The historical development and international context of the Irish corporate tax system.

A report commissioned by the Irish Department of Finance

EY

Building a better working world

Authors

The historical development and international context of the Irish corporate tax system.

Aidan Walsh, Tax Partner

Tel: (+353) 1 221 2578

Email: aidan.walsh@ie.ey.com

Chris Sanger, Global Head of Tax Policy

Tel: (+44) 207 951 0150

Email: csanger@uk.ey.com

Prepared with the assistance of:

Sean Reid, Shane Byrne, Shane O'Donovan, Shannan Feeley, Claire Boushell, Tara Byrne, Nico Schönberg, Dr. Daniel Zöller and Jerome Ardouin.

Contents

TRANSACTION
NEW YORK
07:47
LONDON
12:47
Assets
Peso
income
HONG KONG
YEN

Introduction

The purpose of this paper is to place the Irish corporate tax system in its historical, commercial and economic context.

This paper is divided into two sections. The first is a narrative of how the Irish tax system came to have its present form. In this part we have referred to UK, US and other country developments to show the evolution of the Irish tax system in its international context. This then sets the scene for a larger consideration of the Irish corporation tax system looking at some key elements in the debate on corporate tax that are rarely considered but are important in all taxation and budgetary decisions.

The 12.5% corporate tax rate is at the centre of the 'Irish brand' for inward investment. It is perceived to be the result of a careful strategy to compete for inward investment that other countries struggle to match. However, the purpose of this paper is to provide additional insights behind the origins of the policy, showing that the tale is much less clear and less obvious - where the heroes and villains are not always who they are thought to be.

Executive summary

The Irish corporate tax system has evolved gradually from the income tax system introduced in 1853.

Its main distinctive element, the general relatively lower rate of 12.5%, evolved as a response to the end of our policy of self-sufficiency, the need to attract inward investment and the later impact of EU rules against preferential tax rates.

The UK, US, French and German corporate tax systems are also a function of local political, economic and commercial factors unique to each of those countries. In particular, given that the Irish and UK tax systems have the same roots, the UK system has evolved in a different way to encourage domestic rather than inward investment.

Since the introduction of income taxes in the 19th and early 20th centuries, global trade and movement of people has given rise to problems of cross-border double taxation and mis-matches between countries' domestic tax legislation.

These problems were the subject of detailed League of Nations work in the 1920s. At that stage, multilateral solutions were suggested. Ninety years later this is happening with the OECD BEPS processes.

For reasons that we explain, taxes are difficult to introduce and difficult to change. Therefore, we should not be surprised that cross-border tax issues are difficult to resolve even where agreement in principle is reached on a solution. This is even more so for corporate tax as there are different schools of thought on how corporate taxes should operate.

Ireland's domestic and international tax experiences may be useful for developing countries.

As a fully integrated member of the global economy, Ireland is also constructively engaged with a number of EU and international bodies working on multilateral initiatives to address many of these concerns.

1799

UK - Pitt introduces income tax – rate of 10% seeking more revenue to finance the Napoleonic War. Assessed on total income. Applies to 'every body, politic or corporate…'. Profits distributed to shareholders are exempt at company level but taxable in hands of shareholder

1803

UK - Addington reintroduces income tax after it was repealed in May 1802. Applies only to scheduled income. Applies to 'Bodies Politick or Corporate, Fraternities, Fellowships, Companies …'. In Addington's 'most brilliant reform' tax paid by company but acts as a withholding on the tax to be paid by dividend-holder – an effective imputation system.

A short history of corporation taxes in Ireland

Personal income tax, and income tax on the profits of companies, has its Irish beginnings in an 1853 Act of the British Parliament – An Act for Granting to Her Majesty Duties on Profits Arising from Property, Professions, Trades and Offices. It was this piece of legislation that extended income tax to Ireland for the first time.

Income tax had been reintroduced into Great Britain in 1842, as part of a larger policy to facilitate free trade, by switching government revenues from excise duties to taxes on income. Income tax, at that time, applied to both individuals and corporate entities. There was no 'corporate tax' as such. In 1853, as part of the regular re-enactment of the income tax, Gladstone's government extended these taxes to Ireland.

How does Irish corporation tax work?

Just as with an individual, a company in Ireland is taxed on its income and capital gains. This is a special 'corporation tax' that applies to 'any body corporate'. This tax (at rates of 12.5%, 25% and 33%) is paid to the Revenue Commissioners.

As with any business, a company is taxed on its profits. For companies, the starting point for calculating taxable profits is its accounting profit for its financial year. There are some items that are then added to or taken from that accounting profit for tax purposes (for example, client entertainment is not tax deductible).

Dividends to shareholders are paid from the company's profits after the company has paid its corporation tax bill. Dividends are not tax deductible for the company paying them. If those dividends are taxed again in the hands of the shareholder then you have the issue of the 'double taxation' of company profits which, as we will see, has exercised minds over the past 200 years. If profits are not paid to shareholders they are called retained profits, if they are paid to shareholders they are called distributed profits.

Other forms of distributions to investors, like interest, may be tax deductible, as they are in most countries. It is argued that this encourages debt financing over equity financing.

Dividends received by an Irish individual are taxable. Dividends from an Irish company to another Irish company are exempt from tax for the receiving company.

Irish resident companies are taxed on their income wherever in the world it arises (worldwide basis). Non-Irish resident companies are taxed in Ireland on the profits of the trade carried on through a branch or agency in Ireland (source basis).

The Acts of 1842 and 1853 essentially revived the income taxes that were first introduced in 1803. Until then Government revenues almost entirely lay with taxes on goods and imports like excise and custom duties, and tariffs.

The 1803 Act taxed income but just income from certain specified sources (these were set out in Schedules to the Act, these Schedules are still with us, for example tax 'to be charged in respect of any Trade or Manufacture' is still taxed under the 'First Case of Schedule D', as it was in 1803).

For companies and shareholders the system, set out very briefly in section CXXVII of the 1803 Act, was what we would now describe as an imputation system: the company paid taxes on its income, but to the extent that it paid a dividend it deducted from that dividend the tax the company had paid on the profits out of which the dividend was declared as if the tax had been withheld by the company. In turn, the shareholder could then set-off that tax against their tax bill on the full dividend – throughout the 19th century these were the same. A dividend of £10 (gross, i.e., before tax deducted by the company for its tax bill of £3) was a 'free of tax' dividend of £7 (Bank, 2011, p. 54). The shareholder and the company were tax indifferent to whether profits were distributed or retained. The company, if it declared a dividend of say £10, would actually pay £7. This £7 might have been expressed as '£7 tax free' but it was more accurate to describe it as £7 with a tax credit of £3 attaching; the £3 was a final discharge of income tax (but not surtax etc.) and could be refunded if, for example, the shareholder was not subject to tax.

1815

UK - Large scale pressure to repeal the tax at the conclusion of the war. In February 1815 Chancellor of the Exchequer Nicholas Vansittart announced he would not seek renewal of the tax.

1842

UK - Peel reintroduces income tax. Again applies to 'all Bodies Politic, Corporate or Collegiate, Companies...'. Effective imputation system of 1803 Act revived.

Imputation and classical corporate tax systems

When a company pays tax, the tax system has to decide whether the shareholder should get some credit for that tax paid by the company on its profits – out of which (after-tax) amount any dividends will be paid. A system that reduces the tax paid by a shareholder on a dividend to reflect that tax paid by the company is called an imputation corporate tax system. A system that does not give such a credit is called a classical corporate tax system. Ireland was an imputation system, sometimes fully and sometimes partially, until 1999 when it switched to a full classical system. A further method of avoiding this double taxation is to tax the company but to make any dividends tax exempt for the shareholder.

It is unclear if imputation made much difference to individual shareholders but the removal of the refundable tax credit has affected pensions and pensioners (Bank, 2011, p. 138 and 225). A recent review of the Australian tax system recommended the removal of its imputation system; removing imputation would adversely affect domestic individual shareholders but using that tax saving to reduce overall corporate tax would encourage investment from all over the world (Gruen, 2006).

The incidence and shifting of Corporate Taxes

In the end all taxes are borne by individuals – the question is which individual? For example, if Ireland introduced a new 50% tax on corporate income, an Irish company that only did business in Ireland would pay a lot more tax (the *formal incidence* of the tax lies with the company). The profits available for distribution would be lower and we would expect, all things being equal, that the value of the shares would be reduced. If you were a shareholder when the new tax was introduced you would suffer that loss. If you sold the shares then it can be argued that you suffered all the tax as you suffered the loss in value of the shares. Even though, the new shareholder is the person, year on year, who has smaller dividends. Or perhaps the company was in a powerful competitive situation and could pass (shift, in technical parlance) the tax hike to its customers and, in reality, they suffered the tax, or it could be shifted to suppliers or employees. The *effective incidence* of tax is never clear; the 'ripple effects are very difficult to trace' (Bristow, 2004, p. 11). This is one justification for the classical corporate tax system – is the imputation system benefitting the person who economically suffered the tax? This is also an issue with double tax in an international context, as we will see.

As with the 1803 Act, pressure of war can often be a spur to tax changes. In 1913 the tax system was effectively identical to the 1853 system – despite the enormous fiscal controversies of the previous decade and the introduction of progressive income tax rates for individuals. In 1910 - the marginal rate of income tax was still only 20d in the 20 shillings (or 8.33%). However, the First World War drove not so much changes to the tax system, but a massive increase in tax rates. These super and sur-taxes applied to individuals and not to companies. In an attempt to level-the-playing-field the British Government introduced a Corporation Profits Tax in 1920. This was hugely controversial and was repealed in the UK in 1924.

It is important to note that the Corporation Profits Tax was not a corporation tax as we would understand it today. It only applied to companies, but companies still remained subject to the income tax; the CPT acted more like a surtax for companies (de Cogan, 2013). However, the Corporation Profits Tax did have one important symbolic result – for the first time a classical corporate tax element was introduced into the UK and Irish system and there was a break from a pure imputation system.

With independence in 1922, the entire UK tax system was adopted by the Irish state. The UK tax legislation had been consolidated in the Income Tax Act 1918. This Act remained the core of Irish legislation, even after it was superseded in the UK, until the legislation was rationalised again in Ireland with the Income Tax Act of 1967. Thus, even though CPT was repealed in the UK in 1924, it continued to apply in Ireland (until 1976 when it was superseded by the introduction of Corporation Tax proper). CPT applied to the profits of a company before income tax applied (the base was not exactly the same). CPT was then a deductible expense for income tax purposes for the company.

The next phase of Irish tax development for companies was in 1956. This was the year that an Export Sales Relief was first introduced. Although companies were still liable to income tax, ESR was only available for companies. 1956 is generally given as the date from which Ireland started to re-engage with world markets and it is interesting to note how tentative this change was. ESR initially only applied to exports in excess of the base year of 1956 and, even then, such exports were only relieved from half the tax. It took until 1960 for ESR to apply to all exports and to fully relieve them from tax. ESR also only applied to goods manufactured in

1853

UK - Income tax extended to the island of Ireland with the Income Tax Act 1853.

1862

USA - First federal income tax collected. Income from corporate or partnership profits not specifically mentioned but is taxable.

Ireland – exported services, in particular, were not eligible. It is worth noting that dividends from ESR profits were also exempt from income tax in the hands of individual shareholders.

In 1976 a new tax on companies - Corporation Tax - was introduced. While this was a major change in principle and introduced the modern philosophy of having a completely distinct tax on companies, the change for Irish companies was not major. The base rules were still derived from the income tax system. As this Act largely mirrored the UK 1965 corporate tax reform (as amended in 1970 – thus missing Britain's brief first foray with a pure classical corporate tax system) we will deal with the changes that did happen when we look at UK developments below.

ESR could not survive in an EU environment. However, as part of Ireland's transition to EU membership it was grandfathered until 1990. Instead an effective 10% corporate tax rate was introduced on 1 January 1981 for trading manufacturing profits – the definition of 'manufacturing' was subsequently extended to include services, particularly financial services, activities in the IFSC and Shannon Airport.

Grandfathering

This is a commercial legal term meaning the old rule continues in force for people with an existing arrangement, even though it has formally been repealed. For example, the 10% effective rate of tax on manufacturing was grandfathered until 2010 (from 1998).

The importance of these special low corporate tax rates in a global environment was critical for Ireland as, for various reasons, the regular corporate tax rate was very high – for example, it hit 50% in the years from 1982 to 1988 (Martyn & Reck, 2014, pp. C-61). All companies ended up paying tax at a variety of rates and the application of the reliefs led to much complexity and some unexpected results (see, for example, Charles McCann Ltd v S O'Culachain (Inspector of Taxes): III ITR 304 as to whether ripening bananas was 'manufacturing', or Cronin (Inspector of Taxes) v Strand Dairy Ltd: III ITR 441 whether the pasteurisation and bottling of milk was manufacturing). However it is also important to understand that for many companies 1981/1990 resulted in a, well-flagged, tax increase (as it did again in 2003/2010).

The 10% effective tax rate then fell foul of EU rules in 1998 and, in turn, was replaced by a general 12.5% tax rate that applied to company trading profits (a 25% tax rate applied to non-trading profits, and the capital gains tax rate applied to corporate chargeable gains, currently 33% but then 20%). In 1999 imputation was removed and the Irish tax system became a classical system for the first time. The 12.5% general tax rate first applied on 1 January 2003.

1913

USA - Ratification of the 16th Amendment, corporate income tax is adopted in conjunction with individual income tax. Rate of tax is 1%.

What did other countries do?

United Kingdom

In the UK after 1922, industrial policy became intermixed with corporate tax, resulting in a system that has doubled-back on itself a number of times. For example, in 1947 a Profits Tax was introduced, it had a lower rate for retained profits as the policy of the Labour Government was to encourage retention of profits which they thought would result in increased investment by companies. This differentiation was then eliminated in 1957. Also in 1957, the UK introduced a territorial corporation tax system for 'overseas trade corporations'; this exemption for undistributed profits of a UK company applied to non-UK profits that were then reinvested or retained outside the UK. Neither survived the introduction of Corporation Tax in the UK in 1965.

The taxation provisions in the new UK corporation tax system mirrored the income tax rules. There was not that much of a change. However, as the corporate tax was a new tax, much of the debate at the time was about the 'double taxation' of the shareholder at the company level and then again when a dividend was received. We saw how the old income tax system dealt with this but the corporation tax system took a different approach.

This debate on the retention of profits was never just a tax technical issue, there was an important economic and political point underlying it. It was a commonly held belief that taxing the shareholder on dividends would discourage shareholders from seeking dividends and even discourage individuals from becoming shareholders. This, in turn, would encourage retention of profits in companies and give greater influence to the new professional managers running these companies. In the UK (and this is not an overstatement) this was thought to be a socialist plot – it was, at the time, Labour governments who favoured the retention of profits and asset allocation decisions by rational professional managers and not the 'invisible hand' of the market (Réamonn, 1970, p. 153; Bank, 2011, p. 66). From its formation the Labour Party in the UK has tried to 'favour' companies over their shareholders, by initially not seeking to tax companies at all and later by favouring retention of profits – at the expense of those 'who can live in idleness on the productive work of others' as one activist put it in 1925 (Bank, 2011, p. 193).

The new corporation tax was introduced at what the Chancellor, James Callaghan, called a 'low rate' of 40% in 1965 (Réamonn, 1970, p. 236). It was introduced as a classical system in its purest form (Royal Commission on Taxation, 1955, p. 382). But there was also a further tax for shareholders – a withholding by the company at the standard rate of income tax which could then be offset against the income tax liability of the shareholder.

The Conservatives regained power in 1970 and had promised to abolish corporation tax but instead merely reformed it by returning it to an imputation system. Corporation tax stayed, the income tax withholding was removed and, in addition, the shareholder received a tax credit for an element of the underlying corporate tax paid by the company. The shareholder was taxed on the dividend and the credit but the credit was sufficient to shelter a standard rate taxpayer. A taxpayer on low income or an exempt body (like a pension fund) could reclaim the tax credit if their tax bill on the dividend was lower than the credit. A real innovation was the introduction of Advance Corporation Tax – ACT was an effective prepayment of corporation tax related to any dividends paid – which was designed to solve the problem of shareholders getting a tax credit for corporation tax that the company (because of foreign tax credits, explicitly, or capital allowances) had not actually paid. This then was the system that the Irish authorities adopted in 1976.

The Labour government as one of its first acts in 1997 abolished the refundable tax credit for tax exempt investors. In 1999 they removed it for taxpaying investors (Bank, 2011, p. 224) but retained a partial non-refundable credit for UK individuals.

More recently the UK has announced a long-term reduction in its main corporate tax rate to 20% from 1 April 2015 (EY, 2014).

1920

UK - Corporation Profits Tax introduced. The first UK tax to explicitly target the corporation.

Germany - Corporate tax introduced.

1922

Irish Free State established.

International comparatives

Country	*Main Effective CT Rate for company*	*Imputation, Classical or Exemption System for shareholder*	*Territorial or Worldwide for company*	*Tax Treaty with Ireland*
Ireland	12.5%	Classical	Worldwide	N/A
United Kingdom	21%	Partial Imputation	Worldwide/Territorial	Yes
USA (Federal)	35%	Classical	Worldwide	Yes
Germany	15.825%	Classical	Worldwide	Yes
France	33.3%	Classical	Territorial	Yes
Estonia	0%/*21% (*on distributed profits)	Exemption	Worldwide	Yes
Hong Kong	16.5%	Exemption	Territorial	Yes
Singapore	17%	Exemption	Worldwide (if received into Singapore)	Yes
Australia	30%	Imputation	Worldwide	Yes

USA

The UK's application of income tax and income tax to companies was far in advance of other major jurisdictions. However, by the time these countries came to introduce income and corporate taxes it was felt they could implement superior models.

A US federal income tax had been introduced in 1861, as an obvious wartime measure, but was not collected until 1862. The tax was progressive, starting at 3% and increasing to 5% for incomes above $10,000. The income tax applied to corporates, but shareholders and bondholders could exclude from their income any dividends and interest from corporates who had already paid tax on it – an effective exemption system. But this did produce inequities for taxpayers not paying income tax or who were taxed at lower rates (Bank, 2011, p. 33). This tax expired in 1872.

Income tax was to be introduced in 1894, these provisions specifically applied an income tax to corporations (Bank, 2011, p. 39). However, a constitutional challenge was raised against the tax which was successful – Article 1 of the US Constitution forbade taxes unless in proportion to population.

The Sixteenth amendment to the US Constitution allowed for federal income taxes and was immediately followed by the Revenue Act of 1913. This new income tax applied to individuals and corporates but corporates were only taxed at the lowest rate of 1%. Individuals could be taxed at rates up to 6%. When profits were distributed, the dividend was exempt from the individual's 1% tax but higher rates of income tax still applied. It was, in effect, an imputation system. During the First World War, the US authorities, as they did in the UK, agonised over the effect of the corporate

1936

USA- US introduces undistributed profits tax. Changes to classical system.

1948

France - Corporate tax introduced.

tax on retained earnings and on the unfairness of corporates not being subject to the sur and supertaxes. Thus, similar to the UK, in 1918, Congress enacted a war-excess profits tax that only applied to corporates. This tax was considered a failure and lapsed in 1921 (Bank, 2011, p. 80).

In the US, things largely stood until the crisis year of 1936. Worried about earnings retained by companies, President Roosevelt proposed the abolition of income tax on corporates on distributed earnings, the repeal of the dividend exemption for individuals but the introduction of a new corporate tax on undistributed earnings. In the complex legislative process that followed, a very different result emerged. While the income tax on corporates remained, there was, however, a surtax on undistributed income but the dividend exemption for shareholders was also removed. The US, in a complex opaque process and not always for the most edifying of reasons (Bank, 2011, p. 95), switched from an imputation system to a classical corporate tax system in one bound and, then, overlaid a further tax on undistributed profits.

The double taxation of shareholders became an ongoing and long-lasting issue – largely focused on its effects on individuals' willingness to invest in shares. Eventually, in 1954 President Eisenhower proposed an overhaul of the system – the first $50 of dividends would be exempt from tax, and dividends above that would have a tax credit attaching. That November the Dow Jones Industrial Average finally rose above its 1929 peak.

This credit was repealed in 1964 and the exemption was repealed as part of the 1986 tax reform; in both cases the relief for taxpayers was small (the dividend exemption had only increased to $100 by 1986) and broadening and reforming of the tax base were the larger priorities. The 1986 reform reduced the US federal rate of corporation tax to 34%, currently it stands at effectively 35%. As with the 1936 reform, the double taxation for shareholders (suffering tax at the corporate level and then again on dividends when received) and the subsequent incentive not to distribute earnings has been very controversial and may even have been a factor in recent US corporate scandals (Bank, 2011, p. 234).

It should also be noted, that from the outset, while the US has a worldwide tax system, the US tax on the income of non – US subsidiaries is generally 'deferred' until those funds were paid up to the US.

Worldwide and Territorial tax systems

Another choice that tax systems make is between being 'territorial' or being 'worldwide'. A territorial system exempts from tax in the home country profits that are earned outside of that country. Ireland has a 'worldwide' system – we tax profits wherever in the world they arise. However, Ireland only taxes those profits, generally, when they arrive in Ireland and a tax credit is also given for any foreign tax paid on those profits before they arrived in Ireland. As a contrast, Hong Kong has a 'territorial' system and companies 'carrying on a trade, profession or business in Hong Kong are subject to profits tax on profits arising or derived from Hong Kong' (EY, 2014); all other profits of Hong Kong companies are not subject to Hong Kong taxes.

The dividing line here is never sharp. For example, France largely has a territorial system but also has many exceptions to that rule that do tax non-French profits. The UK has a worldwide system in theory but is in practice primarily territorial, as it now exempts many non-UK profits, such as those made in a non-UK branch or dividends from non-UK subsidiaries. Thus, no country operates a pure form of these systems; rather there is a wide spectrum of taxation that ranges from both extremes (Guenther & Hussein, 2000); (Wade, 2006).

One of the major decisions in US tax reform is whether the US tax system should switch to a territorial system (Hedge, 2011). In the US (and also as in Ireland), income earned by US domiciled corporates are ultimately subject to US taxes but this is usually deferred until the income has been repatriated to the US (Rush & Mincieli, 2010).

1954

USA - President Eisenhower limited 'double taxation' by 'allowing stockholders a credit against their own income taxes as a partial offset for corporate tax previously paid'. Introduction of dividend tax credit and shareholder exemption.

1956

Ireland - Introduction of Finance (Miscellaneous Provisions) Act, relief from tax for companies that manufactured and exported their output.

Germany

Germany had no federal income tax until after the First World War. An income tax that included corporates was introduced in Prussia in 1891 with no tax credit to the shareholder (a classical system). In 1906 this income tax was extended to GmBH's, a German limited liability company, but for those the shareholder was exempt from tax on their return (Hallerberg, 2002/2003). Germany was considered 'backward' in relation to corporation tax (Seligman, 1921, p. 263) until the changes after the First World War when a federal income tax that applied to companies was introduced in 1920.

In 1953 a split rate of corporation tax was introduced with a lower rate of tax for distributed profits but those dividends were taxed again in the hands of the shareholder. This system was designed to create some form of parity between companies and the large number of German businesses without legal form at the time. From 1976 a full deduction for distributed profits was given. This split system survived until 2000, when a flat federal corporate income tax rate of 25% (from 40%) was introduced (applicable both to distributed and retained profits), but the imputation credit for individual shareholders was eliminated (they were exempt on 50% of the dividend). Currently, 100% of the dividend is taxable to the individual shareholder but at a maximum rate of 25% (plus surcharges). German companies suffer both state and local taxes (so-called trade tax). The German federal corporate tax rate is now 15% (plus surcharges). The rate of the trade tax is about 14% on average.

France

France introduced a limited form of income tax in 1914 but income tax, proper, was only introduced in 1917. France's relationship with income and corporation taxes is almost unique for various historical reasons and even now the French State's reliance on consumption and payroll taxes is much higher than other industrialised nations (Morgan & Prasad, 2009). For example, France had important door and window national taxes until 1917 (Seligman, 1921, p. 474); VAT was also a French innovation.

Joseph Caillaux proposed a source-based progressive income tax in 1906 – a watered-down limited version eventually passed on the eve of the First World War. Even at the outset this income tax was territorial – it only taxed income sourced in France (Stamp, 1921, p. 123). Our understanding is that the income tax was territorial as the taxes it replaced were territorial (like the window and door taxes) and as part of French colonial policy. This remains a feature to this day for companies (but not individuals) in France.

Unlike the UK, the US and Germany in the 19th century, the introduction of income tax in France was not part of larger tariff and tax reform to facilitate free trade – there was no coalition of interests in France that favoured an income tax. The resulting law was so limited that, for example, it provided that no taxpayers could be compelled to produce their accounts to a tax inspector in cases of dispute (the inspector had to determine income based on 'external factors' (Morgan & Prasad, 2009)).

In a major tax reform in 1948 a corporate tax was introduced. Companies were taxed at 24% and then later at 50% with a further 24% withholding on dividends. An individual shareholder received a credit for portions of the tax withheld but not the underlying. Réamonn quotes *Le Figaro* from 1965: 'Le résultant, c'est que, lorsqu'une société obtient 100F de bénéfice à distribuer, elle donne 62F à l'Etat et 38F à l'actionnaire' (Réamonn, 1970, p. 206ff)[1].

France solved this problem in 1965 with the introduction of the *avoir fiscal*. This was a tax asset that attached to the dividend paid by the French company of half the dividend (the corporate tax rate remained 50%), this was taxable for the shareholder but then offset against the tax bill on the gross dividend. Importantly, the *avoir fiscal* could be repaid if the shareholders tax bill was lower than the credit. The withholding tax on dividends was eliminated. The *avoir fiscal* was in turn eliminated in 2004 and France returned to a classical corporate tax system.

1 "The result is that when a company generates 100 Francs of profit, it gives 62F to the State and 38F to the shareholders".

1964

UK - James Callaghan Labour Chancellor of Exchequer moves to reform taxation system as 'it does not provide sufficient incentive to companies to plough back profits for growth rather than distribute them as dividends'. Classical system adopted.

USA - Dividend tax credit repealed under J.F.K Administration.

1973

UK - Imputation system reinstated in the UK. Ireland and the UK enter into the European Union.

The International element

Any corporate tax does not act in a vacuum. Firstly, it acts as part of the local-country tax system which causes immense complexity, as we have seen above. Secondly, it acts as part of an international system. Even if a company just buys and sells locally, it will compete with other non-local companies that may be taxed in very different ways. Further, the company will compete for capital from shareholders who may have other capital investment opportunities that provide different after-tax answers. Right from the outset, this international element has been at the forefront of thinking.

'The evils of double taxation'

We have seen that double taxation at company and shareholder level has been a real concern since the invention of corporation tax, however, there is also double taxation involved in any international activity: if citizen A of country X invests in country Y does he or she end up paying tax in country Y and country X on the same income, profit, gain or activity? And if he or she does, is that a problem?

On the face of it, it appears to be totally unfair that you would pay tax on the same thing twice. But in fact, it is not at all clear that the problem is as straightforward as that:

- We pay tax more than once on things all the time. You buy petrol from after-taxed income and the VAT on that petrol includes VAT on the excise duties embedded in the wholesale cost of the fuel and so on. This point was an important element of the debate about the introduction of a classical corporate tax system in the UK in 1965 (Réamonn, 1970, p. 100).
- Economic double taxation is not the same as paying tax twice. Where does the incidence of the tax actually lie? This was a particular focus of the early theorists on double taxation (we will discuss this further below). If I lend money to a Ruritanian company and the Ruritanian government imposes a withholding tax of 20% on interest payments, I will want a higher rate of interest on those bonds. To the extent that I get that higher rate I have not really suffered the withholding tax – the borrower in Ruritiana has. So even if the interest is taxed again in Ireland economically I am not double taxed. This is the same for any foreign activity – I will only do it if I am happy with the after-tax return I will make on this foreign activity.
- Finally, even if we are all against the evils of double taxation, which jurisdiction should provide the relief? One, the other or split between the two?

As global trade developed in the 19th century, distortions and inhibitions to global trade caused by double taxation became more and more of an international problem. In the aftermath of the First World War, and its consequent huge increases in the rates and amounts of taxation, it was decided to do something about it.

League of Nations Report on Double Taxation and Tax Evasion

In 1920 the League of Nations began a process to look at the issue of double taxation. In 1921 it was decided to commission an expert report and to suggest solutions. Four eminent academic tax experts were selected; these were Professor Bruins of Rotterdam, Professor Senator Einaudi of Turin University, Professor Seligman of Columbia University and Sir Josiah Stamp of London University.

While other initiatives (such as by the International Chamber of Commerce) also played a part, this expert report, directly or indirectly, has had huge influence on the development of provisions to prevent or mitigate double taxation right to the present day. In particular, Seligman and Stamp who effectively wrote the Experts' Report and were hugely influential in all tax matters in the US and the UK in the period would have established the intellectual background against which all other developments would have played out (Jogarajan, 2013).

Both Seligman and Stamp wrote extensively about double taxation in the period before the Report and their views were well established. In particular, they were only concerned with economic double taxation in the narrowest sense. They were also focused on what was possible and not what made most sense. For example, Stamp suggested an idealised global tax system in 1920 that every country would impose an 'origin tax for all income going out' of the country and tax residents on all domestic and global income – 'the net result would be no problem of double taxation... The full application of such a principle in present circumstance is, of course, impossible' (Stamp, 1921, p. 125).

1976

Ireland - Corporation Tax Act introduced.

1981

Ireland - Introduction of effective 10% corporate tax rate covering manufacturing activities.

1986

USA - Shareholder exemption repealed under tax reform.

While double taxation in a global market sounds like a modern problem it was an acute problem even then. Moreover, the experts had a large range of potential solutions available, not just from international arrangements (as, say, between Germany and Austria, before the First World War and multilateral arrangements within the British Empire) but arrangements between states in federal jurisdictions such as the US and Germany.

In a process driven by Seligman and Stamp the problem of double taxation was narrowed down to a small number of problems that were susceptible to general agreement and to practical solutions:

- The general view was that the source country of any income was the country that had the primary taxing rights and, to the extent that income was to be taxed twice, that the country of residence of the taxpayer would grant relief (as an exemption or a double tax credit etc);
- There was an emphasis on bilateral treaties to help solve double taxation but this appeared 'rather appalling' to Stamp who favoured a multilateral approach (as was already the practice within the British Empire);
- The primary focus was on investments abroad and there the major concern was on borrowing or investee countries increasing taxes on foreigners (as opposed to the taxes when an investment was first made, which would be reflected in the original price);
- There was less concern about company profits but it was agreed that branches of a business in an country should be taxed in that other country as if they were standalone subsidiaries.
- They gave four options in relation to how double tax was to be relieved in the country of residence of the taxpayer – (1) deduction/credit; (2) exemption; (3) a split of taxes between the two countries; and (4) the classification of income into different categories and the allocation of taxing rights for each (Jogarajan, 2013).

In the light of modern controversies it is interesting that it was never considered that sales into another country was a tax-gap for the country where the sale occurred (a destination based tax). This may have been because of the importance of tariffs and duties at that time. It was not that they did not think of this problem – as both Stamp and Seligman had considered the formulary apportionment of profits under US state taxes – Wisconsin in 1911 being the pioneer in this approach (Stamp, 1921, p. 127). However, even formulary apportionment of total profits required local property and local business.

The original 1923 League of Nations report is said to have favoured capital exporting nations and not 'source' countries (Vogel, 1997, p. 18). However, a careful reading of the previously published books of Seligman and Stamp, shows no such conscious tendency. Instead, with its focus on taxation based on residence unless there was property or a fixed place of business in the other country they relied on solutions that were already working within jurisdictions where double taxation problems were being worked out, like within Imperial Germany, the US states and the cantons of Switzerland. So Stamp noted: 'How have such federal constitutions as Germany and Switzerland dealt with this problem? Generally, double taxation is prohibited, and income from real property is left to the State where it arises, and all other income follows the residence of the taxpayer' (Stamp, 1921, pp. 126, 127).

This 1923 Report was theoretical. A further group was then established, the Committee of Technical Experts on Double Taxation and Tax Evasion, which reported in 1927 (d'Aroma, 1927). This committee was made up mainly of tax officials, and not economists, and its output was a practical document – the first model double tax agreements. While recognisably a tax treaty, it was still a long way away from the modern version:

- There are no maximum rates of tax that can be imposed on non-residents. As we saw the ability of borrower or investee countries to raise taxes on foreigners at will was a particular concern of Seligman and Stamp.
- The model treaty relied on a now obsolete distinguishing between personal and impersonal taxes, which drove complexity in the way that the model granted double tax relief – the model opted for a credit system although they also thought an exemption system was acceptable.

1987

Ireland - 10% effective rate extended to financial services.

1998

Ireland - Charlie McCreevy, Minister for Finance, introduces legislation in 1998 Budget that creates Irelands 12.5% corporation tax for trading income. The reduction had been announced by the previous Minister, Ruairi Quinn, in May 1997.

1999

Ireland - Ireland moves to a classical system in relation to taxation of dividends. A company is subject to corporation tax on its profits and gains and the individual shareholders are liable to tax on dividends received from the company at their applicable marginal income tax rate.

The model treaty combines different methods of avoiding double taxation suggested in the 1923 report – there is an allocation of income into different categories but there is also the use of the deduction/credit system to reduce taxes in the home country.

There was a lengthy discussion by this group on whether tax treaties should be bilateral or collective (a single treaty signed by all parties). In the end it was decided to recommend bilateral, as tax systems were too unique to be susceptible to common solutions but also because bilateral treaties were immediately possible whereas global agreement would require ‘prolonged and delicate negotiations’ (d’Aroma, 1927).

2003

Ireland - Commencement of 12.5% rate with a 25% rate for passive income.

2005

Ireland - Expiration of the 10% rate for IFSC activities.

2010

Ireland - Manufacturing Relief comes to an end for companies that commenced manufacturing trade before 23 July 1998.

2014

International - Multilateral approach taken to international tax avoidance and evasion.

Why is tax so complicated and why is it so difficult to have a 'rational' tax system?

On the 9th of January 1799 Great Britain, under Chancellor William Pitt, enacted an income tax, to take effect the following 5th of April. Britain's debt was then trading at less than 50% of par and, unless funds could be raised, its titanic struggle with Revolutionary France might well be lost. This new income tax was a tax on all residents of Great Britain on their entire global income and on British non-residents on their income from property in Britain. An individual had to make a return of income under four 'heads' of income subdivided into 'cases'. (The four 'heads were: income from real property, income from personal property, trade professions, offices etc, income from outside Great Britain and any income not falling in the other three heads of charge). Any modern taxpayer will see the similarities. The collection mechanism put in place is the foundation of our current system. The tax was imposed at a rate of 2 shillings in the pound or 10%. The tax raised £5.6m in 1801 (Seligman, 1914, p. 98).

In 1803 Addington, Pitt's successor, introduced an income tax that only applied to particular sources of income. The tax was levied at a rate of 1 shilling in the pound or 5%. In 1803 it raised £5.3m (Seligman, 1914, p. 98). At half the rate and on a narrower base of income it raised almost the exact same amount of tax. How can this be?

There are a large number of factors that make a tax 'successful'. The purpose of this section of the paper is to explore often neglected features of the administration of taxes and the international tax debate and put some additional context and background as to why things are as they are.

Why have a corporation tax at all?

It may be argued that the corporate income tax, by virtue of its interference with individuals' economic choices, is an inherently distortionary mechanism. The result is an increase in the corporate cost of capital and, therefore, inefficient underinvestment; the misallocation of capital by favouring the issuance of debt over equity finance (as interest payments, unlike dividend payments, are typically tax deductible); the advantage bestowed on established corporate entities which can issue debt more readily than new market entrants; and the bias in the business decision concerning the location and size of investment.

For example, Barrios, Huizinga, Laeven, & Nicodeme indicate that, all other things being equal, a percentage point increase in the effective tax rate of companies reduce the probability of the location of a foreign subsidiary in a particular jurisdiction by 3.96% (Barrios, 2008). Indeed, developing such a point to its logical extreme has the theoretical recommendation of a zero corporate income tax rate in a context of perfect inter-jurisdictional capital mobility. Any upward departure from such a rate is regarded by classical models as futile and economically incoherent (Nicodeme, 2009) .

However, all taxes have a distortionary effect and all taxes have to be practical. Further, removing tax from the company would remove an important tool from policy-makers in attempts to influence the behaviour of probably the most important economic agent in the market order. Indeed, given how little we know of the real incidence of corporation tax and the effects on company and everyone else's behaviour of an elimination of corporation tax, we cannot be sure that it would have the effect that economists say it will or what the effects of higher taxes directly on individuals to compensate would have, see (Weichenreider, 2005).

Instead, we have a convenient point in the market process where a profit is clearly calculated and a legal entity that can be charged with the tax. We are not clear who ultimately really pays that tax (the shareholder, the customer, the supplier, the employee?) but we do know that the company has the immediate knowledge, ability and cash to pay it. We cannot be clear that this is the case for the shareholder who would have to pay it instead, even if we could find them.

The Nobel-prizewinning economist Ronald Coase pointed out that markets and companies are different: companies are 'islands of conscious power in the ocean of unconscious cooperation like lumps of butter coagulating in a pail of buttermilk' (Coase, 1988 pg 35). It would be difficult for governments to extract taxes from this pail of thin buttermilk while trying to completely avoid the butter floating on top.

The excess burdens of taxation

The burden of taxation is more complicated than people think. Individuals and companies pay tax to the government – that is one burden for them. A further burden is the administration for the taxpayer in making those payments and for the government in collecting it.

There is also a third burden that is often forgotten. Economists call this burden the 'excess burden of taxation' or the 'deadweight cost' of taxation. The Irish economist John Bristow has explained: '[T]axes affect economic behaviour.... When deciding to buy one brand rather than another, or choosing to work more rather than take more leisure, or investing in one asset rather than another, what we concentrate on, other things being equal, is the price or net-of-tax return relative to the available alternatives. Thus if the tax system changes relative prices and returns, it distorts the key signals that determine our behaviour' (Bristow, 2004, pp. 16, 17).

A recent example of the excess burdens of taxation is a 2011 Danish tax on fatty foods with a promised further tax on sugar. Instead of reducing consumption of fatty foods, sweets and fizzy drinks, the Danes drove over the border to Germany and shopped there. The new taxes changed the relative price of local groceries versus the expense of driving to Germany and shopping there. The costs and time of driving to Germany was an excess burden of the Danish fatty tax; it benefitted nobody in Denmark. The tax only lasted a year.

This is true of company behaviour just as it is true of individuals (Scholes, Wolfson, Erickson, Maydew, & Shevlin, 2005). These distortions, caused by the tax system, called the excess burdens of taxation, could be as high as 30% of tax revenues (Bristow, 2004, p. 17) but see also (Goolsbee, 1997). This burden (unlike the taxes paid to government or costs to ensure smooth compliance) benefits nobody. To the extent that companies put in place structures or arrangements that simplify their tax positions and reduce these excess burdens they reduce this waste and improve their (indeed, everyone's) position - even if they end up paying the same amount of tax.

This, at least partly, explains one feature of the Irish tax system that is not often commented on - its relative simplicity. For example, despite the two systems being identical less than 100 years ago and still very similar, core Irish income tax legislation now runs to over 3,000 pages (Brennan, 2014) but its UK equivalent runs to 3 volumes and 8,478 pages of much smaller type (Tolley's Direct Tax Acts, 2013).

Whatever the level of burdens of one tax system, the distortions in arranging activities in two or more are very much greater. Therefore, it makes sense for a country seeking inward investment to make its system as simple and stable as possible to reduce this burden. For US or UK investors, the fact that Ireland is a common-law system and English speaking also helps reduce this burden even further.

However, the opposite is also true. Sometimes, distortions in behaviour are desired. Corporates are central players in all economic activities. Governments want to influence company behaviour. Even without a separate corporate tax, they can apply rules only to companies (Export Sales Relief in Ireland being an example) but obviously things are made much easier if there is a separate corporate tax. This thinking drove, for example, the major corporate tax oscillations in Britain over the past 70 years as the UK flipped between favouring companies retaining profits with differentiated Corporate Profit Taxes (1947 to 1957) and the initial introduction of a classical corporate tax in 1965 (1965 to 1973) and the removal of full imputation (1997/1999 to date), and attempts to make the system more neutral between retention and distribution (1957 to 1965; 1973 to 1998/99). Whatever about the wisdom or actual effect of these provisions (probably minimal (Bank, 2011, p. 141)), what was clear was the British government's intentions with these provisions and the types of behaviour that they wanted.

Understanding that taxes result in burdens for taxpayers is one explanation as to why Pitt's income tax was not successful: it imposed the bulk of its burdens on the taxpayer. These burdens were not just the administration burden on the taxpayer but also changes to commercial or business decisions that the individual might make (for example, a change in business practices to prefer capital gains – exempt from tax until 1965 in the UK – over income) and so on. The taxpayer was able to avoid all his burdens by merely not paying the tax and, obviously, despite everything, that is what they choose to do, however, if that was the case, why was Addington's income tax more effective?

The endowment effect

One of the major breakthroughs in our understanding of human behaviour over the past 30 years has been discovering 'the endowment effect'. The value we place on things is not neutral – we value what we have and the pain of losing it more than we value acquiring new things.

The Nobel-prize winning psychologist, Daniel Kahneman gives the example of an economics professor that owns an expensive bottle of wine that he refuses to sell for a price that is greater than he would be pay for it if he did not own it: 'If he owns it, he considers the pain of giving up the bottle. If he does not own it, he considers the pleasure of getting the bottle. The values are unequal because of loss aversion: giving up a bottle of nice wine is more painful than getting an equally good bottle is pleasurable' (Kahneman, 2011, p. 293).

Pitt's tax required the taxpayer to have their two shillings and then to pay it over to the new General Commissioners. The pain of this new loss to their income must have been acute. Addington's tax worked in a different way: 'stoppage' at source (or what we would call withholding). Now the taxpayer did not feel the loss directly, instead the tax was stopped by the person paying the income to the taxpayer, and that person paid the tax directly to the tax authority.

We have seen that companies were subject to the 1803 tax on the same basis as individuals. Companies paid their tax on their profits. However, when they went to pay a dividend (and at the time, profits were generally distributed) the company could deduct from the dividend the amount of tax they had paid on the profits out of which the dividend was being paid. The dividend was then 'franked' to the individual shareholder and he or she had no further income tax on that dividend or could reclaim the income tax withheld if his or her income was low.

It is worth exploring why this has been called Addington's 'most brilliant piece of legislation' (Réamonn, 1970, p. 29). The individual shareholder never suffered the pain of giving up a portion of his or her dividend, instead he or she only experienced the pleasure of receiving the net dividend and later the frisson of not having to pay any further tax on it or even getting some of that tax back. The managers in the company were suffering the pain of paying the dividend in any event - it did not matter to them that a portion was being paid to the Collector. (Of course, progression, surtaxes and the Profits Tax eroded the core principle but that is later.)

Where the withholding element did not apply the new taxes still struggled. This emphasises a point that is often neglected, the voluntary element in tax compliance. All taxes depend on some element of 'goodwill' (Stamp, 1921, p. 101). Stamp quotes Lord Byron's letter to Thomas Moore in 1815: 'A word more; - don't let Sir John Stevenson … talk about the price for your next poem, or they will come for the property tax for it. I am serious and have just heard a long story of the rascally tax-men making [Sir Walter] Scott pay for his. So take care…'

The 'endowment effect' pervades all decisions on taxes by every stakeholder in the tax system. Everyone feels the pain of new taxes or changes in taxes more acutely than they feel the benefits of even the most obvious tax reform.

A tax has to be collectible, it has to be practical

When Prussia introduced an income tax in 1891 it imposed on the taxpayer a compulsory declaration of all income, 'in such matters nothing can be accomplished by kid gloves' wrote one German (Seligman, 1914, p. 254). The tax proved to be unexpectedly successful.

Everyone was interested in this development but nobody thought they could replicate it. Stamp wrote that the Prussians had the 'advantages of a highly flexible, smoothly graduated tax upon income assessed in a single sum because they paid the price and that price consisted in being subjected to a fire of highly personal questions in which the taxpayer had to account for every action and expose his motives to the full official scrutiny' (Stamp, 1921, p. 102). Seligman thought this system would 'be impractical almost anywhere else' (1914, p. 271). Caillaux thought the same for France: 'It may suit a highly centralized and hierarchic country, and a subservient and docile people' (Seligman, 1914, p. 312). Instead Caillaux favoured the British 'systeme de stoppage' (Seligman, 1914, p. 312). Again, we can see where Pitt made a mistake, he introduced an assessment system that even 100 years later was likely unacceptable to Britons.

And it is this practical element that is probably the most important element in applying a corporate tax – it is very collectible. This is not just because of the endowment effect and the related fact that company managers are paying away someone else's money. As Addington showed, collecting an individual's tax at the company level is convenient for the individual – they have no administrative burden and have avoided the pain of paying away money they have received.

For example, suppose Ireland decided to eliminate its corporation tax and tax individuals as the income arose in companies or as that income was distributed. That would be complicated enough for an Irish shareholder in an Irish company that only carried on activities in Ireland. But what about the US shareholder in a US company that had a factory in Ireland? No tax rule anywhere would say that Ireland would have no taxing rights over that factory. But how would Ireland apply its tax? Would Ireland:

- Tax the US corporate and respect that foreign entity treatment – in which case Irish taxes would work just like a corporation tax except that the Irish income tax machinery and tax rate would have to apply. No real difference for anyone, at best, but more likely complications and inflexibility all round.
- Tax the US individuals but let the US corporate pay the tax on their behalf. This is the same as a corporate tax. But the tax treatment in the US is more complicated, do the US individuals get a tax credit for Irish tax on income that under US rules they have not received yet?
- Tax each US shareholder on their proportionate share of the income of the Irish factory. Require each US shareholder to make a payment and file an Irish tax return? Same US tax problem as above.
- Tax the factory as a form of property and perhaps apply formula apportionment of the profits of the overall business that are attributable to the factory, as taxes in many US states work. But again the problem arises, who pays that tax, how is the formula calculated, to what profits does it apply, can you get a credit for it in the US and so on?
- Finally, the US might also listen to the economists and decide to remove their corporate tax system, however, will that be on the same basis as the Irish system? Will this require each US taxpayer to make a tax payment and file a return in every country around the world they now have a direct taxable presence?

Instead, the Irish corporate tax system makes clear who pays the tax, on what income and how it is paid. This tax treatment recognisably mirrors, even with some distortions, the US tax treatment. This international aspect was an explicit factor in the introduction of Corporation Tax in 1976 (Ryan, 1976). It may or may not be illogical in economic theory but it works. The *convenience* of taxing at the company level is not a factor to be underestimated.

And in the end, whatever their theoretical position, when reforms of the tax system are discussed this is usually where the recommendations end up (Royal Commission on Taxation, 1955, pp. 17, 382; Commission on Taxation, 1982, p. 330; Devereux, Auerbach, & Simpson, 2010; Mirrlees, 2011, p. 905 ff).

Tax competition

As the 19th century opened, Britain was involved in a titanic struggle with Revolutionary France. One factor in victory or defeat was money. By 1803 Britain could no longer pay for the war against Napoleon. Addington's spectacularly successful new income tax became a tool for victory. The pressure of war forged a degree of acceptance for a new tax at that time that may have been impossible otherwise but it also forged a degree of innovation in the UK tax authorities as they experimented with a series of successively more successful taxes, rapidly trying and discarding the ones that did not work.

However, as we have seen with the endowment effect, nobody likes tax changes. Therefore we would expect that everyone would complain bitterly about another jurisdiction that reduced tax rates or changed its tax system in ways that made investment in that country more attractive before they accepted the competitive pressure and made the domestic change.

Tax competition is often phrased in terms of a 'race to the bottom', as a zero-sum game and in terms of winners and losers. It may be better to look at tax competition as one does at any competitive system – as a discovery process. In this discovery process, tax authorities and citizens are trying to find the best mix of taxes that raise the appropriate amount of revenue (Mendoza & Tesar, 2005) Corporate tax rates have fallen considerably in recent decades (Overesch & Rincke, 2011). However, they fell from rates that clearly were not practical and were in the end counter-productive. The actual consequences of the reduction in corporate tax rates are very different from the perception, as a recent study from the ACCA showed:

'OECD economies raise a non-trivial amount of tax revenue from corporate income tax. In 1965 such taxes raised 2.2% of OECD GDP in revenue, while in 2010 that figure had increased to 2.9%... Similarly, the proportion of total tax revenue contributed by corporate income tax was little changed over the period 1965-2010. In 1965 the contribution of corporate income tax to total taxation revenue in the OECD was 8.8%, decreasing slightly to 8.6% in 2010. The minimum share for corporate income tax to total tax revenue was 7.5% in 1992 with the maximum share in 2007 being 10.6%' (Davidson, 2014).

This competition can result in quite fine graduations in tax rates, as for example, along State borders in the US (Chirinko & Wilson, 2008), but it can also result in competition over excess burdens of taxation, mixes of different taxes, tax bases, certainty of tax system and tax expenditures. It may result in less overall corporation tax but that is not to say that the new result is not overall better for everyone taking everything into account including other tax revenues.

Consequent insights into current US tax reform

More than any other individual, the American economist, Edwin Seligman (1861 – 1939) was responsible for the introduction and the form of federal income and corporate tax in the US. He wrote huge tomes comparing and contrasting income and corporate taxes around the world and relentlessly enthused on its possibilities to his compatriots. But the process of introducing federal income and corporate taxes in the US was so involved and complicated that at times even Seligman despaired:

'The older I grow and the more deeply I work into our economic and fiscal problem, the more seriously do I question the value of our much-lauded system of constitutional restrictions, at all events as applied to the problems at hand. We see the embarrassments on all sides' (1921, p. 344).

Given these constitutional issues we should not be surprised that the last major reform of the US tax system was in 1986. There is no difficulty with tax systems remaining stable over the long periods of time (two of Seligman's chapters on income taxes in the UK in the 19th century are titled: 'A Decade of Quiet' and 'The Uneventful Decade' (1914, p. viii)). However, a number of factors have come together to make the US corporate tax system particularly challenging:

- The rate itself is very high at 35% at the federal level. At the time it was introduced it was a relatively low corporate tax rate, but rates have fallen dramatically everywhere else.
- The high-tax rate is coupled with the lack of an imputation system. While most other major economies have moved or reverted to a classical system they have tended to do this at lower tax rates. Seligman himself was clear: 'Corporations should be taxed separately and on different principles from individuals…. Where the corporate is taxed, the shareholder should be exempt' (1921, pp. 314, 315).
- The 1986 reform also took place just before the reopening of the global market-place and the incredible increase in global trade and investment since then.
- The US system is complex, with a large range of tax treatments available for non-corporate persons. For example, a recent US Senate investigation into the use of structured financial products pointed out that individuals investing through certain hedge funds (largely a post-1986 innovation (Plesko & Toder, 2013)) could obtain an overall tax rate of 15% or 20%. This compared to 39% if they invested directly or at rates of up to 39.6%, if a corporate is used, with tax at the corporate level at 35% and then again at the individual level (Levin & McCain, 2014; EY, Worldwide Personal Tax Guide, 2014).

Irish company residence rules

As we have seen, the 1803 Income Tax Act treated a company just like an individual and imposed income tax. An individual was liable to income tax under Schedule D 'Upon the annual Profits or Gains, arising or accruing to any Person or Persons residing in Great Britain…' (section LXXXIV). This was the same rule for individuals and companies. The residence of an individual is relatively easy to establish. But what the residence of a company meant took a number of cases in the 19th century to define; it usually lay where the board of management of the company made its decisions, as a kind of analogy between the board of a company and the brain of an individual. This is still the core Irish rule over 200 years later.

In the US, US citizens are liable to income tax wherever they reside. Therefore, following similar logic, US incorporated corporates are liable to US federal corporate tax. This is a subtle difference from the Irish position.

Recently, there has been considerable controversy over companies that are considered Irish under US rules and not Irish under Irish rules. But this difference has its roots in the origins in both countries' tax systems and not in recent strategic behaviour.

As Professor Bristow pointed out people tend to focus on the after-tax price for things or the after-tax return on investments. Managers in US corporates subject to US federal taxes have to compete for capital and investments against foreign and domestic alternatives taxed at potentially much lower rates and, therefore, able to provide a higher after-tax return.

The effect on decision-making of taxes at this time can be expected to be unusually high for US corporates. However, global US headquartered companies have an advantage over their competitors for capital and investment - their very global structures. Effectively, the US has exported its excess burdens of taxation.

Therefore, we should not be surprised that this has had worldwide effect and that certain aspects of non-US tax systems have been strained to the point of destruction. But at the same time, we can also see why reforming the US system is so complex and difficult and is likely to take a considerable length of time, even after there is agreement on what direction reform should take. And, in fairness, all of this has been explicitly recognised by the US authorities (see, for example, (Lew, 2014)).

Consequent insights for developing countries

In 1917 the Ford Motor Corporation established a plant in Cork. Henry Ford wrote of this decision and the consequences of it for Cork:

'My ancestors came from near Cork, and that city, with its wonderful harbour, has an abundance of fine industrial sites. We chose Ireland for a plant because we wanted to start Ireland along the road to industry. There was, it is true, some personal sentiment in it... Originally it was designed to manufacture tractors for distribution through Europe, but free production was so hampered by politics and we changed the whole plant into a foundry.... Cork has for many years been a city of casual labour and extreme poverty. There are breweries and distilleries but no real industry. The best a man could hope for was two or three days a week on the docks, for which he would receive sixty shillings, or fifteen dollars.... None of this work was steady. The men and their families did not really live. They had no homes – only hovels. No clothing but what they had on... We now have under regular employment about eighteen hundred men.... The average wage is ... five pounds a week.... We have no labour turnover whatsoever...We have never had a complaint about the repetitive work. The only complaints we ever had were during the first few months, when some of the men found it hard to do without smoking while at work... The payment of these higher wages had an immediate effect in the homes of the men... While once it was the custom for a man to get drunk as soon as he got paid, we have no trouble whatsoever with drinking. Where once the men were apt to turn up on Monday morning somewhat the worse for wear, they are now fresh and bright. In spite of the fact that none of the men ever had any previous experience with money, they have quickly learned to buy wisely and to save.... It is only a question of time and the reduction of taxes before most of them will own motor cars, and then the whole standard of living will rise as it has risen in this country' (Ford, 1926, p. 239ff).

Whilst Cork is now a home for many global companies, how much of this is due to Ford's sentimental decision is impossible to say. Certainly, at the time, Ford would not have received any income tax advantage but his decision was assisted by factors that would be impossible to replicate on a wider scale. Because of Ford's sentimental decisions, Corkonians learnt about modern corporate life and global companies learnt about the capabilities of Cork people – a mutual discovery process was started that is still underway.

In 2008 Christian Aid produced a report, Death and Taxes: The True Toll of Tax Dodging (Christian Aid, 2008). In it they point out that for many people in the world small amounts of money can have life or death consequences. They also conclude that tax evasion is completely unacceptable and they were very critical of the global accountancy firms. The OECD identifies that half of sub-Saharan countries 'mobilise less than 15% of their GDP in tax revenues' but also that multinational groups pay 70% of Rwanda's tax base and 88% in Nigeria (OECD, 2014, p. 11).

More recently, both the IMF and the OECD have looked at the consequences of global tax practices on developing countries. The IMF recommended Minimum Taxes, stronger Transfer Pricing Rules, limiting the number of tax treaties developing countries enter into, anti-conduit and anti-interest deduction rules (IMF, 2014). The OECD's work is still in progress but should also result in considerable extra tax complexity in low-income countries and in other countries that traded with or invested in low-income countries.

As we have seen, one of the main tax burdens of any tax system is the excess burdens of taxation – the distortions caused to the price system by taxes. Now imagine what that burden is like if you are deciding to make an investment in a country where the tax rate is likely to be changed at will and probably with retroactive effect. Some may cheer the immediate visible cash benefit for the government in question but what are the invisible consequences of that decision for every investment decision that follows? Having read all of the above we should not be surprised that 'general fiscal instability ... [is] a worry for the private sector, but can also be quite damaging for the host country' (Manley, 2012).

Developing countries need tax revenues, but from every source including employment, production, consumption and transaction taxes, and they need inward investment. The Irish experience may indicate that too strong an emphasis on raising corporation tax or complex rules may not be as useful as sometimes thought.

The future?

In its 1927 Report to the League of Nations the Committee of Technical Experts concluded:

'A question discussed at great length by the Committee was, whether the Conventions should be collective that is, signed by as many states as possible, or whether they should be merely bilateral.... [T]he accession of all countries to a single Convention could only be obtained as the result of prolonged and delicate negotiations, while there is no reason to delay the putting into force of bilateral conventions which would immediately satisfy the legitimate interests of tax-payers as well as those of the Contracting States... It considers, moreover, that the fiscal laws throughout the world will undergo a gradual evolution and this will, in the future, make it possible to simplify the measures it has recommended and possible even to unify fiscal legislation' (d'Aroma, 1927).

This mirrored the point made by the British economist Edwin Cannan when reviewing Josiah Stamp's work. Cannan had made his career on a study of the breakdown of parish taxes in Britain as a result of the creation of truly national trade in the 18th century. Cannan wrote of those first bilateral tax agreements:

'Are there no signs that as communications grow national income taxes will break down in the future as local income taxes have done in the past? The States of the North American Union are treading the path which English parishes trod in the eighteenth century, and the States of Europe and America are likely to have gone the whole way before the end of the twenty-first, if not earlier. The growing arrangements for meeting the "difficulty of double taxation" are the thin end of the wedge of a virtually international income-tax which is likely to precede the abandonment of complete independence by the States' (Cannan, 1927, p. 278).

It may be that the above predictions are correct or they may be wrong. What is clear is that there will be more and more international cooperation on tax. It is also clear that this cooperation must be, to some degree, on a multilateral basis. There are over 190 countries in the UN, if every one of those was to have a bilateral tax treaty with every other country that would be over 35,000 individual tax treaties all with subtly different terms and opportunities.

However, these developments will be time consuming and long-drawn out – Cannan thought it would take 200 years and that was without expecting the massive interruptions to global trade through most of the 20th century. No one could have realised that the multilateral route that seemed so near in the 1920s would take nearly 100 years to develop. However, these international and multilateral developments are now well underway at EU, G20 and, particularly, at OECD level (for example, BEPS Action 15 – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties).

Finally, the Irish experience is interesting, as we have tried many different tax routes to success and were an early participant in these global developments – our insights should be useful, particularly to developing nations, even if we did not have a lot at stake directly.

Bibliography

The historical section of this report relied heavily on Bank (2011) and Réamonn (1970). All errors included in the report are the authors' own.

Bank, S. A. (2011). Anglo-American Corporate Taxation. Cambridge: Cambridge University Press.

Barrios, Huizinga, Laeven, & Nicodeme (2008) International Taxation and Multinational Firm Location Decision. Economic Papers 356. Economic and Financial Affairs, European Commission

Brennan, P. (Ed.). (2014). Tax Acts. Bloomsbury Professional: Dublin.

Bristow, J. (2004). Taxation in Ireland. Dublin: Institute of Public Administration.

Cannan, E. (1927). An Economist's Protest. London: King & Co.

Chirinko & Wilson (2008), Tax Competition among US States: Racing to the Bottom or Riding a Seesaw?, Federal Reserve Bank of San Francisco Working Paper Series

Christian Aid. (2008). Death and Taxes: The True Toll of Tax Dodging. London: Christian Aid.

Coase, RH. (1988). The Firm The Market and The Law. The University of Chicago Press: Chicago.

Coates, WH. (1925). Double Taxation and Tax Evasion. Journal of the Royal Statistical Society, Vol. 88 (No.3), pp.403 - 427.

Commission on Taxation (1982). First Report - Direct Taxation, The Stationary Office, Dublin.

d'Aroma, P. (1927). Double Taxation and Tax Evasion. Geneva: League of Nations.

Davidson, S. (2014). Multinational corporations, stateless income and tax havens . London: ACCA.

de Cogan, D. (2013) The Wartime Origins of the Irish Corporation Tax, Irish Journal of Legal Studies, pp15 - 32

Devereux, Auerbach, Simpson (2010). Dimensions of Tax Design: The Mirrlees Review - Taxing Corporate Income. Institute for Fiscal Studies, Oxford University Press, p.837 - 893.

EY. (2014). Worldwide Corporate Tax Guide. London: EYGM Limited.

EY. (2013). Worldwide Personal Tax Guide. London: EYGM Limited.

Ford, H. (1926). Today and Tomorrow (1988 ed.). New York: Productivity Press.

Goolsbee, A. (1997). Taxes, Organisational Form, and The Deadweight Loss of The Corporate Income Tax, Working Paper 6173, NBER Working Paper Series.

Gruen, N. (2006). Tax Cuts to Compete. CEDA Information Paper 85. CEDA; Melbourne.

Guenther & Hussein. (2000). Does our Tax System tie the hands of U.S. Multinationals?. The Journal of Corporate Accounting and Finance , September/October. pp. 19-22.

Hallerberg, M. (2002/2003). The Political Economy of Taxation in Prussia, 1871-1914. Jahrbuch fur Wirtschaftsgeschichte. pp. 11-34.

Hedge, S. A. (2011). Ten Reasons the U.S. should move to a Territorial System of taxing foreign earnings., s.l.: Tax Foundation

International Monetary Fund. (2014). Spillovers in International Corporate Taxation, IMF.

Jogarajan, S. (2013). Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation. World Tax Journal. pp. 368 - 392.

Kahneman, D. (2011). Thinking, fast and slow. London: Allen Lane.

Kornhauser, M. E. (1990). Corporate Regulation and the Origins of the Corporate Income Tax. Indiana Law Journal.

Levin, C., & McCain, J. (2014). Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits. Permanent Subcommittee on Investigations. Washington DC: United States Senate.

Lew, J. J. (2014, July 27). Close the Tax Loophole on Inversions. Washington DC: US Department of the Treasury Press Centre.

Manley, D. (2012). Caught in a Trap: Zambia's Mineral Tax Reforms. Working Paper 5 - International Centre for Tax and Development.

Martyn, J., & Reck, P. (2014). Taxation Summary. (T. Cooney, Ed.) Dublin: Irish Tax Institute.

Mendoza, E.G. (2005). Why Hasn't Tax Competition Triggered a Race to the Bottom? Some quantitative Lessons from the EU, Journal of Monetary Economics 52. pp. 163 - 204.

Mirrlees et al. (2011) Tax By Design. Oxford University Press.

Mintz, J.M. (2010). Dimensions of Tax Design: The Mirrlees Review - Commentary. Institute for Fiscal Studies, Oxford University Press. pp. 905 - 912.

Morgan, K. J., & Prasad, M. (2009). The Origins of Tax Systems: A French-American Comparison. American Journal of Sociology, 1350-1393.

Nicodeme, L. (2009). Corporate Income Tax and Economic Distortions, Taxation Papers; European Commission.

OECD. (2014). Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries. OECD.

Overesch, M & Rincke, J. (2011). What Drives Corporate Tax Rates Down? A Reassessment of Globalisation, Tax Competition and Dynamic Adjustment to Shocks, The Scandinavian Journal of Economics 113(3). pp. 579 - 602.

Plesko, G.A & Toder, E.J. (2013). Changes in the Organisation of Business Activity and Implications for Tax Reform, National Tax Journal 66. pp. 855 - 870.

Réamonn, S. (1970). The Philosophy of the Corporate Tax. Dublin: Institute of Public Administration.

Royal Commission on the Taxation of Profits and Income. (1955). Final report. London.

Rush, P. & Mincieli, M. (2010). Are U.S. Taxes Causing a Global Disadvantage?, s.l.: Finance Executives International.

Ryan, R. (1976, March 18). Corporation Tax Bill, 1975 Second Stage. Seanad Eireann Debates, 18(13). Dublin.

Seligman, E. R. (1914). The Income Tax: A Study of the History, Theory and Practice of Income Taxation at Home and Abroad. (2nd Ed.). MacMillan: Harvard.

Seligman, E. R. (1921). Essays in Taxation (3rd ed.). MacMillan: London.

Scholes, Wolfson, Erickson, Maydew & Shevlin (2005) Taxes and Business Strategy: A Planning Approach (3rd Ed.). Pearson Prentice Hall.

Stamp, J. (1921). The Fundamental Principles of Taxation. London: MacMillan.

Tolley's Direct Tax Acts. (2013). London: LexisNexis.

Vogel, K. (1997). Double Taxation Conventions. London: Kluwer.

Wade, C. (2006). The President's Advisory Panel's Recommendation To Move From A Worldwide Tax To A Territorial Tax System. Law And Business Review of the Americas, Volume 12, pp. 373-398.

Weichenreider, A. J., (2005). (Why) Do We Need Corporate Taxation?, s.l.: CESifo.

Legislation: Income Tax Acts

An Act for the Granting to His Majesty, until the Sixth Day of May next after Ratification of a Definitive Treaty of Peace, a Contribution on the Profits arising from Property, Professions, Trades and Offices, 1803. (43 Geo III C.122).

An Act for Granting to Her Majesty Duties on profits arising from Property, Professions, Trades and Offices until 6 April 1845, 1842. (5&6 Vict C.35).

An Act for Granting to Her Majesty Duties on Profits arising from Property, Professions, Trades and Offices, 1853. (16 & 17 Vict C.34).


TRANSACTION
NEW YORK
07:47
LONDON
12:47
Peso
income
HONG KONG
YEN
Page
Assets
Map

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organisation and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organisation, please visit ey.com.

6397.indd 09/14. Artwork by the BSC (Ireland)

ED None.

The Irish firm Ernst & Young is a member practice of
Ernst & Young Global Limited. It is authorised by the Institute of Chartered Accountants in Ireland to carry on investment business in the Republic of Ireland.

Ernst & Young, Harcourt Centre, Harcourt Street, Dublin 2, Ireland.

ey.com