

# Column: How Obama's policies may hurt investment in Ireland

**Ireland's foreign direct investment is at risk under Obama's tax proposals. We should be worried, writes Dr Tom Flavin.**



Image: ([Image via Flickr/ciron810](#))

AS THE US electorate prepare to elect their 45th President, the campaign has thus far failed to capture the imagination of the Irish public. Perhaps it's not surprising, given the magnitude of our domestic problems, that the US election has not grabbed our attention. However that might be an oversight on our part. Both candidates have been making promises of economic reform that are likely to impact on corporate America and reverberate around the globe.

Following the recent financial crisis and economic recession, American voters are primarily concerned with the plight of the domestic economy. The slogan 'It's all about the economy, stupid' is as relevant now as when it was first coined in 1992. Weak economic growth and persistent unemployment are the main concerns of the US public.

Both candidates have promised to lower the corporate tax rate to aid domestic firms. President Obama's proposals go further and are designed to make foreign investment less appealing to US firms. Should these manifesto policies become reality, then Ireland's ability to attract Foreign Direct Investment (FDI) from the US may well be compromised. Should we be worried? The answer is almost certainly, YES. So let's look at these proposals in greater depth.

Anything that makes Ireland less attractive to US Multinationals is a concern. Currently we rely heavily on US corporations for creating employment and generating

economic activity here. Some 'stats and facts' available from the American Chamber of Commerce emphasise just how important our relationship with corporate America really is. In 2011, the US accounted for 74 per cent of inward investment into Ireland; and around 70 per cent of the 13,000 jobs created in Ireland by overseas investment were generated by US firms. Globally, we occupy first and third places in US foreign investment in the Information and Chemical sectors respectively. Therefore, and in case there was any doubt, Ireland needs to remain attractive to US MNCs.

The main thrust of Obama's corporate tax plan is to make it less attractive for US firms to move their operations to foreign shores. The main proposals are:

1. To reduce the corporate tax rate by 7 percentage points to 28 per cent;
2. To fund this reduction by eliminating "dozens" of corporate tax breaks;
3. To charge US tax on foreign profits when they are earned as opposed to when they are repatriated (as currently stands);
4. To disallow the writing off of 'moving expenses' against tax for firms opting to move abroad;
5. To introduce a 20 per cent tax credit for firms who move operations back home.

All bear an element of threat for recipients of US FDI. We assess the risks of each and their potential impact on US investment in Ireland.

### **Reducing the corporate tax rate while eliminating tax breaks**

At face value, a lower US corporate tax rate would seem to be the greatest threat. However, in reality few firms pay 35 per cent (the current nominal rate) tax on profits. The effective rate is much lower and is estimated to be around 23-27 per cent. This is due to a plethora (approximately 130) of corporate tax breaks that are available to US firms. Therefore, the overall effect of a tax rate reduction that is accompanied by the elimination of tax breaks is ambiguous. Firms are not necessarily going to pay less tax and this uncertainty will dampen their initial enthusiasm for the rate reduction. Furthermore, any attempts to eliminate tax breaks are sure to be met with powerful opposition from lobby groups and will not be easily or quickly implemented. So far, there is little detail as to what tax breaks have been earmarked for the chop.

### **Timing of the tax liability**

Under the current tax system, US firms can defer their US tax liability on foreign income indefinitely by re-investing profits outside of the US. Tax is only incurred when profits are repatriated. Any taxes paid to the host country receive a tax credit. Consequently many large multinationals have a portfolio of foreign operations and income from high- and low-tax jurisdictions are netted off to reduce the US liability. President Obama proposes to prohibit the deferral of the tax liability. US taxes would be computed on foreign income for the period in which it is earned. If this proposal was to become law, then it would undoubtedly reduce the attractiveness of a low-tax country like Ireland. The main problem for Obama will be getting this through Congress. The full weight of corporate America will be brought to bear against any changes that are likely to raise their tax costs and I predict a long, arduous and ultimately futile battle to write this policy into law.

## **Changes to tax credits**

At first glance, the changes to tax credits are probably the least worrying of Obama's proposals. Firms who locate outside of their home country are usually implementing a long-term strategy. The introduction or elimination of a one-off tax credit is unlikely to influence this decision unduly. However, it is probably the easiest change to implement and may have some small impact on marginal decisions to re-locate or not.

In summary, President Obama's proposed alterations to the corporate tax system are probably less worrying than first thought. However, it does herald a disturbing development within his administration. In these recessionary times, policies that reduce outflows from the domestic economy will be pursued. Ireland must be ready. We have benefited greatly from our low-tax regime but we must continue to develop other comparative advantages. With European colleagues talking up tax harmonisation and the aforementioned US developments, we cannot rely solely on our tax advantage.

A recent research paper at NUI Maynooth by economist, Kate Hynes, highlights the potential advantage from investing in infrastructure (education, telecommunications etc) for a country trying to attract FDI. A positive synergy associated with such investment is that it also helps domestic firms to become more internationally competitive and grow their exports. Ireland must ensure that we are competing for FDI using all our strengths and avoid dependence on our low tax regime.

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