

Tax Monitor

TAX

First Published in *Finance Magazine*, April 2009



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The second chance

Ireland's second budget for 2009 has been described as severe. It had to be that. But it has focussed more on

tax increases than spending savings. The next budget will have to rebalance this if those who are being asked to bear the burden for now are to be treated fairly and long term damage to the economy is to be avoided. In the meantime the Government needs to improve its communications and let the silent majority of taxpayers know it is prepared to make some tough calls.

Defer judgement

It would be a mistake to rush to final judgement on this Budget. The problems it seeks to tackle are many and complex. Many of those problems lie in the areas of macro economics and international finance, as well as in the area of relationships in the EU and Euro zone.

But it is difficult not to be worried by some aspects of the proposals, in particular the over reliance on increased taxation rather than sufficiently focusing on cut backs in public spending. The impression given in the Budget is that not only is this over reliance on taxation the solution for this year, but it might be the solution for next year as well.

Hopefully this is not the case.

The present crisis in public finances has been caused principally by the decisions of the past several years on how the tax revenues from construction activity were spent, and not by the fact that such revenues were generated. If more had been spent on productive capital projects and less on salaries in an unreformed public service we would not now have a problem of any similar magnitude and would have a more competitive economy. The pension levy on State employees does not do enough to bring value for money into the public service compared to costs in the private sector; the attempts to reduce public sector numbers are unfocused and doomed to be short lived; and the task of curbing the costs of the health and social welfare system has been long fingered.

Many of those who are fortunate enough to be still in a job and those who are trying to run businesses in the current environment will be prepared to bear their share of the burden, but only if the Government gives leadership and a clear indication that it is prepared to take the tough calls that many business people are having to take at the moment to remain competitive.

It is critical that between now and the next Budget, the Government sufficiently educates public opinion so

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The VAT package - are you ready for 2010?

You may not be aware of it but some big changes to the VAT regime are due to take effect on 1 January 2010. While you don't need to know all of the technical details of the changes, it is important that you are aware of the impact of the changes on your business.

It is time for Ireland's Go Zone

As Supplementary Budget 2009 indicated, the government is intent on addressing Ireland's budget deficit and growing debt, with a wave of increases in taxation, broadening the tax base and reducing public spending. Kenneth Hardy however expresses the view that this current crisis presents Ireland with an opportunity to invest in the future, and target the scarce resources in a manner which will stimulate rather than stagnate the economy.

that they don't again end up solely appeasing vocal sectional interests and

daytime radio DJs. They must ensure that a fairer and economically healthy balance between increased taxation and savings on public spending is delivered in the next Budget.

Other concerns

The Budget proposals could be accused of displaying certain shortcomings:

There seemed to be a lack of urgency. Much is proposed as desirable in tax terms and in spending terms but action is not to be taken just yet. Why not? The sooner action is taken, the less borrowing is piled up and the faster we will return to economic health.

Because tax reform has been linked to the work of the Commission on Taxation, and spending reform to the work of "an bord snip", we are in the doubly unfortunate position that the work of those bodies, which requires time to be done thoughtfully, has to be rushed, but in the meantime the immediate action on tax is crude and there has not been enough action on spending cuts.

An example of deferred decisions is the statement in the budget speech: "The Government does not think that it is fair to pay the same level of benefit irrespective of the level of income of the recipient. For that reason, the Government has decided that Child Benefit will be means tested or taxed in the Budget for next year." If it is not fair to pay regardless of income, then why do it this year? Why not start the changes in the system right now?

There seems to be failure to prioritise policies to assist competitiveness. The Minister rightly identified the need to address competitiveness in what is an export dominated economy. This was one of the encouraging aspects of the budget speech. But where are the actions to strengthen competition throughout the economy, including in the State dominated sectors? We see instead cuts in tax reliefs for private provision of health services which was critical to achieving a cost effective customer orientated health system.

Where are the actions to ensure that the cost of the State does not represent an uncompetitive burden on the private sector? What we got is additional taxation impacting heavily on employment costs.

The proposal to disallow 25% of the interest cost of rented residential housing on top of exposing it to the "second home levy" seems like a move which will do nothing to restore confidence in the housing market or improve the banks bad debts position. Many affected owners may now have negative equity, partly vacant property, and falling rents. It is possible in such a case that the partial loss of tax relief on the interest may make it impossible for some to meet interest payments and thus lead to foreclosures and further bank bad debts. This seems inconsistent with the otherwise welcome move to establish NAMA - to make NAMA a success will be a major challenge but it is highly likely to be a better solution than having to leave the full State Guarantee of Credit Institutions in place on an open ended basis which might well have been required in the absence of NAMA.

Looking forward to December 2009

At this stage what the minister has done is done. But there can be no excuse for another failure to tackle the real problems over the remaining part of 2009 and in the December 2009 budget.

The errors made in framing the October 2008 Budget, in the discussions on the New National Wage Agreement, and the implementation of the Pension Levy on the public sector were probably significant factors in why the Government backed away now from public service reform and expenditure cuts, and chose to instead place a further burden on the largely silent majority of taxpayers. They have between now and the next Budget to persuade public opinion that a different balance is required.

The Government must also tackle the

management deficit in the public sector. There is some fantastic talent in the public sector, but it isn't being fully supported by Government in its attempts to instill the right approach to the delivery of cost effective quality service to customers. Downsizing must be tackled in an intelligent way by releasing the least effective and least efficient public servants and by identifying entire sectors of activity from which the State should withdraw. The measures announced – a ban on promotions and on replacement of departing staff, and a generous incentive for those aged over 50 years to voluntarily retire - are crude and indiscriminating. They leave the choice of who will leave the public service to factors such as death and illness, and the cherry picking of top talent by the private sector. If the best and most experienced public servants leave, as is possible under these proposals, downsizing may be achieved at the cost of reducing the overall quality of those delivering the service. The proposal to benchmark the salaries of top public servants against other comparable EU States is a good one in principle but it is not clear that you can realign top salaries in this way without impacting on salaries at all levels in the public service.

Social welfare schemes and rates must be based on what we are prepared to pay for as opposed to borrow for. Given that that the real value of social welfare payments is expected to be 7% higher in 2009 than prior to the October 2008 budget, it is difficult to justify either additional taxation or further borrowing to finance this cost.

All of this can be done only if the entire cabinet communicates effectively as to the true nature of what has happened and fearlessly confronts the myth mongers who currently dominate the media. The ground work must be done now and not in a years time if the next budget is to correct the mistaken emphasis in this budget and the previous budget of raising penal taxes to finance inflated, and unsustainable

spending.

Positive steps

The renewed confirmation that the corporation tax rate of 12.5% is to be retained untouched is to be welcomed. Any uncertainty in this area would be the worst disaster this crisis could visit on us. Our competitors would use any suggestion of weakening of resolve here to damage us.

The package of measures designed to produce a tax code friendly to intellectual property management is a positive move. It takes courage to move forward in a crisis and to focus on the future recovery and not the present difficulties. The minister is to be congratulated on this move. The detailed provisions may need some tweaking and improvements in detail in the next budget but this is a good start to the process.

The enterprise stabilisation fund is a good idea in principle. But the amount is too small to be of much use and runs the risk of having high administrative costs relative to the amounts that will reach businesses. It's chances of being useful might be increased if the task of administering it were handed over to the banks that are the natural source of finance for business.

The stamp duty trade in scheme (lets hope it escapes being called a house scrappage scheme!) though welcome as a minor measure is no substitute for the freeing up of mortgage finance and the restoration of confidence in house values and job security. It sits oddly with the restriction of mortgage interest relief which will impact exactly those targeted by this proposal – those trading up. It also sits oddly with the suggestion that the government expects further falls in house prices – which it says will be the trigger for total abolition of mortgage interest relief.

Let's hear from the government

Hopefully the minister will, in the December 2009 budget correct the imbalance between additional taxation

and spending cuts. Hopefully he will recognize that the reforms of the over staffed and under-delivering State machine will be politically possible only if the entire government convinces the country that it really believes in what must be done and that it will, in the national interest, face down opposition from vested interests no matter how good their access to the media.

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Niall Campbell

effect on 1 January 2010. While you don't need to know all of the technical details of the changes, it is important that you are aware of the impact of the changes on your business - what does your business need to do to be compliant and more importantly, what is the cost of getting it wrong?

The VAT package contains a mixture of rule changes, some of which will help simplify business and some which will increase significantly the administrative and compliance burden. Understanding how these changes impact your business and how you will implement them successfully is now critical, given the 1 January 2010 deadline.

A change to the VAT accounting obligations of your business

Under the current system, (subject to certain exceptions) services are supplied for VAT purposes where the supplier is located. From 1 January 2010, for business supplies, the general rule is that VAT will be paid by the purchaser under the reverse charge

mechanism, based on the country where the purchaser is located.

From a financial services perspective, examples of the type of services where the VAT treatment will change will include administration services and leasing of means of transport assets. In some case, these changes will be very significant, for example where services are currently received by a VAT exempt entity from outside of the EU and no VAT is accounted for. The implication in these cases, apart from the new compliance obligations, is that a new irrecoverable VAT cost will arise.

Your business will need to consider what cross border services are currently supplied/received in order to determine the impact of these new rules such as whether changes will be required to the business' IT systems, VAT returns, invoicing process. And of course, any resultant change in the VAT treatment of services will also have pricing ramifications both in relation to contracts currently in place and any contracts which are yet to be negotiated.

Additional reporting requirements

Under the current VAT system, an Irish supplier which is supplying goods to business customers in other EU member states is required to submit a periodic statement (known as a VAT Information Exchange System (or "VIES") return) to the Irish Revenue showing details of the value of goods sold to each EU customer in that period. This information is shared between Member States in order to combat fraud and seek to prevent entities from incorrectly availing of the zero rate.

Under the VAT Package, the requirement to submit a VIES return is being extended to services. Therefore, Irish suppliers which supply services to business customers in other EU jurisdictions will be required to submit quarterly VIES return detailing the value of services provided, the name of the customer and their VAT registration

number. The draft legislation also suggests that "other particulars" may be required. Revenue have not yet indicated what these other particulars may be.

As it is currently designed, can your reporting system prepare a summary of all cross border services supplied by your business in a given period showing the type and value of the services supplied as well as the name, VAT number and address of the recipient? If not, this is a change that your business will need to implement before the roll out of the new rules next January.

The cost of non compliance

The cost of non compliance with these measures could be very significant. Breaching the VAT package rules will trigger exposure to additional interest and penalties. With this brings more Revenue scrutiny taking time and vital resources away from the business. Couple this with damage to the business reputation/customer relationships and extend the problem across multiple jurisdictions. Finally, a breakdown in the VAT compliance process could cause commercial difficulties with suppliers and customers, including non payment of invoices. Is this a cost your business can afford to pay?

Consultation process

On 6 April 2009 Revenue commenced a public consultation process in relation to the VAT Package. Interested parties had until 6 May 2009 to review the draft legislation proposed by Revenue and to revert with comments. This consultation process wont change the fundamental rules introduced by the VAT package but provided taxpayers with the opportunity to seek clarification on certain practical points and implementation issues (such as the point at which a continuous supply should be recorded on the VIES return and the implications of a service having a different VAT treatment in the Member State of the supplier from Member State of the recipient.

And the good news? - Simplified refund procedures

You may be familiar with the current 8th Directive VAT refund procedure for claiming VAT incurred in other EU Member States. The VAT package introduces a new system under which businesses will no longer have to file VAT refund claims in each Member State where they incur VAT. Instead they will submit the VAT reclaim to their own Member State's tax authority. Their home country will then forward the VAT refund claims electronically to the Member States concerned. Under the new procedure, Member States must respond to a VAT refund claim within strict time limits and the failure to meet these time limits will result in interest being paid to the tax payer. The new system should therefore make it easier for businesses to submit cross border VAT refunds and also speed up the time in which they receive the refund claims.

There are, however, a few stings in the tail, in particular the fact that additional information must be provided on the VAT reclaim forms and there will be more consistent application of partial VAT recovery rules.

What does this mean for your business?

With the significant costs of non compliance to be taken into account it is important that your business considers the impact of the VAT package rules now. In view of the length of time which it can take to implement relatively straightforward systems changes, starting your preparation now is essential to being ready for 2010.

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Ken Hardy

It is time for Ireland's Go Zone

As Supplementary Budget 2009 indicated, the government is intent on addressing Ireland's budget

deficit and growing debt, with a wave of increases in taxation, broadening the tax base and reducing public spending. Kenneth Hardy however expresses the view that this current crisis presents Ireland with an opportunity to invest in the future, and target the scarce resources in a manner which will stimulate rather than stagnate the economy. While the United States experienced a much different type of crisis in the aftermath of recent natural disasters, the Go Zone Act 2005 illustrated how targeted tax incentives can greatly assist the rebuilding of an economy.

Go Zone legislation in the United States:

Hurricane Katrina hit the Gulf Coast of the United States on 28 August 2005 with devastating effect. The Gulf Opportunity Zone Act 2005 was signed into law by President Bush on 21 December 2005 in the aftermath of this tragedy. The Act was targeted at major disaster areas. These areas consisted of Louisiana, Mississippi and certain areas in Alabama. The Go Zone package was modelled on the Liberty Zone incentives that were introduced after the 9/11 disaster. The objectives of the Act were to provide significant economic incentives to rebuild the Gulf Coast region as well as to attract new investment to these badly affected areas. It was hoped that these incentives would stimulate private investment in a short time frame to accelerate recovery to the greatest extent possible.

What provisions were contained in this legislation?

The main incentives that were included

in the Go Zone Act were as follows;

- 50% Bonus Depreciation - This was available in the first year that the qualified Go Zone property was placed in service and was equal to 50% of its cost, in addition to the normal depreciation deduction for the balance of these costs. In order to qualify for accelerated depreciation, property must have been placed in service before the end of 2008.

- 5 Year Net Operating Losses carry-back.

- Tax-exempt financing - Tax exempt private activity bonds were available for investment in a wide range of construction or renovation projects. A business could choose between the tax-exempt bonds and the 50% bonus depreciation option.

- 100% First Year Equipment Expense deduction for small businesses - The Go Zone Act allowed small businesses to expense rather than depreciate, up to \$200,000 of investments in equipment and computer software.

- Special Incentives for Employers - An employee retention tax credit was introduced which was equal to 40% of qualifying wages up to a maximum of \$6,000. Employees could exclude from gross income up to \$600 per month in relation to employer provided lodgings, located in the Go Zone.

What impact has the Go Zone incentives had?

The Go Zone incentives have spurred growth in many areas that suffered damage from natural disasters. Mississippi has seen a surge in new businesses being opened and built along its coast and the employment figures have been increasing. More residents have been drawn to the area and therefore rental demand has increased for the new properties being built. Some of the very worst affected areas in Louisiana are still struggling to recover. However the presence of the tax incentive package is encouraging

investment in areas where the economics might otherwise prove too difficult to surmount.

Can Ireland learn from this?

Myron Scholes once said, 'Success is achieved when the tax rules subsidise activities that benefit society as a whole more than the individuals engaging directly in the activities'. This certainly was the case in the Go Zone.

As we enter the second quarter of 2009, the economic crisis which Ireland finds itself in, shows few signs of abating. The tax take continues to fall, the Budget deficit has increased at an alarming rate and unemployment continues to spiral with the seasonally adjusted live register total increasing to 372,800 in March 2009. These figures inevitably led to a supplementary Budget on 7 April as the Government attempts to contain this fiscal deficit. The measures that were announced in the budget are expected to result in a reduction of under €1.5 billion in gross public expenditure and additional tax revenue of €1.8 billion in the 2009 tax year.

The over reliance on tax increases rather than addressing spending savings and the signal that this trend will be continued in the second Budget of 2009, is worrying and could inflict long term damage on the economy. The absence of any significant economic stimulus packages was also very disappointing, at a time when an injection of fresh impetus into our stagnating industries is urgently needed.

Recent history has proven that a focused package of incentives can be very effective in stimulating economic activity. We only have to go back to 1987 to find evidence of how a successful range of tax initiatives can attract investment, by examining some of the tax reliefs that were introduced to coincide with the establishment of the IFSC. These included double rent allowances, rates remission, 100% capital allowances for commercial

development. Tax reliefs have been a very successful feature of taxation policy in recent years as the rejuvenation of areas such as the Customs House Dock area, Temple Bar and the Irish Hotel industry bear testament to.

What measures could be taken now?

- Current Irish legislation allows companies to carry back losses against profits of the prior year. Terminal loss claims allow losses in the final year of trading to be carried back against profits of the previous 36 months. This facility could be made available for all companies, currently trading. This could provide these companies with a much needed cash flow injection as a result of the tax refunds that may be generated. While this would obviously put increased pressure on exchequer finances, this should only be temporary and as the economy recovers, this money should flow back to the exchequer as fewer losses will be available for relief against corporation tax in future periods.

- The scope of the activities qualifying for seed capital and BES relief could be broadened. In addition the restriction of seed capital relief available in respect of non-PAYE income could be removed. With the large pool of highly skilled labour that have recently experienced the pain of redundancy, these initiatives could pave the way for the next wave of Irish entrepreneurs.

- The exemption from corporation tax for new business start-ups could be amended. The current exemption which applies for the first three years where the annual corporation tax is less than €40,000 is insufficient. How many companies are profitable in the first year(s) of trading? This exemption could apply to the first three profitable years of trading and the ceiling possibly increased.

- Similar to that which was contained in the Go Zone incentive package, a first year 100% first year equipment

expense deduction could be introduced for these start-up companies, up to a certain limit.

- The increase in the Research and Development tax credit to 25% in Finance (No2) Act 2008 was a welcome development. However a number of significant changes still need to be made to this incentive.

- The incremental test based on R&D expenditure in 2003 could be ended.

- The method by which unused R&D credits can be refunded could be simplified and any excess of qualifying R&D expenditure over a company's corporation tax liability for an accounting period could be available as a cash refund in that period.

- The option could be made available to allow the R&D credit to be offset against employer's PRSI, similar to the Dutch and UK models. This would reduce wages and social security costs and provide an immediate cash flow benefit to companies at no extra cost to the exchequer.

- I would urge the government to reinstate the right to make R&D credit claims based on the statutory 4 year time limits rather than the 1 year limit brought about by Finance (No2) Act of 2008. Otherwise this is likely to act as a major disincentive to companies commencing or continuing R&D activity in this country.

- Lack of consistency in the way Revenue deal with R&D credit claims is now becoming an issue and should be addressed.

- The introduction of accelerated capital allowances for energy efficient equipment in Finance Act 2008 was a welcome development. However, in order to qualify for these allowances, the specific equipment must be contained in a list of specific equipment listed by the Minister for Communications, Energy and Natural resources and maintained by Sustainable Energy Ireland. Given the pace of innovation and product enhancement that is experienced every day, it is going to be impossible for the list makers to keep up. It would be

preferable to see a 100% deduction being made available for expenditure on energy efficient equipment and a less cumbersome way to have new equipment added to the list. In addition I would propose that a credit similar to the R&D tax credit be made available in relation to such qualifying expenditure. This form of relief would be much more effective in encouraging investment in this area, rather than the restricted form with which it has been introduced.

Time to act

The night is darkest just before the dawn. If there is truth to this saying, we would hope that dawn is fast approaching. The government obviously has an extraordinarily difficult task on its hands. However it is important during this time, to ensure the necessary steps are taken to invest in Ireland's future in addition to solving the problems of the past. However, the Go Zone in the US stimulated the necessary results, and is positive proof that the tax incentives can improve economic conditions, following even the worst crisis. Let's learn from this. The Irish Times said in December 1992 that the IFSC was more of a concept than a place, so it is time for a new concept – Ireland's Go Zone which contains the reliefs outlined in this article – our future is waiting for us.

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