The cost to the taxpayer of this 'toxic asset bank' is estimated to be, at a minimum, €54bn, well in excess of the total tax revenue of €43bn projected for 2009.

We are not happy

Stewart has argued that 'low tax economies or low tax centres, such as the IFSC in Dublin, are incompatible with moves towards a harmonised corporate tax base within the EU, a policy which is supported by the vast majority of Member States' (Stewart, 2008). Ireland's low corporation tax policy is called 'fiscal dumping' by many in Europe. It alienates our fellow EU Member States and has already used up much goodwill towards Ireland.

It has been argued that 'Britain may weaken its opposition to a European Commission plan for a common corporate tax base in the hope that it would stem the tide of multinationals moving their tax domicile to Ireland', according to Brussels' lobbyists. Irish opponents of the Commission's EU-wide tax project fear that they will lose Britain's support as tax competition becomes a growing threat to UK revenues.[14]

There was a proposal in May 2009 to crack down on tax havens, after Barack Obama was elected President of the United States. This caused consternation in Ireland, with headlines such as: 'Taoiseach hopeful of review of US Corporate Tax plans'; 'Obama's tax plan need not spell doom for Ireland'; or 'Obama tax threat needs to be taken seriously'; and 'Reforms a Threat to Investment in Ireland'.[15]

In the UK, the *Financial Times* reported that 'the proposed US crackdown on corporate tax avoidance has provoked an angry response from low-tax countries used heavily by the

13 In 2008, AIB Bank, whose board must have known by then that they were close to collapse, still paid a dividend of €720m on an after-tax profit of €885m. Thus 81% of profit after tax, was paid out. The average pay-out in dividends from profits by this bank for the six years to 2008 was 40%. The imagined profits of AIB, which were largely spurious, amounted to a staggering €8.32bn in the period, while the dividends, which were real and paid out in cash, came to €3.3bn. The Bank of Ireland, which also failed in 2008/09 and had to be bailed out by the Irish taxpayer, paid out an average dividend over the six years to its collapse in 2008 of 40% of its profits. The imagined profits of Bank of Ireland, which were also largely spurious, amounted to €7.47bn in the period, with the dividends, which were real and paid out in cash, came to €2.93bn or also 40% of profits.

14 *Financial Times*, 10 June 2008.

15 *Irish Times*, 18 March, 17 June, 6 and 12 May 2009, respectively.

multinationals that are the target of the Obama administration's reforms'. It continued, 'the US administration highlighted the Cayman Islands, Bermuda, the Netherlands and Ireland. It was feared that the US moves were also likely to be felt in Luxembourg, Switzerland and Singapore, where profits reported by US subsidiaries often appear disproportionately high, given the size of those countries'.[16]

'We're not happy', said Jan Kees de Jager, the Netherlands' finance secretary. 'We have a very transparent policy and we'll work with the US. I expect there'll be a clarification [from the US administration] and we'll not end up on lists like this in future, between Bermuda and Ireland'.[17]

It is extraordinary that each time a review of the US or other tax regimes takes place, official and corporate Ireland expresses great anxiety that action in other jurisdictions on taxation can undermine a key Irish 'strategy'. This anxiety demonstrates how the industrial policy of Ireland, as a sovereign state, is based on a fickle foundation, outside its own control.

On the enlargement of the EU on 1 May 2004, the then German Chancellor, Gerhard Schröder, launched a bitter attack on 'fiscal dumping' by some of the ten new Member States. He called EU subsidies for newcomers into question if they refused to raise business tax levels. 'This is not acceptable', one senior German official told European Voice. 'The new Members use money from the EU to finance their low taxes, while countries, such as Germany, will have to pay more for them. Before 1 May, Ireland had been constantly rebuked for such a practice, as it applies a 12.5% corporate tax. ... We could live with one Ireland, but we cannot live with ten!', one French official in Brussels said – 'The system is not sustainable'.[18]

An investigation by the *Guardian* newspaper into tax avoidance by UK firms found that 'some UK-listed companies which have moved control to Dublin to benefit from Ireland's low-tax regime appear to have little real presence there'.[19] In his study of 46 treasury firms in Ireland, Stewart found that 28 firms had no employees and 39 of them had no fixed assets. His research also found that 29 paid no fees to directors and all but one were audited by one of the Big Four accounting firms (with 18 by PwC). In short, they are 'brass plate' operations, not just tolerated by the Irish authorities, but anxiously defended by them (Stewart, 2008).

Lord Oakeshott, a senior UK Liberal Democrat, describing Dublin as 'Liechtenstein on the Liffey' said 'it promotes itself as a low-tax zone off north-west Europe, a kind of Cayman Islands in a cold climate and aggressively chases footloose financiers and less scrupulous British companies to move to Dublin to dodge tax'.[20]

The *Financial Times* reported that the Irish government had to reassure the UK, its key ally in the European debate on corporate tax policy, that it played no role in wooing UK multinationals, when Shire and United Business Media moved to Dublin for tax reasons. This report went on to say that some tax lawyers reported that Ireland has been targeting international holding companies, pointing to a 2004 tax change, which allowed foreign companies in Ireland to avoid capital gains tax when selling an overseas unit, as long as the business sold is in another EU Member State or in one of the 44 countries Ireland has a tax treaty with. 'That was designed to open up Ireland for holding companies'.[21]

16 *Financial Times*, 6 May 2009.
17 *Financial Times*, 6 May 2009.
18 EuropeanVoice.com, 27 May 2004.
19 *Guardian*, 2 February 2009.
20 *Financial Times*, 10 December 2008.
21 *Financial Times*, 10 June 2008.

Coordination, not harmonisation

If the EU is to continue as a successful economic and political union, the major economic bloc in the world, admired and aspired to by many, it must maintain its social model, in which the citizen is central. Thus corporations must continue to contribute to funding public services – such as roads, education and health services – by paying taxes.

The coordination of tax rates and the establishment of a common tax base does not, and should not, mean that there is only one tax rate for all firms, (or even more rates based on size) but rather that the rates agreed within the EU should be within a range. The range might be between a low of 17 or 18%, rising to 35%.

Finding a common tax base is complex and so also is the issue of deductions, such as capital allowances, interest, etc. There is a strong case for curbing unlimited interest deductions against tax. These deductions are a legitimate business expense for virtually all firms. However, for highly leveraged private equity firms which can raid and asset-strip viable firms, it is a subsidy from the general taxpayer for anti-social business behaviour. The establishment of a common tax base would provide an opportunity for the EU to end tax subsidisation of these anti-social firms.

The author would be opposed to a tax base which discriminates against some countries which may have large exporting firms located within their jurisdictions. As larger Member States, generally, have advantages over those on the periphery, some leeway is required in setting rates. It is also an eminently practical approach when there is a wide range of existing rates. These are nominal rates however, and effective rates may be closer, though Ireland's are close to zero for some firms.[22]

The future

The success of the clampdown on tax evasion by OECD states in recent years and the G20 success in tackling tax havens and Swiss bank secrecy as well as the need for tax revenue during the economic recession, signify a changed and hardened attitude to taxation. For example Jeffrey Owens, Head of Tax at the OECD, 'stressed the significance of transfer pricing in a global economy where multinational enterprises play a prominent role'. He said 'governments also are carefully monitoring the allocation of profits and losses to their jurisdictions, in a context where many of them are striving for a balance between business friendly, pro-growth tax measures and measures to maintain the needed level of tax revenues to support public spending'.[23]

This does not bode well for Ireland. While some argue that, even with reduced tax rates, the level of corporation tax over the past decades has not fallen, this was due to the higher levels of profits and may also have been because of some restrictions in allowances and write-offs.

If the EU cannot complete the single market project by setting some basic rules for its corporation taxation and other areas, then the operation of that market will continue to be suboptimal.

In recent decades there has been a global shift in the share of national income going to capital and away from labour and from employees. This shift should have been accompanied by rising taxes from the corporate sector, had these taxes not been reduced. The same trend has been followed in Ireland. Lane found 'a major factor income shift away from labour and towards capital.

22 For example, Ryanair paid an effective rate of only 1.4% on very large profits in 2006 and, coincidentally, AIB paid exactly the same effective rate of corporate tax in that year.

23 OECD, 21 September 2009, Paris.

The profit share has increased from 25.1% in 1987 to 34.8% in 1996' (Lane, 1998). This shift was maintained for most of the next decade, with a small shift back to labour in recent years.[24]

The argument that the EU would render itself less competitive, even with higher taxes for corporations, with a vast market of 500 million citizens, is facile. It is the world's largest market. Its weakness has been its inability, politically, to set clear and consistent rules for the single market to ensure its efficient operation. If Europe is to protect its social market economy, it must protect its tax base.

With the current banking crisis, it is widely recognised in Ireland that had the country not been part of the euro area, its economy would have collapsed. Furthermore, the Irish banks were supported hugely through the Irish Central Bank by the ECB to the tune of some €48bn. While the ECB is independent and this action is its own, it is not inconceivable that other Member States may put increased pressure on Ireland to play more fairly on taxation in the future and to cease its hostility and veto proposals for coordination of corporate taxation.

The debate during the second referendum campaign on the Lisbon Treaty in autumn 2009 was intense, but this time taxation was not an issue, as the government had secured a guarantee from the other Member States that 'nothing in the Treaty of Lisbon makes any change of any kind, for any Member State, to the extent or operation of the competence of the European Union in relation to taxation'. The real issues debated during this campaign were around workers' rights and the minimum wage. As workers correctly saw that the Charter of Fundamental Rights can potentially enhance workers' rights and redress the balance in the EU from capital to labour to some degree, it may have helped in the overwhelming (67.1% to 32.9%) vote in favour of the Treaty.

Of course, official Ireland must maintain a stern public face on any change in the short term, for to do otherwise would send a signal to multinational firms that increased corporate tax rates were imminent.

Conclusion

Ireland has benefited from the low rates of corporation tax. It has had 'first mover advantage' in the area which made it a more attractive place for foreign direct investment, especially from the US. It has been seen that the Irish government and policy-makers have been tax innovators. Ireland's low corporation tax remains a key industrial policy. It is argued that the low tax rate is a policy instrument which is not within Ireland's control; that it takes tax from other jurisdictions; that it has generated hostility towards Ireland, especially from other EU Member States; and it has contributed to a 'race towards the bottom', where corporations successfully play countries off against each other, in order to have to pay less tax.

Ireland's staunch opposition to tax coordination in the EU is leading to a policy vacuum. The lack of coordination on tax at an EU level means that companies are turning to the courts for clarity. Courts do not make good policy, ignoring as they do the redistributional effects of taxation.

It was seen that the reduction in the nominal rate of corporation tax did not mean that Irish corporation tax revenue declined. Indeed, Ireland gained substantial additional corporation tax revenues even with lower rates, through transfer price fixing by MNCs.

However, with increasing tax competition between Member States to attract investment from multinational corporations, Ireland's corporate tax advantage is being eroded. Some business

24 Irish Central Statistics Office and European Economy database.

people and academics, while staunchly defending the low tax rate, are conscious of the potential erosion of the advantage.

This article has argued that the low-tax regime had unintended consequences. For example, it was of considerable benefit to the once highly profitable banks, other financial institutions and non-trading sectors where there is limited domestic competition. It is argued that the high after-tax profits acted as a disincentive to the boards of the Irish banks to act responsibly and to be prudent in their lending. Thus the low-tax regime may have contributed to the near destruction of the banks and to the immense harm done by them to the Irish economy.

Each time a review of the US or other tax regimes takes place, official and corporate Ireland displays great public anxiety that action in other jurisdictions on taxation can undermine a key Irish industrial 'strategy'. The low-tax regime has been to Ireland's advantage, but it is now clear that Ireland cannot rely on low company taxes for competitive advantage if a change in the laws of the US or of other countries can wipe this advantage out overnight.

A case can be made for peripheral and smaller countries to attempt to compete for FDI with lower company taxes, but, in the longer term, there is a strong case for tax coordination within a certain band of tax rates and on an agreed tax base.

The tough coordinated clampdown on tax havens signifies a changed and hardened attitude to taxation globally. This is combined with the need for increased revenue in a time of increasing fiscal deficits in many countries.

The coordination of tax rates and the establishment of a common tax base does not, and should not, mean that there is only one tax rate for all firms. The issue of the tax base is complex and must be pursed with care, but it provides an opportunity for real tax reform. The near collapse of the international financial system due to the actions of an elite of over-paid and grossly negligent corporate leaders has radically changed public attitudes to corporate greed and the actions of companies. This must spill over in the public and political attitude to transfer pricing and the tax avoidance industry.

This means that tax coordination has to become a key part of the EU agenda, if much needed tax revenue is to be raised to pay for the yawning deficits. Only then will the corporate sector, instead of shirking its responsibility from contributing to the running of Member States, play its role in strengthening the social market economy.

All Member States have a veto on tax reform and Ireland can use this to block change. However, it may be forced to confront the issue in the near future. The 'race towards the bottom' on corporation taxes is no longer being led by Ireland, but by the new Member States reducing their rates, some to a zero rate for certain profits. There are also the general corporate tax reductions by all countries and the overhanging threat of action by the US and other countries which will erode or even eliminate Ireland's advantage. There is now less tolerance internationally of tax evasion and avoidance. Citizens, who are tired of corporate abuse, are now challenging corporate power. After the failure of the international financial markets, they are no longer in awe of the elite. Simultaneously, the economic crisis is forcing all countries to seek new sources of revenue.

Thus it may be only a matter of time before Ireland quietly drops its veto and begins to negotiate as part of an EU-wide reform of corporation tax in order to influence its outcome. To remain Canute-like means Ireland will be without influence in these much-needed reforms.

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