Consultation on New Taxation Measures to apply to Outbound Payments

KPMG Response to Consultation

December 2021

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Dear Sir / Madam

Consultation on new Taxation Measures to apply to Outbound Payments

KPMG is pleased to respond to the consultation on new taxation measures to apply to outbound payments. KPMG is the largest provider of business taxation advice in Ireland. We have drawn on our experience of providing advice to businesses across a range of sectors to provide comments to the consultation.

Our response delineates between payments to jurisdictions on the EU non-cooperative list and to jurisdictions with zero-tax / no-tax regimes. We advocate that any measures introduced on foot of this consultation take into consideration the existing rules that apply in our law with respect to such payments, and to the prospective adoption of future international measures, so as to prevent a stream of overlapping measures which achieve the same objective.

The contact point for this submission is Brian Daly. Brian's contact details are: Email: brian.daly@kpmg.ie ; Direct telephone: (01) 410 1278.

Should you wish to discuss any aspect of the attached submission please do not hesitate to contact us.

Yours faithfully

Tom Woods

Background

The consultation document sets out the background to the issues very comprehensively and appropriately frames the questions by reference to:

- Commitment 6 - to consider additional defensive measures in respect of countries on the EU list of non-cooperative jurisdictions, and
- Commitment 7 - to consider broader actions that may be needed in respect of outbound payments.

Overview and Introductory Comments

With respect to the questions outlined in the consultation document, any consideration of the actions that may be taken on foot of this Consultation should in our view take account of and be framed by reference to recent tax developments at OECD and European Union level. In this context it is clear that Ireland has demonstrated a commitment to eliminating opportunities for base erosion and profit shifting (BEPS) and has been fully engaged in both the OECD BEPS process and has implemented European Union (EU) reforms focused on preventing aggressive tax planning.

We think it is appropriate to look at Commitment 6 separately from Commitment 7 as the issues pertaining to non-cooperative jurisdictions are different to those which apply to payments to other no tax jurisdictions.

1. Commitment 6 - to consider additional defensive measures in respect of countries on the EU list of non-cooperative jurisdictions

Where payments are made to jurisdictions that have been identified by the EU Code of Conduct as being non-cooperative when assessed under the criteria of transparency, fair taxation and the implementation of OECD BEPS standards, we consider that additional measures could be introduced to further prevent the possibility of non-taxation to address aggressive tax planning through non-substantive operations in those countries. Our thoughts in this regard are outlined in response to Questions 2 to 6 below.

2. Commitment 7 - to consider broader actions that may be needed in respect of outbound payments

With respect to payments to countries that are not on the EU list of non-cooperative jurisdictions, Ireland should implement the measures already agreed to at OECD / EU level, and not go beyond them.

There are a number of reasons supporting this approach which are discussed in detail in paragraphs 2.1 to 2.4 below. They are:

1. It would be inappropriate to penalise a country solely because it has a zero or no tax rate – in this regard the EU Code of Conduct (Business Taxation) Group (the EU Group) and the OECD have both indicated that the mere existence of a zero or low tax rate is not enough of an indicator of a harmful regime. Likewise the EU's determination of whether a jurisdiction should be on the list of non-cooperative jurisdictions takes account of a much wider range of factors than merely the question of whether the country has a low or no tax rate.
2. Additional defensive measures should act as an incentive for countries to be treated as cooperative.
3. Ireland has already implemented a significant number of measures which tackle aggressive tax planning, many of which are more burdensome on payments to non-treaty jurisdictions.
4. The Coffey Report indicates that additional measures beyond those already implemented are unnecessary.[1]

2.1. Identification of harmful tax practices

The EU Group and, separately, the OECD's Forum on Harmful Tax Practices (FTPH) assess harmful tax practices. As explained in more detail below, both the EU Group and the OECD indicate that the mere existence of a low or zero rate of tax is not enough of an indicator of there being a harmful regime. On this basis, we consider that a no-tax / zero-tax regime alone does not necessitate the need for broader tax measures applying to outbound payments.

The criteria applied by the EU Group to identify a potentially harmful tax measure are internationally accepted. The EU Code of Conduct (the Code), at paragraph M, considers it advisable that principles aimed at abolishing harmful tax measures should be adopted on as broad a geographical basis as possible, and that Member States commit themselves to promoting their adoption in third countries. As noted in the Consultation Document, in assessing harmful tax measures, the Code (at paragraph B) provides that tax measures "*which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the member state in question are to be regarded as potentially harmful and therefore covered by this code*". The measure is then assessed using five further criteria to determine if the measure is harmful;

[1] 'The changing nature of outbound royalties from Ireland and their impact on the taxation of the profits of US multinationals', Seamus Coffey, May 2021

- whether tax advantages are granted even without real economic activity or substantial economic presence;
- whether the rules for profit determination in respect of economic activities within a multinational group depart from internationally accepted principles, namely transfer pricing rules;
- whether the measures lack transparency;
- whether tax advantages are accorded only to non-residents or in respect of transactions carried out with non-residents; and
- whether tax advantages are ring-fenced. [2]

Hence, the Code demonstrates that a zero or low rate of tax is not in and of itself enough evidence for a tax regime to be considered harmful.

The OECD's FHTP also focuses on whether a tax regime constitutes a harmful preferential regime. As noted in the OECD BEPS Action 5 2015 Final Report 'Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance' (the Report), "the work on harmful tax practices is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates. Rather, the work is about reducing the distortionary influence of taxation on the location of mobile financial and service activities, thereby encouraging an environment in which free and fair tax competition can take place".[3]

The Report sets out four "key factors" (one being that the regime has no or low effective tax rates on income from geographically mobile financial and other service activities) and eight "other factors" which are used to determine whether a preferential regime within the scope of the FHTP's work is potentially harmful. Where a regime meets the "no or low effective tax rate" factor, the Report provides that an evaluation of whether that regime is potentially harmful should be based on an overall assessment of each of the other three "key factors" and, where relevant, the eight "other factors". Hence, the Report recognises that whilst zero taxation is a factor in assessing whether a tax regime is a harmful one, it is not the sole determining factor.

The consistent approach taken by the EU Group and the OECD's FHTP referred to above in determining what constitutes a harmful tax regime demonstrates that the mere existence of a low or zero rate of tax is not enough of an indicator of there being a harmful regime. On this basis, we consider that a no-tax / zero-tax regime alone does not necessitate the need for broader tax measures applying to outbound payments.

[2] Conclusions of the ECOFIN Council meeting on 1 December 1997 concerning tax policy (the "EU Code of Conduct")

[3] OECD BEPS Action 5 2015 Final Report 'Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance'

2.2. Assessment of non-cooperative jurisdictions

The EU Group also identifies jurisdictions that are non-cooperative for tax purposes by assessing third countries and providing these assessments to the Council of the EU for approval. The jurisdictions are assessed under the following headings[4]:

- tax transparency – the jurisdiction is assessed based on compliance with the OECD Automatic Exchange of Information standards and whether they have ratified or brought in equivalent measures to the OECD Multilateral Convention on Mutual Administrative Assistance,
- fair taxation - the jurisdiction should have no preferential tax measures that could be regarded as harmful according to the criteria set out in the Code, listed in section 2.1 above, and the jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction, and
- implementing anti-BEPS measures – the jurisdiction is assessed based on their implementation of the OECD anti-BEPS minimum standards, namely countering harmful tax practices (Action 5), preventing the granting of treaty benefits in inappropriate circumstances (Action 6), implementing revised transfer pricing documentation and country-by-country reporting (Action 13) and improving dispute resolution mechanisms (Action 14).

The Economic and Financial Affairs Council configuration (ECOFIN, of the Council of the EU) reviews the assessments and failure to satisfy any of the above criteria can result in jurisdictions being listed in Annex I to the Council Conclusions (the EU list of non-cooperative jurisdictions). The list is updated twice a year. A zero-tax regime requires assessment under the further criteria set out in section 2.1 before it could be determined as failing to satisfy the 'fair taxation' or 'implementing anti-BEPS measures' criteria relevant to the listing process. Hence, a zero-tax regime is not an individual criterion and therefore does not result in automatic inclusion on the EU list of non-cooperative jurisdictions.

In addition, following the assessment by the EU Group, certain non-EU no-tax / zero-tax jurisdictions (which included Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man and Jersey) addressed the EU Group's concerns regarding economic substance. The governments in each of these jurisdictions worked closely with the EU Group to ensure that those concerns were adequately addressed. As a result of this engagement, new laws and regulations were adopted in each jurisdiction and their regimes were ultimately accepted by the EU Group as not harmful.

In 2019, the EU Group agreed, with endorsement by the Council of the EU, that listed jurisdictions must be subject to one of four legislative defensive measures.[5] The legislative measures include:

- the non-deductibility of costs,
- controlled foreign company rules to include the income of an entity resident or a permanent establishment situated in a listed jurisdiction in the tax base of the taxpayer,
- withholding tax measures, and
- the limitation of participation exemption on profit distribution.

[4] Council conclusions (8 November 2016) Criteria and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes

[5] Report to the Council, Code of Conduct Group (Business Taxation) 14114/19

Ireland has met these requirements by implementing enhanced Controlled Foreign Company (CFC) rules applying to the list of non-cooperative jurisdictions in Finance Act 2020. Regarding the denial of the participation exemption, it was determined that as Ireland has a worldwide system of taxation as opposed to a territorial regime, our regime already provides the protection that would be offered by the limitation of a participation exemption.

As noted above, we consider that any further defensive measures introduced into Irish law should be confined to jurisdictions on the EU non-cooperative list. Applying additional defensive measures to non-cooperative jurisdictions should act as an incentive for these jurisdictions to comply with the Code.

2.3. Recovery and Resilience Facility

We note that the Consultation Document refers to the National Recovery and Resilience Plan, which seeks to address challenges identified in the European Commission's Country Specific Recommendations (CSR). Concerns are expressed in 2019[6] and 2020[7] generally on the level of outbound payments from Ireland. The commentary in the CSRs does not refer to the location of the recipient of the outbound payment. As noted in the Consultation Document, the research by Coffey[8] demonstrates that recent international tax reforms are having the desired effect with outbound payments increasingly going directly to the US (where the property rights are held) where they are taxed, and not to 'offshore financial centres'. Hence the volume of outbound payments in 2019 and 2020 would not be grounds, in our view, for adding any further provisions, beyond those that may be proposed with respect to Commitment 6, into our law.

2.4. Defensive measures in Irish tax legislation

Ireland has a comprehensive list of existing measures that tackle anti-avoidance behaviour and reduce the risk of base erosion and profit shifting, with additional measures to be implemented in due course if, as expected, the recommendations from the OECD in respect of BEPS2.0 are accepted and implemented internationally.

As we explain below, a significant number of measures have recently been implemented, and others are about to be, which have already and will further limit the use of zero-tax jurisdictions for aggressive tax planning arrangements.

It will be important to ensure that Ireland's tax system is clear and transparent, and potential new anti-avoidance rules form an integrated whole, rather than a patchwork of overlapping measures. We believe this can be best achieved by engaging in and implementing internationally agreed standards in relation to third countries and assessing the current measures in light of these standards.

We consider that the below measures are extensive in preventing double non-taxation with regard to jurisdictions who cooperate within the international tax framework. Many of these measures provide for a withholding tax obligation or a denial of a deduction:

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[6] European Commission's Country Specific Recommendations 2019

[7] European Commission's Country Specific Recommendations 2020

[8] 'The changing nature of outbound royalties from Ireland and their impact on the taxation of the profits of US multinationals', Seamus Coffey, May 2021

Ireland's domestic legislation contains defensive measures which include withholding taxes and the denial of deductions. Measures include the implementation of international standards.

As demonstrated below, under our existing regime, certain exemptions apply to payments made to DTA partner jurisdictions. Ireland has only one DTA with a jurisdiction currently on the EU non-cooperative list[1], and our DTA network with no-tax / zero-tax jurisdictions is very limited.

Measure	Summary of measure
Withholding tax on interest	An Irish resident company is required to deduct withholding tax from yearly interest payments. There are some exceptions to this rule, including where the interest is paid to a resident in a country with which Ireland has a DTA. The exemption will only apply where the tax regime in that DTA partner jurisdiction is one that imposes a tax that generally applies to interest receivable in that territory by companies from sources outside that territory, or where the interest is exempt from tax under the terms of the double tax treaty between Ireland and the relevant territory.[2] This is evidence that Ireland has within our domestic law sought to link the general exemption from interest withholding tax to circumstances where the income is being taxed in the other country.
Withholding tax on dividends	Ireland imposes a withholding tax on distributions from Irish tax resident companies. 'Distributions' are widely defined for Irish tax purposes and include interest paid on related party debt in certain circumstances. There are some exemptions from the withholding tax, including where distributions are made by an Irish tax resident to a company which is resident in a DTA partner country and which is not under the control of persons who are Irish resident[3]. An exemption from dividend withholding tax is also available for distributions made to a company which is controlled by persons that are tax resident in a DTA partner country[4]. This is evidence that our tax code links the general exemption from withholding tax to circumstances where the income is ultimately under the control of Treaty residents, most of whom currently have (or will, post BEPS2.0, have) an effective Controlled Foreign Company regime that will see the income being taxed.
Deemed distribution treatment	Interest on debt with 'equity type' characteristics (e.g. profit participating debt and convertible debt), and interest on debt without any 'equity' characteristics where it is payable to a non-resident 75% group member, may be recharacterised as a distribution for tax purposes, with the application of dividend withholding tax and the denial of a corporate tax deduction.
Withholding tax on patent royalties	An Irish resident company is required to withhold income tax from patent royalty payments. An exemption applies where the royalty is paid in the course of a trade / business carried on in Ireland to a DTA partner country in certain circumstances. The exemption will only apply where the receiving company is resident in a relevant territory, the payment is made for bona fide reasons and not as part of any tax

	avoidance arrangement, and the country of the recipient has a tax that generally applies to royalty income receivable in that country from sources outside that territory.[5] This is evidence that Ireland has within our domestic law sought to link the general exemption from withholding tax to circumstances where the income is being taxed in the other country.
Withholding tax on pure income profits	Ireland imposes a withholding tax on pure income profits earned by the recipient.
Worldwide tax system	A company resident in Ireland is subject to Irish tax on its worldwide income and gains. One of the four legislative defensive measures put forward by the EU Code of Conduct Group and endorsed by the Council of the EU in 2019 concerned the limitation of participation exemptions on distributions of profits received from a listed jurisdiction. As Ireland does not have a territorial regime and instead has a worldwide tax system, our tax regime already provides the protection that would be offered by a measure which would limit the participation exemption on profits from a listed jurisdiction.
Corporate tax residence	Ireland has amended its corporate tax residence rules to prevent Irish incorporated companies from being stateless for tax purposes. A company resident in the State is liable to corporation tax on its worldwide profits. A company is deemed to be tax resident here if it was incorporated in Ireland on or after 1 January 2015 unless it is treated as tax resident in another country under a DTA.
Exit tax	Ireland amended its existing exit tax provisions to ensure they were compliant with the Anti-Tax Avoidance Directive which prevent companies from avoiding tax when relocating assets.
General anti-avoidance rules (GAARs)	Ireland has measures to tackle abusive tax practices that are not dealt with through specifically targeted provisions.
Transparency and information exchange	Ireland has a best in class regime regarding tax transparency and exchange of information, including the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters. This Convention provides for the cross-border sharing of information between tax administrations to detect and prevent tax evasion and to ensure, among other things, the correct application of Ireland's tax legislation. Ireland's various Double Tax Agreements also provide for the exchange of information.
Anti-Money Laundering measures	Ireland has adopted the Anti-Money Laundering Directive (AMLD), including AMLD 4 and 5 on Central Registers of Beneficial Owners. These measures are an important and effective tool to prevent double non-taxation.
Public Country-by-Country reporting (to be	New measures will require multinational groups/companies with a total consolidated revenue of €750 million to report information if they either have an EU parent or otherwise have EU subsidiaries or branches of a

implemented by 22 June 2023)	certain size. The information must be broken down for each EU Member State where the group is active and also for each jurisdiction deemed non-cooperative by the EU or that has been on the EU's "grey" list for a minimum of two years. Information concerning all other jurisdictions may be reported on an aggregated level.

Ireland has been to the forefront in implementing the BEPS recommendations.

The OECD's BEPS project commenced in 2013 and marked a fundamental shift in the international tax landscape for the taxation of multinational enterprises. It also marked the commencement of an intensive period of legislative change across EU and OECD countries, as existing legislation is updated and new rules introduced to implement the agreed new standards. The measures, which include withholding taxes and the denial of deductions, are outlined below.

Measure	Summary of measure
Transfer Pricing legislation	Ireland has incorporated the OECD 2017 Transfer Pricing Guidelines into domestic legislation and the transfer pricing rules, which previously applied to cross-border trading transactions, have been extended to include cross border non-trading and capital transactions. These measures will give rise to non-deductible expenses in respect of excessive payments.
Country-by-Country reporting	Multinational groups with a total consolidated revenue of €750 million are required to report information to taxing authorities on the revenue, profits, taxes and other indicators of economic activities for each tax jurisdiction in which the group operates. Tax authorities can then use this information to perform high-level transfer pricing risk assessments and to evaluate other BEPS related risks, which can lead to additional tax assessments.
Anti-hybrid legislation	These measures deny a corporation tax deduction in respect of payments made by Irish tax resident companies where there is a hybrid mismatch outcome. Reverse hybrid mismatch rules, effective from 1 January 2022 seek to counteract potential arbitrages between the taxation systems of two countries which could result in profits being untaxed in either jurisdiction.
Interest deductibility	Ireland's tax code provides that a corporation tax deduction will only be available for interest payments in limited circumstances. Interest will only be available as a trading deduction[6], a rental deduction[7] or as a deduction as a charge[8].
Interest limitation rule	These new measures which will apply from 1 January 2022 will cap deductions for borrowing costs at 30% of a corporate taxpayer's EBITDA.
Controlled Foreign Company (CFC) rules	Ireland has incorporated anti-abuse rules into our legislation that deter the diversion of profits from controlling companies in the State to controlled offshore subsidiaries in low-tax or no-tax jurisdictions. The

	CFC charge arises on the portion of undistributed income attributable to relevant Irish activities. There are a number of exemptions in the CFC regime dealing with, for example, low profit subsidiaries / limited risk distributors. As a defensive measure in respect of CFC's which are resident in non-cooperative jurisdictions, the CFC rules were amended in Finance Act 2020 to provide that the exemptions from the CFC charge will not apply where the CFC is resident in a non-cooperative jurisdiction.
Directive on Administrative Cooperation	Action at EU level in recent years has provided powerful new tools to curb the use of abusive and aggressive tax structures by companies operating across border, these include: Implementing the Directive on Administrative Cooperation bringing in the automatic exchange of information (AEOI) (DAC 1-5 on AEOI, e.g., financial account information, cross-border rulings, country-by-country reports), DAC 6 (outlined below) and DAC 7 (AEOI regarding sellers on digital platforms). These measures are important new tools to prevent double non-taxation.
EU Mandatory Disclosure (DAC 6)	DAC 6 provides for the exchange of taxpayer information between the tax administrations of EU Member States for certain cross-border transactions that could potentially be used for aggressive tax planning. Tax deductible payments made to low tax / no-tax jurisdictions are reportable if one of the main purposes of the transaction is to obtain a tax benefit. All tax deductible payments made to persons tax resident in non-cooperative jurisdictions are reportable. The information obtained will enable tax authorities to react promptly against harmful tax practices by undertaking risk assessments and carrying out tax audits.
BEPS multilateral instrument	Ireland has ratified the BEPS multilateral instrument to ensure Ireland's tax treaty network is compliant with BEPS standards. Applicable treaties now include a principal purpose test where the application of treaty provisions are denied if a principal purpose of the arrangement is to obtain treaty benefits. Denial of treaty benefits are likely to give rise to a withholding tax cost for the payor.

More recently the OECD is working on BEPS2.0 proposals which will further limit the ability of large MNEs to reduce their taxes by availing of zero-tax regimes.

The new proposals involve the creation of a new framework for the allocation of profits (Pillar One) and the imposition of rules which will in effect require MNEs to pay tax at a minimum rate of 15% (Pillar Two). These rules will have a very significant impact on the use by MNEs of zero and no-tax jurisdictions. We consider that the measures agreed by the OECD Inclusive Framework, following significant technical work and consideration, represent the best path forward to address opportunities for MNEs to avoid tax.

Measure to be implemented	Summary of measure
OECD BEPS 2.0 agreement	Pillar Two consists of two interlocking domestic rules (together, the Global Anti-Base Erosion (GloBE) Rules):

— An Income Inclusion Rule (IIR) that imposes top-up tax on a parent entity in respect of low-taxed income of constituent entities within an MNE group; and

— A supporting Undertaxed Payment Rule (UTPR) that denies tax deductions, or requires an equivalent adjustment, to the extent the low tax income of a constituent entity is not subject to an IIR.

— Pillar Two also includes a treaty-based Subject to Tax Rule (STTR), which allows limited source taxation of certain related party payments subject to tax below a minimum rate. Where an Inclusive Framework jurisdiction applies a nominal corporation tax rate below the STTR minimum rate (9%) to interest, royalties and other payments, that jurisdiction would be required to incorporate the STTR into Double Tax Agreements with developing countries, on request.

The UTPR will deny deductions where relevant, and the STTR, which is effectively a withholding tax, will apply in certain circumstances to payments and is only relevant for developing countries.

[1] Ireland has a DTA with Panama: Convention between Ireland and the Republic of Panama for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains.
[2] The withholding tax exemption does not apply where the interest is received by the non-resident company in connection with a trade or business carried on in the State through a branch or agency ((s246(3)(h) TCA 1997).
[3] S172D(3)(b)(i) TCA 1997.
[4] S172D(3)(b)(ii) TCA 1997.
[5] S242A TCA 1997.
[6] S77(3) TCA 1997.
[7] S97(2)(e) TCA 1997.
[8] S247 TCA 1997.

1. General Questions

Question 1

a) Are there any specific criteria that should be considered to identify payors and recipients to which these measures should be applied?

b) In responding to this question, consideration could be given inter alia to the degree of association between the payor and recipient, fiscal transparency of entities, interaction with CFC rules, remittance basis, and worldwide versus territorial systems of taxation.

c) Are there any other legislative, policy or administrative considerations that should be taken into account?

Application to non-cooperative jurisdictions

As outlined above, we consider that it is important to distinguish between jurisdictions that have a cooperative tax regime, and jurisdictions that have been assessed by the EU Group under internationally accepted principles as being non-cooperative.

Any further measures that may be brought in should apply only when the recipient is resident in a jurisdiction on the EU's non-cooperative list. Payors could be identified as those making payments to a resident in a jurisdiction that is on this list.

Substance carve-out

It is noted that the purpose of the consultation, as regards Commitment 6 of 'Ireland's Corporation Tax Roadmap – January 2021 update'[9] (additional defensive measures for countries included on the non-cooperative list), is to ensure that defensive measures against listed jurisdictions are appropriate and effective, while also ensuring that profits which are generated from actual substantive activities in listed countries are not unfairly impacted.

As envisaged in the Roadmap, a substance carve-out should be included when seeking to apply these measures to payors. In this regard, to align with international practice, as outlined below, a determination of whether sufficient substantive activity is being conducted in a listed country should be assessed by reference to the level of activity performed in that jurisdiction rather than by reference to the activity performed solely by the entity to which payments are made.

The jurisdictional basis has been accepted by the EU Group in assessing whether sufficient substance exists in countries when determining the compliance of jurisdictions with the 'fair taxation' criterion in the EU listing process. The Code specifies that the jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity

[9] Ireland's Corporation Tax Roadmap - January 2021 Update

in the jurisdiction.[10] To satisfy this criterion, jurisdictions are required to demonstrate that the core income generating activities are undertaken by the entity or in the jurisdiction.[11] In analysing the substance requirements brought in by certain non-EU jurisdictions, the EU Group has made it clear that outsourced activities can count towards the substance in that jurisdiction provided the outsourced activity is conducted in that country.[12] This demonstrates that the substance of related and unrelated parties within a jurisdiction should be assessed in determining whether substance is met.

The OECD Model Convention on Income and on Capital[13] provides commentary on the application of the Principal Purpose Test (PPT) which has been incorporated into various bilateral treaties[14]. The PPT provides that tax benefits under covered treaties should not be available where one of the principal purposes of certain transactions or arrangements is to secure a treaty benefit and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant treaty provisions. The OECD commentary includes a fund example which supports the granting of treaty benefits to an investment scheme where a regional investment platform, special purpose vehicles (SPVs) holding the investments and a service company, in which the substance is pooled and core commercial activities are conducted and sub-delegated to the SPVs, are located in a single jurisdiction. Hence, this also illustrates that substance should be determined on a jurisdictional basis, including with regard to unrelated party substance.

Application to tax transparent entities

Given that the purpose of any additional measures that are introduced in respect of payments to non-cooperative jurisdictions will be to impose additional tax burdens on such payments, it will be important to make sure that these additional burdens are correctly applied to these payments.

In this regard, we recommend that any measures should consider the tax residence status of the beneficial owner when a payment is made to a tax transparent entity. We consider that this practice should apply more widely to the Irish withholding tax regime.

In determining if additional measures should be applied, transparent entities should be looked through to identify the beneficial owner of the relevant payment, with the measures applying only where the beneficial owner is tax resident in a non-cooperative jurisdiction. We consider that this is appropriate regardless of where of the recipient (i.e. the transparent entity) is located.

We note that the general Irish tax provisions which apply withholding tax on interest, royalties and dividend payments lack clarity in respect of payments which are made via tax transparent entities to beneficial owners which would themselves be entitled to avail of domestic exemptions if they had received the payment directly.

[10] Council conclusions (8 November 2016) Criteria and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes

[11] Where jurisdictions are being assessed under Criterion 2.2 of the Code, the substance requirements in the Group's scoping paper on criterion 2.2 (doc. 10421/18) should apply.

[12] The EU list of non-cooperative jurisdictions for tax purposes - Bermuda: final legislation and assessment under criterion 2.2, 9671/19

[13] OECD (2017), Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing.

[14] The PPT was incorporated following the implementation of the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI).

Guidance issued by the Revenue Commissioners in respect of interest withholding tax only permits a "look through" approach in relation to tax transparent entities when seeking relief under a Double Taxation Agreement. In this regard, where a payment is made by an Irish tax resident company via a tax transparent entity (e.g. a tax transparent partnership which aggregates different categories of investors), it is not clear that the payor can look to the beneficial owner of the income in assessing whether an existing domestic exemption from withholding tax can apply.

We note that although partnerships do not have a legal personality in Ireland, certain provisions in legislation have included partnerships as an entity when applying taxing provisions. For example the definition of "entity" for the purposes of the anti-hybrid rules and the interest limitation rule includes partnerships.[15] In general, we consider that Ireland should move to adopt a consistent approach of looking through a tax transparent entity to the beneficial owner.

We recommend that clarity is provided on the ability to rely upon domestic withholding tax exemptions based on the status of the beneficial owner when a payment is made to such beneficial owner via a tax transparent entity.

Reasonable knowledge test

In applying any new measures, we consider that it is appropriate to take account of the state of knowledge of the payor.

The payor of an outbound payment may not always have sufficient information to identify the recipient. This may for example occur where different categories of investors are pooled into a single partnership and the residence of each individual investor is not known. The tracking of investors would likely require an excessive burden on the payor to investigate whether a payment of interest on an investment is being made to a resident of a non-cooperative jurisdiction. This issue would also arise where the underlying instrument is of a tradable nature and there are regular transfers of ownership. As noted further below, the OECD recognises the difficulty in obtaining information on beneficial owners.

We consider that a "knowledge test" should be incorporated into any new measures to take account of the knowledge of the payor.

A "knowledge test" is included in the anti-hybrid measures when identifying the recipient of a payment in determining whether a mismatch outcome arises. It is noted in Revenue guidance that it is not expected that the taxpayer has perfect knowledge as this would likely require an excessive burden on the entity to investigate the treatment of a payment. The language used in the legislation is *"where it would be reasonable to consider"*[16], which requires a reasonable person of ordinary prudence to think carefully about, to contemplate, or to reflect upon whether a mismatch outcome arises.[17] Perfect knowledge is not required.

The OECD's "Treaty Relief and Compliance Enhancement" (TRACE) Implementation Package, which was approved by the OECD's Committee on Fiscal Affairs in 2013, is a standardised system that allows the claiming of withholding tax relief at source on portfolio investments. It aims to remove the administrative barriers that affect the ability of portfolio investors to claim reduced rates of withholding tax. The

[15] Section 835Z TCA 1997 and section 31 of Finance Bill 2021.

[16] Section 835AD(1), TCA 1997

[17] Tax and Duty Manual, Guidance on the anti-hybrid rules Part 35C-00-01, March 2021

system produced by the adoption of the Implementation Package would allow "authorised intermediaries" to claim exemptions or reduced rates of withholding tax pursuant to tax treaties or domestic law on a "pooled basis" on behalf of their customers that are portfolio investors. The initiative aims to minimize administrative costs for all stakeholders and enhances the ability of both source and residence countries to ensure proper compliance with tax obligations. The TRACE initiative demonstrates the international recognition of the fact that it is administratively complex and costly to obtain information on beneficial owners.

Absent the implementation of such a system, we consider a reasonable knowledge test should be applied to any further defensive measures when determining the residence of the beneficial owner of a relevant payment.

Other considerations

Our policy considerations in differentiating between jurisdictions that have a cooperative tax regime and choose to apply a zero rate of taxation, and jurisdictions that have been assessed by the EU Code of Conduct under internationally accepted principles as being non-cooperative are set out in our introductory comments.

Question 1

d) Are there any considerations around how interest, royalties or dividends could be defined for these purposes?

We consider that existing definitions of interest, royalties, and dividends can be used for the purposes of any new measures that are brought in for non-cooperative jurisdictions.

Interest

The OECD Model Tax Convention on Income and on Capital, 21 November 2017 provides internationally recognised definitions. The Model Convention provides that the term "interest" means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest.

This definition is consistent with the definition of interest in Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

Dividends

The definition of the term "distribution" for tax purposes should be used to define a dividend for these purposes.

Royalties

With regard to royalty payments, Ireland's current withholding tax regime applies to patent royalties and annual payments, as outlined in the 'background' to our response. The meaning of "annual payments" is well established through case law and, in broad terms, refers to pure income profit, or income of a kind in respect of which the incurring of an expense is not required.

Question 1

e) Are there any other considerations that should be included as part of this process?

We do not have further considerations to those set out above in Question 1 and in the 'introductory comments' to our response.

Question 1

f) In your opinion, as regards the potential application of any of the above measures to Ireland's treaty partners, are there any specific issues or obstacles relating to tax treaty commitments that would have to be considered? If so, how might these be best acknowledged or addressed?

Ireland has limited tax treaties with countries on the EU list of non-cooperative jurisdictions[18]. Panama is the only jurisdiction Ireland has a tax treaty with and it allows for a 5% rate of withholding where our domestic exemptions do not otherwise apply.

If Ireland chooses to introduce additional measures with respect to jurisdiction on the non-cooperative list, articles in a tax treaty will potentially override the domestic provisions.

A treaty containing lower withholding tax provisions in respect of interest / royalties / dividends will override domestic charging provisions seeking to impose a withholding tax on the payment. Similarly, a non-discrimination article will prevent Ireland from denying a tax deduction on a payment made to the treaty jurisdiction where it would otherwise be allowable if the payment was made to an Irish company.

Consideration would need to be given to whether tax treaties with jurisdictions on the EU list should be amended in light of any additional measures that are introduced. The extent of this issue is limited, as currently only one jurisdiction on the non-cooperative list has a tax treaty with Ireland.

[18] Convention between Ireland and the Republic of Panama for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains.

2. Measures in relation to outbound interest payments

Question 2

a) Where measures are taken regarding outbound payments of interest to no-tax or zero-tax jurisdictions, or jurisdictions included on the EU list of non-cooperative jurisdictions for tax purposes, in your opinion would a denial of deduction or the imposition of a withholding tax be the more effective approach? Please identify the advantages of, and potential issues with, each approach in your response.

b) Where it is your view that a denial of deduction would be the better approach, how should this measure be designed to interact appropriately with other domestic legislation, including the new interest limitation rule which will be implemented from the beginning of 2022? Are there specific amendments to relevant legislation that should be considered?

c) Where it is your view that a withholding tax would be the better approach, how could this measure be designed to interact with other legislation, and/or tax treaties and would this require any amendments to relevant legislation?

As outlined in our introductory comments, under our existing regime, Irish resident companies are generally required to deduct withholding tax on interest payments to non-DTA countries. As Ireland generally does not have DTAs with countries on the EU list of non-cooperative jurisdictions or with low or no tax jurisdictions, a withholding tax obligation at the standard rate will typically apply to interest payments made to most of these jurisdictions.

Broadly, where interest is paid to certain related companies it may be reclassified as a distribution with no corporate tax deduction available and the application of dividend withholding tax. Certain exemptions apply, however Ireland has rules which impose a withholding tax or a denial of a deduction on interest payments to non-DTA partner countries.

Other domestic measures also apply which may deny a deduction of an interest expense, i.e. the interest limitation rule, transfer pricing legislation, deemed distribution rules, and the anti-hybrid rules. Similar provisions are also included in the BEPS Pillar Two Undertaxed Payments Rule.

For these and the other reasons outlined in our introductory section above we do not consider that there should be any further measures imposed on interest payments to cooperative no-tax / zero-tax jurisdictions.

If further defensive measures are to be introduced in respect of interest payments to countries on the EU list of non-cooperative jurisdictions, we consider that an increased rate of withholding tax of 5% on payments

subject to a withholding tax obligation would be the better approach.

In considering whether any measures introduced should be in the form of a withholding tax or a denial of a deduction, we are of the view that a withholding tax measure would be more effective.

Firstly, it would give rise to a higher tax cost than a denial of a deduction. Secondly, it would be very easy to communicate and understand and hence, more likely to be an effective defensive measure.

It is also likely to be easier to administer under the current Irish regime as it won't involve having to deal with the complexities of layering a denial of a deduction on payments made to non-cooperative jurisdictions on top of existing measures which already deny deductions. In this regard we already have, as pointed out in our introductory comments, a number of provisions which can deny deductions for interest such as the interest limitation rules, deemed distribution rules, transfer pricing rules, anti-hybrid rules and the forthcoming BEPS Pillar Two Undertaxed Payments Rule.

We would also point out that based on our research, the imposition of a higher rate of withholding tax on certain payments to non-cooperative jurisdictions is in line with actions taken by other EU Member States following the issuance of the 2019 guidance by the EU Group.

3. Measures in relation to the outbound payment of royalties

Question 3

a) Where measures are taken regarding outbound payments of royalties to no-tax or zero-tax jurisdictions, or jurisdictions included on the EU list of non-cooperative jurisdictions for tax purposes, in your opinion would a denial of deduction or the imposition of a withholding tax approach be more effective? Please identify the advantages of, and potential issues with, each approach in your response.

b) N/A

c) Where it is your view that a withholding tax would be the better approach, how do you feel this measure could be designed to interact with other legislation? In your opinion would this require any amendments to relevant legislation?

d) Are there any specific considerations necessary in relation to the interaction of a measure applying to the outbound payment of royalties and the existing treatment currently in place?

As outlined in our 'introductory comments', under our existing regime, Irish resident companies are generally required to deduct withholding tax at the standard rate on patent royalty payments and payments of pure income profit to non-DTA countries. As Ireland generally does not have DTAs with countries on the EU list of non-cooperative jurisdictions or with low or no tax jurisdictions, a withholding tax obligation at the standard rate will typically apply to such royalty payments made to most of these jurisdictions.

Other domestic measures also apply which may deny a deduction of a royalty expense, i.e. transfer pricing legislation and anti-hybrid rules. Similar provisions are also included in the BEPS Pillar Two Undertaxed Payments Rule.

For these and the other reasons outlined in our introductory section above we do not consider that there should be any further measures imposed on royalty payments to cooperative no-tax / zero-tax jurisdictions.

If further defensive measures are to be introduced in respect of patent royalty payments to countries on the EU list of non-cooperative jurisdictions, we consider that an increased rate of withholding tax of 5% on payments subject to a withholding tax obligation would be the better approach.

In considering whether any measures introduced should be in the form of a withholding tax or a denial of a deduction, we are of the view that a withholding tax measure would be more effective.

Firstly, it would give rise to a higher tax cost than a denial of a deduction. Secondly it would be very easy to communicate and understand and hence more likely to be an effective defensive measure.

It is also likely to be easier to administer under the current Irish regime as it won't involve having to deal with the

complexities of layering a denial of a deduction on payments made to non-cooperative jurisdictions on top of existing measures which already deny deductions. In this regard we already have, as pointed out in our introductory comments, a number of provisions which can deny deductions for royalties such as transfer pricing rules, anti-hybrid rules and the forthcoming BEPS Pillar Two Undertaxed Payments Rule.

Based on our research, the imposition of a higher rate of withholding tax on certain payments to non-cooperative jurisdictions is in line with actions taken by other EU Member States following the issuance of the 2019 guidance by the EU Group.

4. Measures in relation to outbound dividend payments

Question 4

Are there any amendments necessary to relevant legislation regarding the operation of dividend withholding tax, in respect of dividends to no-tax or zero-tax jurisdictions, or jurisdictions included on the EU list of non-cooperative jurisdictions for tax purposes, in order to ensure no double non-taxation? In your response, you may wish to consider all amounts treated as distributions under relevant legislation.

With respect to the question of whether amendments to relevant legislation is needed in order to ensure no double non-taxation is occurring, we would point out that the current Irish worldwide corporation tax regime ensures double non-taxation does not arise. In this regard dividends (or deemed distributions) paid from Ireland are typically made out of profits taxed in Ireland as a deduction is not allowed for these amounts under Irish law. As a result of our worldwide tax regime this also applies to a dividend paid by an Irish company out of profits received via a dividend from a foreign subsidiary, as a foreign dividend is typically taxed in Ireland at 12.5% / 25%[19].

If the reference in the question on double non-taxation is to the absence of withholding tax combined with no taxation in the foreign jurisdiction [which is not typically what double non-taxation is understood to be], in our view it is relevant to note that existing Irish dividend withholding tax measures, as noted in section 2.4 above, apply dividend withholding tax on payments to companies in foreign jurisdictions unless the payment is to a company tax resident in a tax treaty jurisdiction and is not under the control of persons resident in Ireland, or is to a foreign company who is ultimately controlled by persons tax resident in a tax treaty jurisdiction. The income will be taxed in accordance with the regime applied by the tax treaty partner. Hence, we would not consider that our existing regime would facilitate such double non-taxation.

[19] Portfolio dividends under section 21B(4), Taxes Consolidation Act 1997 are exempt from tax in Ireland. We understand this specific exemption is likely outside the scope of this consultation.

5. Consequential amendments

Question 5.

In your view are there any existing anti-avoidance rules that may be simplified or eliminated where new denial of deductibility or withholding tax measures are put in place on outbound payments to no-tax or zero-tax jurisdictions, or jurisdictions on the EU list of non-cooperative jurisdictions?

We do not consider that the new measures outlined above would require any existing anti-avoidance rules to be simplified or eliminated.

6. Non-cooperative jurisdictions

Question 6.

Are there any further issues that should be taken into account in relation to payments to jurisdictions included on the EU list of non-cooperative jurisdictions for tax purposes?

We do not consider that any additional issues, beyond what we have discussed above, need to be taken into account in relation to payments to non-cooperative jurisdictions.

Ireland has satisfied our commitment to introducing one of four legislative measures put forward by the EU Code of Conduct (Business Taxation) Group and endorsed by the Council of the EU[20] by implementing enhanced Controlled Foreign Company (CFC) rules in Finance Act 2020 to the list of non-cooperative jurisdictions. Regarding the measure to limit the participation exemption, Ireland has determined that our worldwide system of taxation already provides the protection that would be offered by such a measure.

[20] Report to the Council, Code of Conduct Group (Business Taxation) 14114/19

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