Financial Post

News

Ireland's business tax to survive

Tim Shufelt, Financial Post · Wednesday, Nov. 24, 2010

The enormity of Ireland's debt crisis has its leaders citing the need for collective sacrifice. If Irish fortunes are to reverse, the government says, all will have to share the burden.

Except the business community.

To secure billions in bailout money from the European Union and the International Monetary Fund, Ireland put forth a €15-billion ($20.21-billion) austerity package meant to stave off insolvency and restore investor confidence.

Blood will be drawn from virtually all limbs of the national budget, with deep cuts to pensions and welfare, reductions in public-sector salaries and the minimum wage. The corporate tax regime, however, will not be touched.

At 12.5%, the corporate rate has been the cornerstone of Ireland's industrial growth strategy, leading to establishment of the Celtic Tiger. It remains among the most favourable business tax regimes in the developed world.

But while the austerity plan may create the perception the private sector is not shouldering its fair share of the weight, a corporate tax hike would run the risk of truly foiling any Irish recovery, analysts say.

"To me, it would seem a backwards idea to increase the corporate tax rate, damage the investment climate and harm your chances at recovery," said Niels Veldhuis, senior economist at the Fraser Institute. "If you penalize the corporate side, a lot of those businesses have a relatively easy time moving their activities elsewhere."

In refusing to interfere with business taxes, the government of Prime Minister Brian Cowen is sending a message to multinationals that it will not resort to chilling its investment climate, even under the most dire of fiscal circumstances.

"What they're trying to say is, 'Look, we're not doing it now,' " said Ben May, an economist at Capital Economics in London. "And even if things get a little bit worse and we're forced to implement further cuts, we'll shield corporations from it," Mr. May said.

The Irish government may not have too much trouble selling the notion to its own taxpayers. In fact, the tax regime is popularly regarded as the single biggest factor in turning Ireland into a European gem and stemming the scourge of emigration.

"Everyone in the tax world talks about that corporate tax rate," said Chris Edwards, director of tax policy studies at the Cato Institute. "And it has been a neon sign to advertise that the Irish economy is open for business."

That 12.5% has become a point of pride. So much so that faith in the corporate tax regime has become something of a cultural phenomenon, said Jan Randolph, director of sovereign risk research at IHS Global Insight in London.

"It's important not to fetishize the 12.5%. It's not sacrosanct and even if it does go up a couple of percentage points, it's not going to fundamentally alter the positive proposition that Ireland has in terms of an industrial location," Mr. Randolph said.

While Ireland needs to retain the multinationals that have set up shop there, and needs additional foreign direct investment more than ever, there's nothing preventing minor corporate tax hikes, he said.

"On an equity basis and a fairness basis, one could argue on the corporates carrying their fair share of the burden going forward."

But he also points out that corporate Ireland is not responsible for the fiscal mess that has befallen the once blistering economy.

Blame for the current crisis lies solely with government spending that rose uncontrollably throughout the boom. Once the housing bubble burst and the credit crisis hit, tax revenues plummeted, creating an unbridgeable fiscal gap.

In addition, even a marginal increase in corporate taxes could cause an outflow of capital from Ireland, Mr. Edwards said.

Other European countries have closed the gap in tax regimes, with the average rate in Europe now switting at about 23%.

And with a highly interconnected global economy, capital is more mobile than ever, he said.

"If you try to tax things that are very mobile, like corporate investments and corporate profits, you end up hitting the workers underneath, because they're the ones that can't move."

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