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Consultation on Measures to apply to Outbound Payments
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
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BY EMAIL TO: intltax@finance.gov.ie

Re: **Response to Consultation on Measures to apply to Outbound Payments**

A Chara

1. Introduction

We welcome the opportunity to respond to the Department of Finance's (the "**Departmen**t") Consultation on New Taxation Measures to apply to Outbound Payments (the "**Consultation**"). As a policy matter, we consider it hugely beneficial that the Department engages in regular and detailed consultations and feedback statements on a broad range of tax policy matters. Taking this proactive approach will ensure a more reflective, principled approach to tax policy in Ireland.

2. Policy Context

Before one can begin to consider the questions posed in this consultation, one must first establish:

- Whether any changes to the rules are necessary (i.e. what is the perceived issue to be addressed? Is it a real problem? Do existing rules already address it adequately?);

- The nature of any such changes in the context of the changing international fiscal environment;

- What impact these rules will have on businesses (i.e. the cost of the additional compliance burden across the economy) compared to the quantified benefit; and

- How to implement these rules so that they impact only genuine avoidance situations and do not impact legitimate transactions.

One must first consider whether any change to the rules is necessary. The existence of the current transfer pricing rules, withholding taxes, distribution rules, "wholly and exclusively" deductibility rules, specific and general anti-avoidance rules, anti-hybrid rules and interest limitation rules means, in overview, that a specific regime on outbound payments is unnecessary. Bearing in mind the effect of the existing rules, any such regime could only apply to payments that:

(a) are carried out on arm's length terms;

(b) involve only amounts that are incurred "*wholly and exclusively*" for business purposes;

(c) do not involve a hybrid mismatch;

(d) are not entered into with the sole or main purpose of tax avoidance;

(e) in the case of interest is not excessive nor to any extent profit dependent;

(f) in the case of interest or patent royalties is paid to a resident of an EU Member State or of one of our tax treaty partners; and

(g) escape taxation either locally or on an indirect basis.

Since these factors would all suggest that only "good" payments would be affected by any new regime, we would be interested in examining examples of payments that are not affected by current rules that are "bad" and ought to be within scope of any new regime. We find it difficult to understand what remains to be within scope of any new regime.

In relation to the final point in the above list, many jurisdictions apply indirect taxation of such payment through mark-to-market rules, offshore funds rules, PFIC, assignment of income rules as well as Controlled Foreign Company ("**CFC**")/global intangible low-taxed income (GILTI) rules. These are applicable to the offshore entities that typically receive payments made outside the Irish treaty network. Arguably, where this is not the case, this is a sovereign policy choice for the recipient jurisdiction and it is not appropriate for Ireland to interfere in matters of other countries' domestic taxation policies. To give an example, in the past, the US deferred the taxation of many of these types of payments but may now tax them currently under GILTI (which may have led to the change in the flow of royalties in the last year). Should Ireland impose a tax penalty simply because the US decides to defer taxation on these amounts as a matter of its own sovereign policy choice?

The recently agreed OECD Pillar Two proposals should also be considered as they are likely to address many of the concerns around payments to low tax jurisdictions.

Finally, the identity of all recipients of dividends, interest and royalties payments is clear to tax authorities through FATCA/CRS, information exchange and cooperation. As a result, the risk of revenues "disappearing" is now almost non-existent. Combined with the impact of the existing rules and the ability to identify all recipients of such payments, it is unclear what policy basis exists for imposing additional burdens on business rather than simply enforcing existing rules. We assume that this has been the subject of a full economic assessment of the costs and benefits and look forward to it being published.

3. Responses to questions in the Consultation

Question 1: *General Questions*

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?

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

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

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?

As set out above, we do not think such rules should be necessary. If they are deemed to be necessary, the proposed taxation measures should not apply to publicly traded instruments such as listed debt or commercial paper. Issuers of publicly traded instruments require certainty and since these types of instrument are not used in tax avoidance situations, they should fall outside the scope of any new taxation measures that may be introduced. In addition, the existing information gathering systems available to tax authorities apply equally to these instruments, for example, we understand that clearing systems provide this information routinely. As noted above, existing general anti-avoidance legislation should be sufficient to tackle any instances of avoidance and there should therefore be no need to target such public instruments. This will be discussed in greater detail below in response to question two.

For remaining instruments deemed to be in scope, there are a number factors that should be considered. This leads to the question of how to implement any new rules (if they are necessary - which we do not consider to be the case) so that they impact only avoidance situations and do not impact legitimate transactions. This is the most difficult line to draw and one that tax policy makers often struggle with and on which taxpayers and tax policy makers have different views. There is a temptation in some tax policy makers' minds to introduce broad, widely applicable rules in order not to miss a single avoidance transaction. By contrast, businesses wish to have certainty and objectivity in their rules (without an unnecessary administrative burden) so that they know how to operate their affairs within the appropriate policy framework and at a reasonable cost. It is unacceptable for anyone to be subject to arbitrary confiscation of their property through vague and broad tax changes due to the whim of a tax authority. Therefore, objective and proportionate rules that are capable of practical implementation must be the benchmark for any tax policy maker. Finally, tax administrations must operate the rules in a manner that is not overbearing and does not impose penalties for innocent non-compliance, especially where there are other methods of achieving the legitimate goals of the tax administration (e.g. by utilising their existing cross-border information gathering apparatus). This leads to the conclusion that only jurisdictions on the EU list of non-cooperative jurisdictions should be within scope.

Accordingly, a broad-brush approach to determining the level of connectivity is not appropriate. For example, where there are two parties to a bilateral agreement in respect of royalties or interest (i.e. a licence agreement or a loan agreement respectively), it is possible to determine between these two parties the nature of their connection or relationship. This is not possible for publically traded instruments so this is another reason to exclude them from scope.

Should new taxation measures be considered appropriate and they can be crafted to be proportionate and not to overlap with existing rules, even where they apply to non-public instruments held by entities in jurisdictions on the EU list of non-cooperative jurisdictions, there should be a further exclusion for payments that are ultimately taxed. This needs to go beyond mere "inclusion" (anti-hybrid rule) or "subject to tax" (Section 110 Taxes Consolidation Act 1997 ("**TCA 1997**")) and should include taxation on a distribution or a mark-to-market basis. If not, double taxation will arise. In addition, where payments are made to jurisdictions that charge tax on a remittance basis or to jurisdictions that employ a territorial system of taxation, Ireland should respect this policy choice of that jurisdiction.

In the context of discussing the proposed new taxation measures to apply to outbound payments, it should also be noted that the undertaxed payments rule which will come into force in 2024 under Pillar Two, is intended to serve the dual purpose of being both a backstop to the income inclusion rule and addressing base erosion through deductible intra-group payments. As such, the proposed rules the subject of this consultation should be repealed as soon as Pillar One and Two come into force. This would avoid a situation where businesses are faced with duplicative sets of rules, which makes their application costly, difficult and cumbersome.

In terms of defining "royalty" and "interest" for the purposes of the proposed new measures, we should follow existing definitions as set down in the TCA to avoid a scenario whereby the same payment could be viewed differently under different sections of legislation. With this in mind, the term "royalty" should be defined as a payment of a revenue nature for the use of intangible assets (as defined in section 291A TCA 1997); and "interest" should be defined as the amount of interest that would be deducted in Ireland and dividend should be a "distribution" within Section 130 TCA. The proposed new measures should only apply to deductible interest and royalties.

Clearly, payments to treaty partners should be excluded from any such rules.

In summary:

- To avoid layering complexity upon complexity when a simple enforcement of rules by the tax administration achieves the same ends, we consider that no changes should be made.

- If any new regime is to be introduced (which we do not accept as necessary), public instruments must be excluded.

- If any association test is to be implemented, it should mirror the Anti-Hybrid Rules or Interest Limitation Rules so that businesses do not have to deal with a multiplicity of overlapping yet subtlety different rules.

- Interaction with Pillar Two should be considered.

Question 2: *Measures in relation to outbound interest payments*

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?

Ireland, unlike most EU jurisdictions, applies a withholding tax on interest – with exemptions for residents of treaty countries. Hence, in principle, action is not needed in respect of interest.

As noted above in answer to question one, "interest" should be defined as the amount of interest that would be deducted in Ireland. It is also worth noting in this context, that the payment of interest is a capital movement protected as a European freedom. Therefore, the only legitimate and justifiable basis for restricting this freedom would be in cases of genuine tax avoidance (See CJEU cases such as *ICI v Colmer*, *Cadbury Schweppes*). Bearing in mind the considerations set out above, the existence of interest withholding tax (which is not common across the EU) and existing anti-avoidance legislation (for example, under Section 811C TCA 1997), it is difficult to see how any change can be proportionate.

In relation to outbound interest payments, we would reiterate that any measures should not apply to listed bonds or commercial paper. It is generally not possible to know in the case of a bond issuer whether a noteholder will be connected or what its tax status is. Accordingly, bond issuers will not know at the time of any interest payment whether they ought to withhold/deduct the interest payment.

In addition, when undertaking a rated transaction, bond-issuing companies will not be able to confirm to rating agencies whether withholding/deduction issues will arise in the future based on current law as the facts cannot be determined. An approach that denied deductions or imposed withholding tax on bond-issuing companies would fundamentally undermine the EU Capital Markets Union process by making such capital markets transactions impossible.

Equally, prior to discussing what measures ought to be taken, one must consider what the policy objective to be achieved is. The vast majority of companies in no tax or zero tax jurisdictions or jurisdictions included on the list of non-cooperative jurisdictions for tax purposes are subject to fiscal rules in other countries – normally the large OECD countries with which we have double tax treaties. For example, Cayman companies used in investment fund structures are often treated as tax transparent for US tax purposes such that the income arises to their investors which are generally taxable in the US. In addition, blocker Cayman companies are introduced for tax-exempt investors (such as pension funds and charities). This is a protective measure against unforeseen consequences and is not avoidance of any fiscal rule. By imposing any withholding tax or non-deduction in these cases, Ireland would be effectively seeking to reallocate taxing rights from the recipient jurisdiction to Ireland. This is unacceptable and could lead to retaliatory measures.

Consequently, the first action to be taken is to identify the payee of the interest. Whilst companies will have some visibility in some cases, Revenue authorities have full visibility through the FATCA and CRS systems. Accordingly, no measures should be imposed on companies unless and until the Revenue authorities have identified that there is avoidance occurring (on foot of the information at Revenue's disposal or in their power or possession) and a notice is given to the payer of the interest to take remedial action. This remedial action should only occur in the case of actual avoidance of tax and not simply as a matter of course. It is not acceptable to impose on business requirements that they cannot fulfil but which can easily be fulfilled by tax authorities operating within their existing powers and information access rights.

The question as to what remedial action is to be taken then arises. In our view, a withholding tax is a better approach for a number of reasons. First, the payee may be entitled to treaty benefits (unbeknownst to the payer) and therefore if there were a withholding tax levied, it would have a right of refund against the Irish Revenue. Whilst this adds to the Revenue's administrative burden, it is the correct policy outcome. To impose a denial of deduction means that a refund would not be available. Instead, the payer must undertake a mutual agreement procedure under the treaty invoking the relevant non-discrimination article (usually in OECD standard terms) to restore the deduction previously claimed by the payer. In particular, the payer may not have that full information and therefore the proceedings may become protracted. In addition, the Irish competent authority is under-resourced and adding more workload would seem to be an inappropriate measure to take.

The question of the interaction of any new denial of deduction rule with the vast swathe of rules denying a deduction to Irish companies for interest taken with the narrow scope of the right to deduct interest in the first place means that the interest deduction system may finally come crashing down. We have previously advocated (*see link*) that the interest deduction system needs to be fundamentally overhauled. The original interest deduction system was designed in the absence of EU law and was modelled on UK concepts. Other countries in the EU do not model their tax systems on the UK model and have fundamentally different approaches to interest deduction. It is noteworthy that in 1996, the UK moved away from the technical basis on which our interest deduction rules are formed and introduced loan relationships rules. Therefore, Ireland stands alone with its unusual charge on income and trading basis of deduction for interest. A fundamental rethink is long overdue. This is supported by the fact that the vast majority of the distribution rules overlap with the anti-hybrid rules. The anti-step-up provisions[1] introduced many years ago conflict with the interest limitation rules that have been recently introduced. The Department of Finance previously noted that Ireland's interest deductibility rules (prior to the enactment of the anti-hybrid rules and the interest limitation rules) were at least "equally equivalent" to the rules proposed in the Anti-Tax Avoidance Directive ("**ATAD**") and, now that anti-hybrid rules and the interest limitation rules have been enacted, the duplicative and over-extensive scope of the rules denying an interest deduction in Ireland have become untenable. Adding a new denial of deduction rule would be disproportionate.

Accordingly, if a denial of deduction approach is to be taken then it adds more pressure on the overall Irish tax system to the extent that it becomes practically impossible for a business to predict whether the interest it incurs will be deductible or not. In the absence of a fundamental reform (which we advocate strongly) a denial of deduction approach may be the straw that breaks the camel's back.

Question 3: *Measures in relation to outbound payment of royalties*

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) Where it is your view that a denial of deduction would be the better approach, how could this measure be designed to interact with other legislation? In your opinion would this necessitate any amendments to relevant legislation?

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 was discussed in response to question one above, the term "royalty" should be defined as a payment of a revenue nature for the use of intangible assets (as defined in section 291A TCA 1997).

[1] See for example Section 840A, Section 247 (4A)-(4G), Section 817 TCA 1997.

Similar issues arise in relation to the outbound payment of royalties although royalties are not paid on publicly traded instruments.

In addition to the revised GILTI regime and OECD Pillar Two proposals, the principles of OECD BEPS 1.0 ensure that profits from intangibles are linked to value creation by putting greater emphasis on the key “DEMPE” functions and the arms-length principle. We are of the view that many of the existing measures are already having an impact in changing the structures used by multinational groups and profit allocation within those groups. We consider it premature to consider the introduction of additional measures until a thorough assessment is made on the effect of the existing OECD and proposed international measures.

An example of this is the profile of outbound royalty payments from Ireland. These outbound payments were €84.3 billion in 2019 and preliminary figures for 2020 show a figure of €83.6 billion. Under the pre-2018 US tax regime, these outbound royalty payments were primarily routed to low tax jurisdictions. While these royalty payments continued to be made from Ireland, in 2020, around 60 per cent of the royalty payments from Ireland went to the United States[2] indicating that revenues are increasingly being allocated to large jurisdictions. Time should be given to allow for a proper assessment of the extent and impact BEPS 1.0 measures and US tax reform and the proposed OECD Pillar Two proposals prior to introducing further changes.

Once more, if a change is being made (which we do not consider to be needed) it should only be a withholding tax on payments to non-cooperative jurisdictions in circumstances where there is no direct or indirect tax in another jurisdiction. It would be incumbent upon the Revenue authorities to maintain a list of such jurisdictions so businesses know exactly what is required.

If the rules apply beyond the list of non-cooperative jurisdictions, we would need to define what is a no tax or zero tax jurisdiction (see below). By contrast, the list of non-cooperative jurisdictions is a publicly available list and therefore that should be the model for all obligations imposed on business under this outbound payments proposal.

Furthermore, where a withholding tax is applied to royalties, the recipient may have a right of refund under a tax treaty. Equally, most if not all agreements have provisions to deal with withholding tax and gross up risk. For these reasons, a withholding tax approach is the preferred approach for these payments.

Question 4: *Measures in relation to outbound dividend payments*

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.

We respectfully submit that the proposed taxation measures should only apply to deductible interest and royalties and never to dividends. We do not believe that any amendments are necessary in relation to the imposition of dividend withholding tax. It must be recalled that dividends are already paid from previously taxed income. Therefore, there can be no double non-taxation since the profit out of which the dividend has been paid has already been taxed once. The imposition of further withholding taxes would be an additional administrative burden for no policy benefits. In addition, we note that Ireland is unique among European (including UK) jurisdictions in imposing both a dividend and an interest withholding tax. For example, the vast majority of European jurisdictions do

[2] Coffey, Seamus (2021). The changing nature of outbound royalties from Ireland and their impact on the taxation of the profits of US multinationals.

not impose interest withholding tax at all. The UK does not impose dividend withholding tax. Accordingly, the existing dividend withholding tax system is perfectly adequate for dealing with no tax or zero tax jurisdictions.

Question 5: *Consequential amendments*

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 reiterate our position that the rules for deductibility of interest must be fundamentally simplified and put on a modern footing. In relation to non-trading interest, the charge on income/recovery of capital system that has developed is unworkable, ineffective and fundamentally conflicts with the policy rationale behind the interest limitation rules. The distribution rules fundamentally conflict with the anti-hybrid rules. Our proposal in this regard is set out here (*see link*).

Question 6: *Non-Cooperative Jurisdictions*

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?

As countries come on and off the non-cooperative jurisdiction list, it will be necessary to ensure that businesses have sufficient time to react and to impose a withholding tax if required. Imposing a denial of deduction would conflict with gross up risk allocation in contractual documentation. Most commercial loan agreements use the Loan Market Association ("**LMA**") form. There is a variety of these for different situations but in all cases, the withholding tax risk allocation has been agreed in the market. There is no risk allocation for denial of deduction. In principle therefore, a withholding tax approach would be more consistent with market norms on tax risk allocation than a denial of deduction approach. Under the LMA facility agreements, typically a lender is entitled to be grossed up if it is a "qualifying lender". Typically, this definition reflects the range of withholding tax exemptions in the jurisdiction of the borrower at the time the agreement is entered into. Effectively, from the date the lender becomes a party, changes of withholding tax law are a borrower responsibility and changes in facts in relation to the lender are a lender responsibility.

The Department should be very concerned with a proposal to introduce withholding tax in circumstances where the current exemptions from withholding tax apply (see Section 246(3) TCA). If this were to be the case, lenders would, in principle, have a right to be grossed up and the borrowing costs of Irish borrowers would be increased by the amount of the withholding tax (on a grossed up basis). This would have a real economic effect on the capacity of Irish business to borrow as the costs of finance would increase. This argument sustains the position that any change should be grandfathered and should only apply in respect of new borrowing entered into after the date of introduction of the change, as otherwise the costs of borrowing in Ireland would simply increase, thereby imposing a burden on business for no good policy reason.

The measures should only apply to the list of non-cooperative jurisdictions (an objectively verifiable list of countries) for tax purposes and should not apply to zero tax/no tax jurisdictions. The reasons are as follows:

- It is not going to be possible to draft a workable definition of a no tax/zero tax jurisdiction. For example, what will be considered as the hallmarks of a no tax jurisdiction, i.e. should Investment Funds be included? These proposed changes to the taxation of outbound payments impose substantive obligations and businesses necessarily require certainty as to the scope and impact of the new rules. By contrast, DAC6 is purely a reporting obligation and so is less sensitive to this point.

- A restriction of the proposed measures solely to the list of non-cooperative jurisdictions is required. Otherwise, special economic areas could be impacted. For example, the UK has suggested introducing free ports that have local tax rates. Were this to happen, how would this be dealt with?

- Another justification for limiting the scope of application of new measures to the list of non-cooperative jurisdictions is the challenge that would present itself in addressing instances where foreign countries impose a tax but effectively refund it through State Aid measures (not illegal outside the EU). For example, where a tax authority imposes a 15% rate of tax on a company and then offers a grant at 14.9%. How would a situation such as this be dealt with under the proposed new rules?

- In addition, the question arises as to how countries that impose a tax at an acceptable rate but offer greater deductions will be addressed? For example, where a non-EU country introduces a DEBRA equivalent that effectively eliminates tax, the question then arises as to how this will be addressed?

- There is uncertainty as regards a definition of no tax/low tax. Is it a rate or a base? Are Revenue to introduce rules effectively requiring a lender/licenser/shareholder's tax base to be computed using Irish rules to determine if it has an acceptable level of taxation? How would one deal with loss carry forwards, depreciation etc. in this regime? We have come across other jurisdictions that introduce a re-computation requirement and it often requires that transactions over decades are reanalysed due to these issues. Frankly, we do not believe that Irish business or the Revenue authorities have the capacity to operate such a system.

We have no additional comments.

Yours faithfully

Arthur Cox LLP

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