Focusing on FDI Fundamentals
Foreign investment into the future

By Kerri O'Connell, ACA and Liz Lyne


During these times, even the most sanguine of individuals would acknowledge that we are in unprecedented territory in terms of the economic crisis. However, while there has been ample media coverage of the negative economic outlook facing the country, the positive factors which will assist in an economic upturn are being overlooked, as Kerri O'Connell and Liz Lyne explain.

It is widely accepted that Ireland's fate as an open economy is very susceptible to changes in the international economic environment. Nonetheless, no one can argue that domestic factors, such as the property crash, have exacerbated the recession in Ireland, relative to the recession experience internationally. While accepting we cannot control many factors external to our own economy, we must seek to improve internal factors we can influence. It is also important to remember that many of the internal economic factors which contributed to emergence of the Celtic Tiger are still operative and will assist in Ireland's economic recovery.

A continuing trend of foreign direct investment in Ireland, albeit at a slower pace than in the heady days of the Celtic Tiger, is evidence that for many companies, Ireland remains a good location for business. It is extremely important that we work to enhance those factors which have attracted foreign direct investment (FDI) in the past and which can attract new investment in the future.

Taxation Regime

There is no doubt that the 12.5% rate of corporation tax has been a key factor in terms of attracting FDI and that this will continue as an incentive for foreign companies to locate in Ireland. Most of our EU neighbours continue to have very high corporation tax rates with many countries having corporation rates ranging between 30% and 40%. It is acknowledged that some European countries (many of them, ironically, following the Irish model) currently have lower rates, e.g. Poland has a 19% corporation tax rate, while Latvia and Lithuania both have corporation tax rates of 15%. Notwithstanding such tax competition, Ireland will continue to remain attractive for investors if improvements continue to be made in relation to other tax incentives, infrastructure and general cost competitiveness and provided the 12.5% rate of corporation tax continues. It is imperative that the government does its utmost to defend Ireland's corporation tax system, particularly in light of recent suggestions that proposals by the European Commission for a common tax base are being worked on.

While the 12.5% rate of tax is a key factor in maintaining the attractiveness of the Irish tax system, there are many other factors discussed below which make the tax regime in Ireland friendly to business.

Due to a number of factors, including the abolition of capital taxes and the introduction of the Irish capital gains tax 'participation exemption', Ireland represents an attractive holding company location. Further incentives include generous exemptions from withholding taxes on the payments of royalties, interest and dividends from Irish tax resident companies in certain circumstances, and the lack of an exit tax from Ireland in many instances.

The fact that Ireland is not perceived to be a tax haven supports our attractiveness, both as a holding company location and also for inward investment generally. It is noteworthy that Ireland has implemented the 'internationally agreed standard' in accordance with the April 2009 G20 tax havens blacklisting system.

Ireland has signed tax agreements with all of its main trading partners; there are 56 double tax agreements in existence, of which 48 are operational. The double tax agreement network continues to be developed and where a double tax agreement is not operational, relief from double taxation is provided to foreign investors on a unilateral relief credit system under domestic tax provisions.

Research and Development (R&D) activities are incentivised in Ireland, by way of a corporation tax deduction and also a 20% credit leading to an overall tax deduction, for certain research and development work, at an effective rate of 37.5%. In some circumstances, the R&D credit may be complemented by a generous patent royalty exemption. It is to be hoped that such incentives will increase the R&D activities of foreign businesses in Ireland.

The fact that Ireland does not have a ‘controlled foreign corporation’ tax regime system is an advantage in terms of attracting foreign investment. Furthermore, while Finance Act 2010 introduced ‘thin capitalisation’ legislation, this is perceived as neutral to our investment attractiveness, due to the ongoing global focus on regulation.

While the above highlights features of the Irish tax regime which are attractive to investors, it must be acknowledged that ongoing improvements in the administrative operation of the Irish tax system also play a role in reinforcing the perception that Ireland has a pro-business environment. The Revenue online system (ROS) has played a crucial role in enhancing the transparency of the Irish tax system and, indeed, its efficiency. Over the last decade or more, many innovative steps have been taken to improve the operation of the tax system and this is a welcome ongoing trend.

Infrastructure and Competitiveness

Very significant progress has been made in terms of national infrastructure development during the 1990s and early 21st century, though this has decelerated to some extent in recent years. While broadband penetration has improved, our broadband speeds still lag behind many of our European counterparts. Our road and rail systems have dramatically improved and the opening of a second terminal in Dublin airport, scheduled for later this year, is to be welcomed. In the longer term, complacency in relation to the ongoing development of our national infrastructure will cost us dearly, and it is imperative that significant capital spend continues to be a feature of future government budgets.

Our competitiveness, not only in the sphere of infrastructure, will be a key driver in maintaining and increasing foreign direct investment into the future. Volume I of the report published by Forfás and the National Competitiveness Council (NCC) in July 2010 frankly analyses the factors which operate in gauging competitiveness performance. The report indicates that while Ireland lost competitiveness over the past decade, there has been recovery in this regard since January 2008. The Forfás and NCC report is emphatic that the regaining of competitiveness, including the further development of our infrastructure, is imperative to our economic recovery.

The report indicates that, in overall terms, unit labour costs have fallen and labour supply has increased due to rising unemployment. Furthermore, there has been a decline in the cost of constructing or renting a prime industrial site or office space despite the fact other property-related costs remain very high. While cost competitiveness on utilities is mixed, the cost of our water services compares favourably with our main trading partners.

Educational performance is highlighted in the report as a key factor in terms of maintaining Ireland’s competitiveness, with Ireland producing more maths, science and computing graduates per 1,000 of the population than the EU average. However, it must be conceded that there is a limited supply of mathematical graduates,and the recent Leaving Certificate results give rise to concern as to performance levels in maths. Added to these issues are the recent slippages in university rankings, all of which challenges must be faced.

The report recently published by the World Economic Forum shows that Ireland’s international competitiveness ranking has fallen to 29th position for the survey for 2010-2011. However, it is clear that the latest decline is largely attributable to macroeconomic factors and ongoing concerns over financial markets.

Despite the current challenges facing the economy, the country has a proven track record in terms of attracting FDI. This has led to the acquisition of key management and other skills necessary to attract future foreign investment. The Industrial Development Agency has played a very important role in promoting Ireland as a centre for foreign business investment and continues to do so. Furthermore, where there is any deficit in skills available in Ireland, these may be supplemented by secondments from other locations. The ‘remittance relief’ for foreign executives continues to be an important tax incentive for those individuals locating in Ireland.

Conclusion

The profile of Ireland, from an international perspective, while indisputably tarnished by the banking crisis and our current public deficit, is of a country with a flexible, modern pro-business outlook. Abroad, despite some negative comment, the government is generally winning plaudits for taking the hard decisions in order to get the public accounts in order. These decisions are impacting heavily on the population but the fact that they have not led to significant protests and social unrest, as has happened in other European countries, must also be viewed in a positive light by potential investors.

Only the naively optimistic would believe that Ireland does not face significant economic challenges in relation to a myriad of issues, such as restoration of confidence in our banking system and our public finances, etc. However, there are many positive fundamentals which will help drive the economy forward when the global economy begins to lift. In the interim, the challenge for Ireland is to confront the domestic economic difficulties we face, to promote the many incentives on offer to potential foreign investors and to maintain a sense of perspective in fraught and frustrating times.

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