Building a better working world

Ernst & Young
Business Advisors
Harcourt Centre
Harcourt Street
Dublin 2
D02 YA40
Ireland

Tel: + 353 1 475 0555
Fax: + 353 1 475 0599
ey.com

Consultation on Measures to apply to Outbound Payments
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
D02 R583

20 December 2021

By email: intltax@finance.gov.ie

# Consultation on Measures to apply to Outbound Payments

Dear Sir/Madam

EY welcomes the opportunity to respond to the Consultation on Measures to apply to Outbound Payments ("the Consultation") published by the Department of Finance.

**ABOUT EY**

EY is a global leader in assurance, tax, transaction and advisory services with almost 300,000 people based in over 730 offices in 150 countries.

In EY's capacity as tax advisors to our large and diverse client base (including large multinationals, domestic public limited companies ("PLCs"), small and medium-sized enterprises ("SMEs") and financial services organisations), we assist our clients on a variety of international tax issues. Our work includes assisting clients understand the impact of changes to tax law, including change arising from the OECD BEPS initiative and the ongoing OECD/G20 Inclusive Framework initiative, implementation of the European Union ("EU") Anti-Tax Avoidance Directives, and helping those clients in meeting their tax compliance obligations around the world.

Our clients' legitimate choices in organising their business activities, acquisitions, and other business projects are an important aspect of what we do. Those choices and the tax cost associated with those activities will be directly affected by the OECD/G20 Inclusive Framework international tax proposals if implemented. Many of our clients also make payments of dividends, interest and/or royalties to non-residents, and so are potentially affected by any new compliance obligations in this area, depending on their scope.

We are therefore well placed to comment on the relevant issues and welcome the opportunity to comment further on the Consultation in line with our participation in other public consultations on changes to Ireland's international tax rules.

**INTRODUCTORY AND GENERAL COMMENTS**

This Consultation takes place at a time when a series of major international tax reforms have just taken place, with another wave about to be initiated[1]. The stated purpose of the possible measures that are the subject of the Consultation is: *"to prevent double non-taxation in relation to outbound payments of interest, royalties and dividends".*

[1] In the form of the OECD's Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy ("BEPS 2.0")

This aim is unobjectionable in itself, but we note that the prevention of double non-taxation is the clear goal of initiatives such as:

- The OECD BEPS Actions whose reports were first published in October 2015 ("BEPS 1.0")
- The US Tax Cuts and Jobs Act 2017 ("TCJA"), including the introduction of GILTI
- Ireland's move towards treating all Irish-incorporated companies as tax resident in Ireland, regardless of where managed and controlled
- The OECD's Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy ("BEPS 2.0")

The data available indicates that BEPS 1.0, the TCJA and the related changes to Irish law have been very successful in dealing with double non-taxation. BEPS 2.0 has not yet been implemented, but we are sceptical that any material opportunities for aggressive tax planning involving in-scope companies will remain once implementation is complete.

We appreciate of course that a driver for proposed change may be solidarity with EU Member States and other countries wishing to pursue the same objective, but we submit that the proposed solution risks damaging competitiveness, and also risks going beyond what is necessary to address any remaining issues not already solved by BEPS 1.0 and TCJA, or about to be solved by BEPS 2.0. Any new measure on outbound payments should therefore be designed very carefully to address these risks.

Given the other demands on Ireland's tax legislative resource, it seems improbable that any proposed new measure could be ready for implementation before 1 January 2024. The intervening period should be used to gather the most recent data to inform the detail of any limited law change. Stakeholder dialogue is critical to ensuring that competitive harm is minimised, and any change is appropriately focused. In turn that will determine which existing rules it may be appropriate to relax as part of a rebalancing effort.

Our response to the questions in the Consultation is set out below and follows the numbering in the Consultation. In some cases we have responded to related questions together.

## 1. GENERAL QUESTIONS

At the outset we note that the Consultation makes much reference to trends with respect to royalty payments but is largely silent on interest and dividend flows. However, it should be quite evident that BEPS 1.0 has explicitly tackled double non taxation via the overlapping reforms in many areas which have resulted in behavioural changes that may not yet be reflected fully in data sets underpinning policy decisions. Recent policy developments include:

- US tax reform in 2017 via the TCJA, including the introduction of GILTI
- Updated transfer pricing rules, including the DEMPE framework
- Economic ownership rules in many offshore locations
- Anti-hybrid rules
- Controlled foreign company rules
- Interest limitation rules
- MLI implementation including anti-treaty shopping
- Country by country reporting and exchange of information rules
- Amendments to Irish corporation tax residence rules

To the extent that BEPS 1.0 and existing targeted rules are considered insufficient, BEPS 2.0 proposals will effectively neutralise double non-taxation arising from the use of no-tax or 0% tax locations through the imposition of a 15% minimum effective tax rate on multinational groups with revenue above €750 million.

Ireland is a small open economy with a significant amount of international trade and investment that forms a large percentage of GDP. It is inevitable when examining data that there will be significant outbound payments of dividends, interest and royalties which does not signify aggressive tax planning, particularly from 2021 onwards. Indeed, the profile of the Irish economy means it is inevitable such flows will form a larger proportion of GDP than for larger European economies – as indeed is also the case for trade in goods and merchandise.

For historical reasons, there is a tendency for certain commentators to assume that large dividends are signs of dubious tax practices. Yet by their nature dividends are generally paid out of profits that have been subject to tax in an Irish context.

Any future policy changes with respect to outbound payments should be subject to some broad principles that ensure they do no harm to ongoing commercial transactions.

1. Any changes that might be proposed should at a minimum meet both of the following criteria:

   a. They should only be proposed if targeting clearly identifiable risks. This may require additional data to support an impact assessment.
   b. They should not have the potential to have an adverse impact on ordinary commercial transactions (e.g. payments of interest to third party customers by licensed banks).

2. It is vital for the continued functioning of capital markets transactions by Irish debt issuers that no new measures inadvertently place obstacles in the way of issues of listed debt, in particular that the quoted Eurobond withholding tax exemption in Section 64 Taxes Consolidation Act 1997 is protected.

3. If any changes are to be proposed, we believe that the priority of focus should be on payments to countries on the list of non-cooperative jurisdictions, for the very reasons that the list is compiled. It would be inappropriate to apply the same measures to payments to countries which, by definition, have a fundamentally different status in terms of any risk of aggressive tax avoidance. Furthermore, the need for certainty and targeting means that affected jurisdictions should be specifically identified (by naming or importing by reference a list of the jurisdictions in question) rather than the subject of a general definition.

4. The economic impact of any required changes should fall on the recipient of the payment whose status is triggering the relevant measure. For that reason, to the extent any Irish sanction is required it may favour a withholding tax rather than a disallowance of deduction, for the Irish payor of the income.

5. If any measures are to be proposed it will be vital that there is substantive and timely engagement with relevant professional and sectoral bodies to minimise the chances of any unintended adverse consequences for the Irish tax system and the economy generally.

In relation to General question 1(d), as it pertains to the definition of interest for this purpose, we believe that no additional special definition of interest should be added to Irish tax law. This would accord with the existing approach in tax law where there is no special definition of interest for general withholding tax purposes under Section 246, thus securing consistency and symmetry. Interest payments by all types of companies in all scenarios should rely on the general legal meaning of interest, unless for the purposes of an agreed international tax rule.

***Question 1(a) Are there any specific criteria that should be considered to identify payors and recipients to which these measures should be applied?***

***Question 1(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***

Please see our introductory comments.

To the extent that companies are within scope of BEPS 2.0 proposals there should be no additional burdens imposed. Payments received in non-tax or 0% tax locations will already be neutralised by such rules. Indeed, taxation at group level ought to be sufficient to avoid detailed analyses of the myriad of rules in recipient jurisdictions.

Similarly, double non-taxation concerns should also not arise where payments are taxed by reference to CFC and similar rules (e.g. US GILTI provisions), at investor level or through taxation on subsequent dividend payments. However, the requisite knowledge may not be available for payments to unrelated parties, especially in real-time. It will be critical to understand the level of knowledge expected of payors and/or protections available to payors acting in good faith to gauge the potential impact on normal commercial transactions and ascertain what proposals are workable in practice.

In this regard the design of any measure should consider what is the relevant connecting factor with a particular jurisdiction. For example, might it be tax residence or the place of incorporation of the recipient? This is a specific area where the burden of proof may be relevant, and clarity will also be required on this.

As indicated above, it does not seem appropriate to subject a payment to a proposed measure where double non-taxation does not arise. Ireland's anti-hybrid rules contain a suitably broad definition of 'included' which may serve as a starting point to identify situations such as:

- Deduction against dual inclusion income
- Inclusion via a CFC rule
- Inclusion via Pillar 2
- Deferred inclusion via later onward dividend and relief for previously taxed income

A rule not adequately reflecting these situations would create harmful double taxation and so should be avoided.

***Question 1(c) Are there any other legislative, policy or administrative considerations that should be taken into account?***

Please see our earlier comments.

Outbound payments (other than dividends) are a legitimate cost of doing business. Taxable profits should continue to reflect the actual activities undertaken in Ireland.

Administration costs for both business and Revenue should be to the fore of any policy decision. In keeping with our earlier comments any policy response should be proportionate to the objective bearing in mind the low perceived risk to the Irish Exchequer. Existing rules have been framed over several decades in the context of managing such risks.

***Question 1(d) Are there any considerations around how interest, royalties or dividends could be defined for these purposes?***

***Question 1(e) Are there any other considerations that should be included as part of this process?***

The meaning of interest, royalties and dividends are well understood in Irish law especially in the context of withholding taxes for which certainty is required. Given the objectives of double taxation agreements and much of EU tax legislation[2] is to eliminate double taxation in a wide range of situations, wider meanings are appropriate in those contexts. Applying non-deduction or withholding tax rules for new categories of payments raises particular concerns in terms of disruption of commercial business arrangements and additional administration, e.g.to ensure that any new rules do not apply. Wider application than necessary would raise other concerns, e.g. to bundled payments, where valuation difficulties and gross-up clauses may need revisiting especially in unconnected party situations.

Businesses often enter into long-term arrangements that result in outbound payments of one type or another. Care should be taken to ensure that disruption to such bona fide arrangements is minimised by narrowly targeting any rule change which may be introduced. As is usual practice in Ireland, appropriate grandfathering or transitional relief is likely to be necessary to alleviate stakeholder concerns.

Detailed consideration will be required as to how any new withholding tax provisions would be overlaid on top of existing exemptions or with specific disapplication in limited circumstances. Deduction restrictions face significant complexities in their interaction with and priority or otherwise over anti-hybrid, interest limitation and the forthcoming Pillar 2 rules. Timing issues would also need to be considered especially in the context of expenses incurred or payments made to jurisdictions on an Annex I list that changes twice a year.

***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?***

We recommend that double taxation agreement provisions should continue to be respected and prevail over any domestic laws. It is doubtful if it would be permissible under the Constitution to do otherwise. More importantly, the principle of *pacta sunt servanda* applies in international law, and it is bad policy not to respect international obligations. If Ireland finds the results of a tax treaty unpalatable it is incumbent on the country to renegotiate it, or in the worst case revoke it in accordance with its terms.

We observe that double taxation agreements will normally include a principal purpose test and other protections. To the extent that concerns remain, consideration should be given to reviewing how particular treaties, particularly with Annex 1 jurisdictions[3] are operating in practice.

---

[2] For example: the Parent-Subsidiary Directive (Council Directive 2011/96/EU); the Interest and Royalties Directive (Council Directive 2003/49/EC); the Merger Directive (Council Directive 2009/133/EC); and the EU Arbitration Convention (Convention 90/436/EEC)

[3] Panama is the only Annex 1 jurisdiction with which Ireland has entered into a double taxation agreement.

## 2. MEASURES IN RELATION TO OUTBOUND INTEREST PAYMENTS

Please see our introductory comments and our responses to the General Questions in the Consultation. The tax treatment of outbound interest payments by Irish residents and Irish branches of non-resident companies is subject to a wide range of conditions and restrictions applicable to:

- the deductibility of the interest and
- the application or otherwise of withholding tax.

This context continues to evolve at pace, with increased tax costs to business arising from the introduction of the interest limitation rules in 2022 and the potential general impact of BEPS 2.0. The possibility of adding further complexity in a short timescale gives rise to a risk of unanticipated and unintended consequences in relation to the tax treatment of outbound interest payments.

***Existing protections***

Within this evolving framework of Irish tax law, the features of the Irish tax system listed below already provide a high level of protection against aggressive tax avoidance involving outbound payments of interest from Ireland.

1. The EU's Anti-Tax Avoidance Directive[4] ("ATAD") interest limitation rules, being implemented by Finance Bill 2021 for accounting periods beginning on or after 1 January 2022.

2. The ATAD anti-hybrid rules, in effect from 1 January 2020, bolstered by the reverse hybrid rules taking effect from 1 January 2022.

3. The restrictive and complex rules limiting the deductibility of non-trading interest expense, as a charge on income under Section 247.

4. The rule denying interest deductibility for borrowings used to fund intra-group asset acquisitions under section 840A.

5. The restriction of exemption from general withholding tax under Section 246 for cross-border yearly interest payments to low-risk situations only, being:

   (a) Interest payments in the ordinary course of a trade or business to a treaty country resident (subject to further conditions).
   (b) Interest payments on "wholesale debt instruments" as defined by Section 246A and subject to the detailed conditions in that section as to minimum denomination, method of holding of the instruments and of payment of the interest.
   (c) Interest payments on listed debt ("quoted Eurobonds") as defined by Section 64, also subject to further conditions to limit application to low-risk scenarios.[5]
   (d) Interest payments by Section 110 companies to residents of treaty partner countries.

6. Potential treatment of interest as a non-deductible distribution in a range of scenarios as provided for in Section 130 Taxes Consolidation Act ("TCA") 1997.

7. International multi-lateral exchange of information on cross-border payments by financial institutions under the OECD Common Reporting Standard.

[4] Council Directive (EU) 2016/1164

[5] It is interesting to note that the corresponding UK withholding tax exemption for listed interest-bearing debt is less stringent than Section 64, in not containing any of the further conditions as to how the bonds are held and how the interest payments are made.

8. Mandatory disclosure requirements for certain cross-border transactions under the Irish implementation of DAC 6.

9. The general scheme of transfer pricing rules in Irish law, incorporating OECD guidance and implementing OECD transfer pricing principles

10. For Section 110 companies, the highly detailed and stringent rules within Section 110 itself which permit deductibility of interest on profit participating notes only in certain strictly defined low risk situations.

We note one particular point in relation to the withholding tax treatment (and in the case of Section 110 companies' profit-participating debt, the deductibility) of outbound interest payments on listed debt and Section 246A wholesale debt instruments. In these cases, it is recognised by the tax legislation that ordinary issues of debt instruments into the international capital markets will generally be made through custodial and settlement systems that would not enable the interest payor to know the identity of the ultimate beneficiary of an interest payment. It is vital for the continued functioning of these capital markets transactions that no measures are introduced that inadvertently cut across this principle and place obstacles in the way of ordinary international capital-raising, securitisation and investment transactions.

***Imminent further protections – OECD/G20 Inclusive Framework***

As flagged above, the proposed implementation of BEPS 2.0 (targeted for commencement in 2023 and 2024) will add a further significant barrier to the possibility of outbound interest payments from Ireland to a foreign affiliate forming any part of an aggressive tax avoidance transaction, in the case of large multi-national groups.

On the basis of this framework of existing and imminent protections, it can be seen that the potential for any material level of aggressive tax avoidance involving outbound interest payments from Ireland is extremely limited. This must form a key part of the context in which the issues outlined in the Consultation are addressed.

In addition, we note that the Irish tax system already contains a range of inter-related and complex rules impacting on the tax deductibility and withholding tax treatment of outbound interest payments. Adding further complexity to this position needs very careful consideration and should require a high level of justification to underpin any changes that might be proposed. There is a strong case for simplification of the existing framework due to the overlapping nature of many pre-existing and ATAD provisions.

***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***.

As stated earlier, we believe that the economic impact of falling within scope of any new targeted measures may favour an approach which falls on the recipient of the income whose tax status gives rise to the outcome. Therefore, withholding tax is favoured over disallowance, provided that any new measure meets the other general principles we have outlined in our response.

***Question 2(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?***

Not applicable, given our response on 2(a).

***Question 2(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 is suggested by the question, it is very important that if any withholding tax provision were introduced that it be drafted very specifically (including naming or importing by reference a list of the jurisdictions in question) so as not to give rise to unintended limitations of the exemptions that have been put in place for valid tax policy reasons, in sections 64, 246, 246A and 256.

## 3. MEASURES IN RELATION TO THE OUTBOUND PAYMENT OF ROYALTIES

Please see our introductory comments and our responses to the General Questions in the Consultation. The Consultation acknowledges that the issues raised in respect of outbound payments 'relate primarily to historical issues which have largely been remedied by recent Irish and US tax reforms. We agree and expect the trends identified in the economic analysis of outbound royalty payments to continue.

***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***.

Consistent with our earlier comments, we believe that the economic impact of falling within scope of any new targeted measures should logically fall on the recipient of the income whose tax status gives rise to the outcome. Therefore, withholding tax is favoured over disallowance, provided that any new measure meets the other general principles we have outlined in our response.

***Question 3(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?***

Not applicable, given our response on 3(a).

***Question 3(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?***

***Question 3(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 suggested by the questions, it would be important that if any withholding tax provision were introduced that it be drafted very specifically (including naming or importing by reference a list of the jurisdictions in question), so as not to give rise to unintended limitations of the exemptions that have been put in place for good policy reasons, in sections 242A TCA 1997 and the administrative practice contained in TDM Part 08-01-04.

The potential application of withholding taxes to royalties paid in respect of a bundle of rights can already be disproportionately problematic from a valuation and administrative perspective. Any additional restrictions on outbound payments may interfere with bona fide commercial arrangements with resultant costs for Irish businesses.

## 4. MEASURES IN RELATION TO OUTBOUND DIVIDEND PAYMENTS

Please see our introductory comments and our responses to the General Questions in the Consultation.

Dividend payments are not deductible in an Irish context so double non-taxation should generally not arise. Furthermore, dividends are paid out of after-tax profits, so should not generally be considered to offer an opportunity for aggressive tax planning. Ireland (like some other countries, e.g. the UK) has always taken the policy stance that after-tax profits may be freely distributed to non-residents, and Irish dividend withholding tax is effectively a mechanism for collecting income tax from Irish resident individuals.

***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.***

It would be important that if any withholding tax provision were introduced that it be drafted very specifically so as not to give rise to unintended limitations of the exemptions that have been put in place for good policy reasons, in sections 172C and 172D TCA 1997.

## 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?***

Our response to this question is highly dependent on the detail of any proposed measure. However, as indicated above, while we are sceptical of the need for any change, the rules around interest payments are in particular need of simplification regardless of the outcome of the Consultation.

## 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?***

As indicated at the outset, the objective of preventing double non-taxation involving no-tax and zero-tax locations appears to be substantially achieved through the extensive international tax reforms as discussed earlier in this submission. The EU has clearly seen fit to deem a list[6] of non-cooperative jurisdictions as meriting additional defensive measures, less because of the risk of double non-taxation, and more in light of:

[6] Most recently on 5 October 2021 – see https://www.consilium.europa.eu/media/52208/st12519-en21.pdf

*"the importance of promoting and strengthening of tax good governance mechanisms, fair taxation, global tax transparency and fight against tax fraud, evasion and avoidance, both at the EU level and globally"*[7]*;*

We submit that the type of measures that are appropriate in response to these concerns are rather different to that of double non-taxation, and their design should reflect this.

**CONCLUSION**

Ireland's economy relies heavily on its ability to attract international investment, which necessarily results in outbound payments. Changes in tax provisions affecting such payments require careful design and should not go beyond what is required to secure their objectives.

We look forward to continued dialogue as the process evolves.

We are at your disposal to discuss the matters raised in this submission in further detail.

Yours faithfully

EY

Ernst & Young

[7] Ditto