



A focus on broad tax issues will attract more business

While the government focuses on the battle to preserve our 12.5 per cent corporation tax rate, Kevin McLoughlin, head of tax services with **Ernst & Young**, said we needed to look more broadly at our tax system if we were to stay ahead of, or even on par with, our competitors when it came to attracting foreign direct investment (FDI).

"There is a lot of change taking place in the world of tax – countries that in the past didn't seem quite so engaged in enticing FDI, including our nearest neighbour the UK, are now joining the race, and are introducing a range of enticements to further their ambitions," said McLoughlin.

For economies that are increasingly knowledge-driven, intangible assets are an important resource, and it is therefore important that the tax system treats them in an up-to-date way.

In Britain, as part of an overall corporate tax reform programme, the corporation tax rate was slashed to 26 per cent last month, the lowest rate among the G7 countries, with a commitment to ultimately reduce it to 23 per cent.

While on the face of it, this may seem like a very small threat to Ireland's attractive 12.5 per cent rate, what is interesting is that the British government has also set in train the introduction of tax credits and incentives, specifically to attract greater R&D activity.

One of its commitments is to introduce by next year a preferential regime for profits arising from patents, known as a 'patent box'. It is anticipated that the patent

box will encourage companies to locate high-value jobs and activity associated with the development, manufacture and exploitation of patents in Britain. It will also enhance the competitiveness of the British tax system for high-tech companies that obtain profits from patents.

"While we sometimes forget it, the UK has long been



Kevin McLoughlin, head of tax services with Ernst & Young

a competitor of ours for FDI," said McLoughlin. "We aren't the only ones with close ties to the US; the UK has that advantage too. The difficulty in the past for the UK has been its ability to compete with us on tax, but under the new Conservative-led government that is changing, and it is becoming apparent that the UK now wants to be one of the most tax-competitive economies in the world.

"The recent reduction in its corporate tax rate sends out the signal that the UK is going to compete on the tax front. But my real concern centres on its commitment to introduce special rates for profits derived from intellectual property," he said.

"While Ireland has a competitive regime for IP, the fact that the UK is stepping into the market means we need to stay imaginative and perhaps be even more competitive to maintain our position

on the global stage. We may need to evaluate our IP regime to ensure it is on par with what's offered elsewhere – and that includes Belgium, the Netherlands and Spain.

"Other countries have introduced lower tax rates for IP, regardless of whether applying to trading or non-trading income. It's straightforward. My concern is that investors have a tendency to be attracted to the shiny new penny, so Ireland needs to ensure it doesn't fall down in this area," said McLoughlin.

"The significance for us of the introduction of the patent box to the UK is that the UK already trumps us when it comes to some of the economic reasons to locate there. By comparison, the UK offers a huge home market and a massive workforce with multilingual skills. Typically, multinationals already have people on the ground in the UK because there is such a big market there, and the danger is that the balance when making a decision on where to locate might tip in favour of a country where there is a big market and where the company already has a presence."

While McLoughlin identified our need to stay vigilant with regard to our overall tax regime, he said he was confident that Ireland could maintain its successful track record in attracting FDI.

"The almost exclusive focus on our 12.5 per cent corporation tax rate takes from what Ireland offers investors in terms of our overall tax regime. We still offer a very compelling overall tax package in Ireland," he said.

"What we need to do is to refine our R&D tax credit system, because having dipped our toes in the water it has become obvious that it

could be improved upon and made better, with a small amount of tweaking.

"For example, the regime in its current format is incremental, and is referenced to R&D spend in 2003, which I don't believe is a strong enough incentive," he said.

"We also need to re-examine R&D tax credits as they apply to outsourced services. Outsourcing in some industries has to be done – for instance, within the pharmaceutical sector clinical trials are usually outsourced to be conducted elsewhere out of necessity. While you can outsource R&D and still benefit from the tax credit, you can currently only do so up to a relatively small limit.

"We have a critical need to retain our 12.5 per cent corporation tax rate, but that debate has become so consuming and high profile that it makes it more difficult for us to push through favourable changes to any other aspect of our tax system."