AMERICAN CHAMBER of COMMERCE IRELAND

A Territorial System of Taxation

Response from the American Chamber of Commerce Ireland (AmCham) to the Department of Finance's public consultation on a territorial system of taxation.

March 2022

The American Chamber of Commerce Ireland
The Voice of US-Ireland Business

The American Chamber of Commerce Ireland (AmCham) is the collective voice of US companies in Ireland and the leading international business organisation supporting the Transatlantic business relationship. Our members are the Irish operations of all the major US companies in every sector present here, Irish companies with operations in the United States and organisations with close linkages to US-Ireland trade and Investment.

Policy Benefits of Participation Exemption and/or Branch Exemption Regimes

Question 1: What is your opinion of Ireland's corporate tax potentially moving from the current worldwide system with credit relief for foreign tax to a territorial system of double taxation relief, including participation exemption and/or branch exemption provisions?

In light of the current international tax climate, and recent changes to the Irish tax system, AmCham is of the view that now is the correct time to initiate the move to a territorial system of taxation and that the transition should be effective from 1 January 2023.

A territorial regime would bring many benefits to taxpayers: certainty of treatment and a reduction in the compliance burden. The current credit system, that operates under our worldwide taxation system, gives rise to considerable difficulties not just for US multinational enterprises (MNEs) operating out of Ireland but also for Irish headquartered groups. The consequential record-keeping and computational requirements are very burdensome, with little corresponding incremental tax yield for the Exchequer. In this regard, the Department's consultation document states that "in practice, this often results in limited amounts of incremental tax becoming payable in Ireland on foreign earnings."

In our submission to the Department of Finance's public consultation on the OECD international tax proposals (September 2021), AmCham outlined the need for Ireland to enhance its domestic tax offerings so that it can be at the forefront as a location for FDI. To this end, AmCham recommends moving to a territorial system of taxation and simplifying the existing rules for double tax relief under Schedule 24 TCA 1997.

In particular AmCham is of the view that:

- Ireland's worldwide system of taxation for dividends/branches is currently out of step with other EU member states and with most OECD countries. The transition to a territorial system of taxation is important to address the comparative disadvantage for Ireland and bring Ireland in-line with competitor countries.
- The transition to a territorial taxation system will remove a competitive disadvantage and ensure that Ireland remains an attractive and competitive location for inward investment into the future. As outlined above, Ireland should transition to an exemption regime, with an effective date of 1 January 2023.
- Timing is important because the introduction of Pillar II is likely to prompt some re-evaluation of holding, financing and operational activities. This will likely result in a consolidation of activities to substance-based locations. Ireland has not historically been viewed as an attractive location for holding company activities due to the absence of a participation exemption. In order to continue to attract substance to Ireland, the opportunity now exists for Ireland to broaden its offering and become a 'go-to' location for holding, financing and operational structures. Delay may result in a lost opportunity for Ireland.

- The transition to a territorial system is overdue as the recommendations of the Coffey Report are now several years old. In addition, Ireland has had CFC rules for over 3 years which means that the credit system is no longer necessary to act as a deterrent to address the risk of avoidance. This allows for the transition from the credit system to an exemption regime, with no further back-stop measures being necessary.
- The transition to a territorial system of taxation should not result in any significant loss to the exchequer – as acknowledged in the consultation document – and may even result in incremental exchequer revenues through increased FDI.

Question 2: What would the broad benefits be for multi-national enterprises if Ireland were to move to such a system?

AmCham is of the view that a move to a territorial system of taxation will be beneficial in reducing the complexity of the Irish tax code, and in removing a disincentive for using Ireland as a holding company jurisdiction.

As several European jurisdictions (e.g. the Netherlands, Switzerland) demonstrate, there is a natural synergy between balanced tax rules dealing with investment and repatriation on the one hand, and high-skilled employment in related functions, including treasury, group IT, FX management etc, on the other.

As things stand, business often hesitates to use Ireland as a holding company jurisdiction because of the complexity of the current rules. By moving to a territorial system of taxation, there should be greater simplicity for businesses, particularly in addressing the current cumbersome method of calculating credit relief for foreign tax. AmCham is of the view that this must be a key consideration in moving to a territorial system of taxation.

Furthermore, AmCham is of the view that a move to a territorial taxation system will ensure that Ireland remains an attractive and competitive location for inward investment following the implementation of the OECD international tax agreement.

Question 3: Are there any particular drawbacks or concerns for multi-national enterprises which should be considered if Ireland were to move to such a territorial system of double tax relief, including any indirect consequences or risks?

AmCham has not identified any fundamental concerns arising directly from a move to a territorial system of taxation. However, AmCham does recognise that there may be indirect issues arising either from situations where there may be an attraction in having an amount of taxable income (e.g. interest limitation rules) or there may be unexpected interactions with other Irish tax rules. Some of these points are covered later, but in summary for these reasons AmCham believes that any exemption should be optional, at the taxpayer's election.

Question 4: Are there particular examples of best practice associated with a change to territoriality in other jurisdictions which could be considered, with a view to reducing compliance burdens without increasing avoidance risks?

AmCham notes that Ireland is one of the few countries in the developed world which does not have an exemption system for dividends and branches. Whilst the transition to a territorial regime would represent a significant change to our tax code, other countries have effected a relatively seamless transition from a double tax credit system.

The UK transitioned from a credit system for dividends in 2009 to a broad-based participation exemption system where, subject to targeted anti-avoidance rules, companies can qualify for an exemption under a broad number of categories.

The UK's rules are designed for the particular circumstances of the UK tax system, and as such, in the context of Ireland, AmCham believes that a simpler framework of anti-avoidance rules would be appropriate.

In moving to a territorial taxation system, AmCham is of the view that it is essential that the transition is to a model which fits with the shape of Ireland's economy, its stance on international tax generally and the existing protections now contained in the Irish tax code. It is important that the territorial system adopted by Ireland is fit for purpose rather than merely adopting a model from another country.

Scope of Exemption Regimes

Question 5: Taking account of the above, what in your view would be the potential impacts of moving to a participation exemption regime as set out in the Coffey Report?

AmCham is of the view that moving to a participation exemption, as suggested in the Coffey Report, would, if implemented properly, be beneficial in terms of providing greater ease of doing business in Ireland. Such a move would have the potential to benefit Ireland, and support Ireland's pro-enterprise landscape.

Compared to other European locations, Ireland's system of taxing dividends means that Ireland is less attractive as a headquarter location. AmCham believes that moving to a participation exemption regime, as set out in the Coffey Report would be beneficial for Ireland in ensuring this particular disincentive for using Ireland as a headquarter location would be eliminated.

Question 6: Are there particular considerations or design features that should be considered in reviewing the basis of the Irish corporation tax system?

As AmCham has indicated, Ireland should move to a regime with a broad-based exemption. To the extent any targeted anti-avoidance rules are considered, it is AmCham's view that any such rules should be limited, given Ireland's existing targeted and general anti-avoidance rules. The design of such rules should not delay the implementation of the transition to a territorial system of taxation and the introduction of a broad-based exemption, given that targeted avoidance rules can be amended in the future, as required.

Furthermore, the final OECD Pillar II Model Rules provide broad-based exemptions for dividends and capital gains. Conforming the Irish tax code to the same exemptions will allow Ireland to simplify administrative burdens and maximize competitiveness following the implementation of Pillar II.

As regards specific design features, AmCham's view is that a dividend exemption should be broader than the existing exemption for gains in the following respects:

- There is no reason to limit the exemption to the EU or countries with which Ireland has a tax treaty. This is not a condition of credit relief. Irish investment hubs potentially may have a need to repatriate funds from a wider group of countries (most of which have high tax rates) than those with which treaties have been concluded.
- AmCham believes it would be unwise to use the Irish domestic tax concept of 'trading' to frame access to the exemption. The persons tasked with judging whether the conditions are met may struggle to access the data needed to inform the decision. (This is already the case with dividends subject to the 12.5% tax rate under Section 21B TCA 1997).
- AmCham does not believe the 'ordinary share capital' criterion is appropriate – at least not if narrowly applied as currently seems to be the approach of the Revenue Commissioners. A broader definition of a return on equity for which not tax deduction has been obtained by the payer seems more appropriate.

As regards a branch exemption, AmCham believes that the legislation should build on existing wording in the OECD Model Rules, which in connection with ATAD-compliant anti-hybrid rules should guard against abuse.

Furthermore, as AmCham has outlined to the Department of Finance previously, Ireland must enhance its domestic offering to ensure it remains a competitive location for US MNEs to invest in. Such enhancements include:

- Reducing the marginal income tax rates and the thresholds at which they apply to encourage and retain a talented work force in Ireland.
- Making the personal tax regime for key, in-demand individuals more attractive to encourage talent to move to Ireland. This could be done through the non-application of CAT and CGT to such individuals and through further enhancements to the SARP regime.

- Removing Section 757 TCA 1997 which provides for a Case IV charge on capital sums received for the sale of patent rights.
- Removing the 25% rate of corporation tax.

Question 7: Taking account of, but not limited to, the design elements above, what in your view would be the best regime for Ireland to transition to, should a change take place? Please elaborate with consideration of the impacts, benefits and potential drawbacks both of (a) your preferred approach and (b) any approaches which you do not think would be beneficial.

AmCham is of the view that it is essential to ensure the correct conditionality is in place. It is AmCham's view that Ireland should transition to a broad exemption regime, which would provide certainty for business.

For further details, see AmCham's response to question 6.

Interaction with CFC Rules

Question 8: Please outline your view of whether Ireland's CFC rules would be adequately aligned with participation exemption and/or branch exemption regimes should these be introduced. What synergies or risks, if any, do you foresee arising?

It is AmCham's view that the rule which attributes undistributed income of a CFC to an Irish shareholder which carries out relevant Irish activities (i.e. significant people functions or key entrepreneurial risk-taking functions) is a sufficient protection against the risk of artificial diversion of income away from Ireland.

Whilst the credit system originally provided a back-stop against the artificial diversion of profits offshore, with CFC rules, that back-stop is no longer required. As such, Ireland now has the opportunity to move away from the credit system. Furthermore, given Ireland's CFC rules are ATAD compliant, AmCham is of the view there is no need for these rules to be reviewed, subject to AmCham's response to question 10.

Question 9: Please identify any particular design features of these exemption regimes that could have positive or negative impacts in this context? Please elaborate.

AmCham's view on this matter is outlined in response to question 10 below.

Question 10: Please identify any adaptations to Ireland's CFC rules that should be considered in conjunction with the introduction of such exemption regimes.

The majority of countries with an exemption regime have CFC rules. Whilst some technical adaptations to Ireland's CFC rules may be required, AmCham notes that many countries with exemption regimes have CFC rules, very similar to Ireland's.

AmCham is of the view that, where a branch exemption regime is in place which exempts the profits of a branch, the treatment of these profits, under CFC rules, should be similar to that of foreign subsidiaries. AmCham acknowledges that ATAD requires a technical amendment to Irish CFC rules in this regard, but this is a purely technical matter.

Furthermore, AmCham strongly recommends that where foreign sourced profits have previously been subject to Irish CFC rules, these profits should also be exempted (regardless of whether they met the conditions for the dividend exemption or the branch exemption). The current treatment of such income is complex, involving seeking credit not only for the foreign tax but also the Irish corporation tax arising via the CFC charge.

Interest Charges associated with Exempt Income

Question 11: In your view, should tax relief for funding costs of investments be reviewed, with a view to restrictions, if foreign income from such investments were to be exempted? What EU law or tax treaty constraints, if any, might impede such restrictions?

Ireland's rules on when interest is allowable as a deduction are already extremely complex. This is particularly the case regarding rules associated with borrowing to make equity investments. These rules were overdue for review prior to the introduction of interest limitation rules.

As part of the introduction of interest limitation rules, policymakers indicated a willingness to review the whole area of interest deductibility and AmCham supports a review in this context. AmCham does not believe it is currently the appropriate time to layer on additional complexity in this regard until a wider review has been undertaken and completed. Such a review should take into account EU treaty freedoms, tax treaty considerations, and comparative analysis with similar jurisdictions.

Exit Tax

Question 12: Please outline what in your view the impacts, if any, of participation exemption and/or branch exemption regimes might be on Ireland's Exit Tax rules. Do you foresee any synergies or risks in this space?

AmCham is of the view that Ireland's exit tax rules are ATAD compliant. Most European countries have similar exit tax rules as well as exemption systems. AmCham acknowledges that minor adjustments may be required to ensure exit tax rules remain ATAD compliant in the transition to an exemption regime.

Question 13: Please identify how particular design features of the exemption regimes could have positive or negative impacts in this context.

AmCham's view on this matter is outlined in response to question 12 above.

Schedule 24

Question 14: Do you believe that a review and simplification of Schedule 24 could be feasible and sufficient, instead of changing to participation exemption and/or branch exemption regimes? How might this simplification be achieved?

AmCham is of the view that a simplification of Schedule 24 without a transition to a territorial system would achieve limited benefits for the majority of currently affected taxpayers, and almost no benefit from a competitiveness perspective. The complexity in Schedule 24 arises from a combination of:

1. Observance of EU treaty freedoms.
2. A desire to avoid anomalies that directly arise out of the credit system.
3. A desire to guard against abuse of some of the other basic rules and preserve the 'backstop'.

A territorial system avoids numbers 1 and 2 above, and number 3 seems no longer applicable for reasons discussed earlier.

In any event, even a simplified Schedule 24 inevitably involves the tracking of taxes paid at lower tier subsidiaries, with all the record-keeping that involves. AmCham submits that this treatment should be reserved for a small minority of cases, i.e. where the taxpayer so elects or the conditions for exemption are not met.

Question 15: What in your view are the relevant considerations in terms of any simplification of Schedule 24?

In relation to simplification of Schedule 24, AmCham believes this should only be considered as a fall-back regime for dividends which do not qualify for the participation exemption. It is already the case that a competitive disadvantage exists in relation to the Irish taxation regime, and simplification of Schedule 24 would, in effect, make the regime more difficult for taxpayers to navigate. This could also potentially increase the competitive disadvantage.

Question 16: In the event of Ireland moving to participation exemption and/or branch exemption regimes, what simplifications, if any, could be considered for the remaining credit system of double taxation relief - including in respect of foreign-source interest and royalty income and out-of-scope dividend, branch income and capital gains?

As outlined in our response to question 15, such a simplification of Schedule 24 could make the regime more difficult for taxpayers. However, AmCham is of the view that a simplification of Schedule 24 could be assisted by a move to a broad exemption regime. AmCham believes the broader the exemption regime introduced, the greater the level of simplification that can occur in Schedule 24.

Interaction with Anti-Hybrid rules

Question 17: Please outline how territorial participation exemption and/or branch exemption regimes could impact on Ireland's Anti-Hybrid rules. Do you foresee any synergies or risks arising from the change?

Under ATAD, it should not be possible to obtain a dividend exemption in Ireland in circumstances where a payment from a subsidiary is deductible in the source country. Ireland's financial instrument anti-hybrid rule provided for in section 835AJ TCA 1997 already has this effect, but AmCham is open to discussion as to whether a more specific provision would be required.

In relation to branches, branch anti-hybrid rules can be quite complex, and ATAD2 offers some optionality as to their scope. It is AmCham's position that, in principle, a branch exemption should be available without the need to rely on a tax treaty, provided that the basic definition of a branch is met. An exception might be made for situations where the tax authorities of the branch location do not recognise the existence of the branch, and in such case the credit system would apply.

Again, AmCham is of the view that this seems to involve no more than a minor technical amendment of existing rules.

Question 18: Please identify any specific design features of exemption regimes that could have positive or negative impacts in this context? Please elaborate.

AmCham's view on this matter is outlined in response to question 17 above.

Question 19: Please identify any adaptations to Ireland's Anti-Hybrid rules that should be considered in conjunction with a transition to such exemption regimes.

AmCham's view on this matter is outlined in response to question 17 above.

Interaction with the Two-Pillar Solution

Question 20: Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for the way in which the two pillar solution is implemented in Irish tax law? Are there any potential synergies or risks with the implementation of the two-pillar solution and such exemption regimes?

It is worth noting that Pillar II of the OECD framework effectively assumes that the countries involved use an exemption system for foreign branches and intra-group dividends. In OECD parlance, a foreign Permanent Establishment of a Constituent Entity of an MNE Group is generally treated as a Constituent Entity in its own right. Consequently, any taxes paid in the head office jurisdiction do not count towards the Adjusted Covered Taxes amount that appears as the numerator of the calculation of Jurisdictional ETR. (A similar treatment applies to any tax applied in a parent company jurisdiction as a result of the remittance of dividends).

More importantly, whilst there are already compelling reasons for the introduction of a territorial system of taxation, as discussed above, it is AmCham's position that the implementation of the two pillar solution should put the case beyond doubt. A global minimum tax would remove any supposed incentive for MNEs to divert income to low tax jurisdictions.

Ireland's Double Taxation Treaty Network

Question 21: Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for Ireland's tax treaties?

AmCham does not foresee any potential adverse impacts for Ireland's tax treaties arising from a move to a participation exemption. Nor does AmCham foresee a situation occurring whereby Ireland's tax treaty partners will take issue with Ireland's transition to an exemption system. As exemption regimes are typical in the international tax arena, such a transition should not be a cause of concern for tax treaty partners.

As far as taxpayers are concerned, there is a theoretical possibility that a taxpayer might seek to rely on a treaty to invoke the credit method. If the exemption is optional in any event, it seems hard to imagine this arising in practice.

Question 22: Should the renegotiation of Ireland's tax treaties, as respects the Elimination of Double Taxation article, be considered in the event of the enactment of participation exemption and/or branch exemption regimes? Would this be necessary? If so, how might it be feasible to accomplish this in a targeted and efficient manner?

AmCham is of the view that the elimination of double taxation article can be renegotiated as tax treaties themselves come up for renegotiation. As outlined in response to question 21, exemption systems are typical in the international tax arena. As such, Ireland's tax treaty partners should understand the system to which Ireland is transitioning. The transition to an exemption system should not create barriers in relation to Ireland's tax treaties.

AmCham would highlight the experience of the U.K. when it transitioned from a credit regime to an exemption regime. Based on AmCham's understanding, there was no need for treaty renegotiation, nor was renegotiation regarded as an urgent priority.

Question 23: Would any amendment of Ireland's worldwide tax system to allow for exemption of foreign dividends, gains or branch income necessitate a review of specific tax treaties in Ireland's network, where previously Ireland's worldwide charge would have ensured taxation of such dividends, gains or branch income? Alternatively, could such taxation be ensured by limiting the scope of any exemptions enacted in domestic law?

AmCham is not aware of any specific territories which take the view that the treaty benefits for dividends, gains or branch income are contingent on those items being taxable in Ireland.

Transitional Arrangements

Question 24: Do you foresee impacts in relation to the matters identified above or any other matters related to transitional arrangements?

In relation to transitional arrangements, it is AmCham's view that clarity regarding the effective date of transition is of the utmost importance. An early commitment to a 1 January 2023 transition would be very welcome. This is vital to allow the taxpayer to adequately plan for the transition.

AmCham acknowledges that in respect of the transition from a credit regime to an exemption regime, the most important element will be the introduction of the core exemption rules.

Following the implementation of the core exemption rules, AmCham anticipates that it may take some time for the second-level impacts to be fully understood. Once any second-level impacts are fully understood, any necessary legislative adjustments can then be made in line with the relevant circumstances and legislative resources available.

Other Issues

Question 25: In your view, what other relevant considerations should be taken into account? You may wish to consider this question in the context of the recent OECD Inclusive Framework Two-Pillar agreement.

AmCham is aware that Pillar II, and its associated timeframe, requires the focus of Department of Finance resources, however, it is AmCham's view that there is an urgent need for a transition to a territorial system of taxation, with an effective date of 1 January 2023. As such, it should be a priority for the Department to make resources available to advance the required changes to support the transition.

The move to a territorial system of taxation is long overdue, given that Ireland will have had CFC rules in place for at least four years by the time there is a prospect of a transition to a territorial regime being implemented – and that is on the assumption that a January 2023 implementation is achieved. It is AmCham's view that the current credit system causes significant frustrations for companies undertaking the normal repatriation of profits that have already been taxed in the source country.

Pillar II will result in some review, and possible restructuring, by MNEs of their operations. In the absence of clarity on the transition to a territorial regime, Ireland will lose out on opportunities to attract FDI as MNEs make their decisions based on the current rules. Urgent clarification on the transition will address this disadvantage.