Consultation on Territoriality
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Consultation on a territorial system of taxation

We welcome the opportunity to make a submission on the implementation of a territorial system of taxation and we would be delighted to discuss any of the points raised in this submission with you. The focus of our submission is purely on the adoption of a participation exemption for dividends. Please note that signatures to this letter represent a number of Irish headquartered public listed companies with a global annual turnover of roughly $90 billion and employ over 5,000 people in Ireland.

We have provided our recommendations on the regime more generally and have only provided a brief response to some of the questions posed, as detailed in the Appendix. Our key message is that Ireland urgently needs to introduce a participation exemption for dividends. The regime needs to be as simple and uncomplicated as possible. As a recommendation, the Irish Department of Finance could look to the dividend exemption regime that has been adopted by the UK as a blueprint to what the Irish regime may look like. Under that regime, foreign dividends are generally exempt from corporation tax, except where tailored anti-avoidance legislation applies.

The current foreign tax credit regime is antiquated and outdated. It is cumbersome, complicated and administratively challenging. In this regard, Ireland is an outlier internationally – it is the last EU country and one of the last of the OECD countries to implement a participation exemption regime for foreign dividends. The current Irish foreign tax credit regime (a) creates administrative inefficiencies, (b) suppresses repatriation, and (c) increases the risk of error due to its complexity.

The current regime also makes Ireland less competitive in attracting new foreign direct investment. With the advent of the proposed introduction of a 15% minimum taxation as approved by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) ("Pillar 2") and the EU Directive setting forth rules to prevent the misuse of shell entities for tax purposes ("UNSHELL"), many businesses are revisiting their operational and holding company structures. The outcome of these and other changes will likely lead to a consolidation of substance and entities in a smaller number of jurisdictions. If Ireland's holding company regime is substandard then it is less likely that it will be a location for substance. An exemption for foreign dividends would position Ireland on an equal footing with other jurisdictions within the EU and OECD with regard to these reviews. A great opportunity will be lost if an Irish participation exemption is not available as soon as possible, and that the Department of Finance does not provide clarity with regard to the introduction of such a regime, and the timing of same. In this regard, we would strongly recommend that a participation exemption is enacted from 1 January 2023 to coincide with the introduction of the EU Directive giving effect to Pillar 2.

The new regime needs to be simple and provide certainty to taxpayers. Schedule 24 is a patchwork of differing legislative changes and is not fit for purpose. Our overall recommendation would be to enact new legislation to affect the introduction of a participation exemption for dividends. However, to avoid any unintended consequences with regards to the introduction of a participation exemption, or where the current regime is preferable for certain taxpayers, Schedule 24 in its current format should be retained as an optional regime. The exemption would, however, be the prevailing legislation for taxpayers.

With regards to any concerns that a participation exemption regime could undermine the Irish tax base, recent Finance Acts have effectively addressed these concerns by implementing EU Anti-Tax Avoidance Directive ("ATAD") and BEPS measures, including the introduction of a CFC regime, anti-hybrid measures, transfer pricing rules, and the removal of certain exit tax exemptions. This will be further reinforced upon the implementation of a global minimum tax of 15% pursuant to Pillar 2. Whilst not the subject of this consultation, we would recommend that Ireland should push for a delay in the implementation of the global minimum tax pursuant to Pillar 2, until there is international consensus on the adoption of the rules. In particular we reference the US constraints with regard to the adoption of the minimum tax.

While an analysis will need to be performed to support this assumption, we would not expect a significant cost to arise to the exchequer on implementation of an exemption for foreign dividends as, in many instances, the current foreign actual and deemed tax credit system generally eliminates Irish tax on foreign dividends (which, as mentioned above, unfortunately necessitates an exceptionally onerous process which is subject to error in order to validate a "nil additional tax" position)[1].

It is noted in the specific questions as to whether the Irish CFC regime would require a review with the introduction of a participation exemption for dividends. It is unclear why such a review would be required, given the fact that the Irish CFC rules are already ATAD compliant and are functionally similar to CFC requirements in other EU and non-EU countries with participation exemptions.

With regard to the potential review of the deductibility of interest by reference to section 247 TCA 1997, we would welcome the modernisation of the overall Irish interest deductibility rules. The "charge on income" approach was abolished in the UK in the mid-1990s (being outdated and uncommercial) and no other EU jurisdiction has such a system. However, if section 247 TCA 1997 is only being reviewed in isolation in the context of the introduction of a participation exemption for dividends, this would be seen as a negative step internationally. The Irish interest deductibility rules are already overly restrictive. Further reducing the instances where interest may be deductible in Ireland would be excessive, especially given the introduction of the 30% interest limitation restriction effective 1 January 2022.

We have given a great deal of thought to the summary positions outlined above, as well as to how the participation exemption provisions might be designed to optimise the benefits and protections mentioned above. We would welcome the opportunity to discuss this proposal further with you at your earliest convenience.

Yours sincerely,

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[1] As noted in The Review of Ireland's Corporation Tax Code by Seamus Coffey – 30 June 2017

Appendix – Response to Specific Questions

Q1. 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?

- As noted, it is crucial that Ireland acts now and introduces a participation exemption for dividends effective 1 January 2023. With the introduction of the Pillar 2 global minimum tax, groups are beginning to review their operational and holding structures. As such, absent an exemption for dividends, Ireland may not be considered as a choice location going forward particularly as substance and holding structures coalesce.

Q2. What would the broad benefits be for multi-national enterprises if Ireland were to move to such a system?

- Some of the benefits would be to simplify the burdensome and increasingly complex double tax relief calculations, reduce uncertainty and administrative costs, and eliminate year on year change of law risk through the alignment of the tax treatment of Irish / foreign dividends.
- Further to this, from a capital allocation perspective, the ability to repatriate funds to, and redeploy funds from, Ireland in an administratively efficient manner may potentially assist Ireland as a treasury, operational, supply chain etc. location going forward.
- Aside from the complexities around the calculation of tax under Section 21B TCA and the application of double tax relief under Schedule 24 (including in some cases complex on shore pooling calculations, the requirement to trace back profits over many years and disaggregate the profits of an intermediate company) issues of technical interpretation frequently arise in the context of double tax relief under Schedule 24 TCA including:
    - Complexities arising where a dividend is paid from an Irish company to an EU intermediate holding company which pays a dividend from those profits onto Ireland.
    - Requiring dividends to be attributed to a particular year based the year in respect of which the profits were declared for company law purposes which can give rise to complexities due to differing rules and concepts in foreign corporate law.
    - Difficulties in applying Paragraph 9H of Schedule 24 to certain forms of foreign merger.
    - Claiming relief under Paragraph 9B of Schedule 24 TCA in respect of distributions which are not dividends for foreign company law purposes.
    - Claiming relief for non-cash distributions many levels down in the group which are not regarded as dividends for Irish company law purposes.
    - Claiming relief under Paragraph 9I of Schedule 24 TCA where the dividend is paid out of profits attributable to a share buyback rather than a dividend.
    - Complexities arising in respect of companies joining and leaving "consolidated groups" in circumstances where Section 9G of Schedule 24 applies.
- These technical complexities arising on bona fide commercial transactions within an international group give rise to significant uncertainties in many cases. Where the quantum of the relief is significant, this can represent an unacceptable tax exposure for multinational groups.
- Due to the complexities arising from the application of schedule 24, many Irish headquartered groups fund dividend payments to their ultimate shareholders through inter-company borrowings. As a result of the Irish interest deductibility rules, the interest on such borrowing is non-deductible for Irish tax purposes but is generally subject to tax in the lending jurisdiction. This can represent a significant tax cost for many businesses, as well distressing Irish company balance sheets without permanent repatriation of these funds.

Q3. 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?

- Providing that the participation exemption is as broad and simple as possible, there shouldn't be any indirect consequences or risks. This is borne out by the fact that Ireland is one of the last countries within the OECD and the EU to introduce a participation exemption. By including a potential election option to the regime, this could eliminate any unforeseen consequences of the introduction of a regime on certain tax payers.

Q4. Are there particular examples of best practice associated with a change to territoriality in other jurisdictions which could be considered?

- UK participation regime for dividends would be a prime example as best in class.
- The UK corporation tax exemption for dividends was introduced with effect for distributions paid on or after 1 July 2009, with only minimal transitional provisions pertaining to specific sections of the legislation.
- The regime brings all distributions received by UK tax-resident companies within the charge to corporation tax (where they are taxed at the same rate as other corporate income), but subject to a wide-ranging exemption regime. Under this regime, distributions falling into any of several 'exempt' classes are treated as exempt from UK corporation tax. Exempt classes include, for example, distributions received from controlled participations, distributions from portfolio investments and distributions derived from transactions that are not designed to reduce tax. In practice, the vast majority of dividends received by UK corporate taxpayers are exempt under this regime.
- The dividend exemption is subject to overriding anti-avoidance provisions, which apply where the distribution takes the form of certain non-dividend distributions, or where a deduction has been taken for overseas tax purposes by the payer of the distribution. Each exempt class also includes its own anti-avoidance legislation to prevent the manipulation of the exemption regime for tax avoidance purposes. Where distributions are otherwise taxable as trading income (for example, in the hands of a trader in shares) or as profits of a UK property business, the exemption is not applicable, and taxation of the relevant distributions is calculated based on normal tax principles.
- A simplified regime also applies for distributions received by small companies.
- All companies can elect against exemption if, for example, doing so reduces the cost of source-based taxation, and in such cases, the UK tax code retains a number of provisions for crediting both direct and underlying foreign tax suffered against the UK corporation tax chargeable on taxable distributions.

Scope of Exemption Regimes

Q5. 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?

- One of the key benefits would be to make Ireland a more competitive holding company location as well as a potential hub for centralised group activities by delivering tax certainty and allowing Ireland to compete on a more level playing field with other OECD/EU countries.
- A participation exemption would encourage expansion and solidify existing investments, as well as attract further business investment in Ireland by providing a truly tax neutral holding company environment.

Q6. Are there particular considerations or design features that should be considered in reviewing the basis of the Irish corporation tax system?

- The new regime should be as simple and straightforward as possible. Given all of the recent anti-avoidance legislation adopted by Ireland, and the likely introduction of Pillar 2, there is no necessity to overcomplicate the regime.
- In particular, the regime should not apply a residence test for the payer jurisdiction or in respect of the underlying profits so that there is no requirement to trace the profits of the payer company through multiple layers of a corporate structure to assess qualification for the exemption.
- Further to this, the regime should not look to incorporate any type of trading test with regards to shareholdings or to the sourcing of profits, as this can be overly restrictive and administratively burdensome on taxpayers.
- As discussed in our response to question above, the UK dividend exemption regime merits consideration. Except in the case of small companies the UK regime does not contain a residence test in respect of the payer jurisdiction.
- Given the similarities of the UK and Irish tax regimes and legal concepts we consider that the design of the UK dividend exemption regime should be compatible with Irish tax law.

Q7. 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

- Ireland should transition to a full exemption for foreign sourced dividends, with an election to tax and apply Schedule 24. The regime should not include any restrictions on the availability of the exemption but could include certain discrete anti-avoidance – similar to the UK regime.

Interaction with CFC Rules

Q8. 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?

- ATAD compliant CFC rules are aligned with a participation exemption noting that all EU countries that have participation exemption must also have ATAD compliant CFC .
- The current CFC regime should not require material modification to ensure that it is compatible with a dividend participation exemption.

Q9. Please identify any particular design features of these exemption regimes that could have positive or negative impacts in this context? Please elaborate.

- As noted, the CFC regime is already compliant with EU ATAD.

Q10. Please identify any adaptations to Ireland's CFC rules that should be considered in conjunction with the introduction of such exemption regimes.

- See above.

Interest Charges associated with Exempt Income

Q11. 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?

- The Irish interest deductibility rules are already one of the most complex rules in the EU. As such, a review the applicability of section 247 relief should not be made in isolation. Either the relieving provisions are left unchanged, or the overall Irish interest deductibility rules should be restructured to grant a deduction for all interest on debt incurred wholly and exclusively for legitimate business reasons. Excess interest is addressed by the interest limitation rules, anti-hybrid rules and Section 817A, and also with the recent implementation of the 30% restriction on interest.
- Also, any general restriction of interest relief based on the country of establishment of the investee entity may be incompatible with EU case law in respect of freedom of establishment and free movement of capital under Article 49 and Article 63 of the Treaty on the Functioning of the European Union ("**TFEU**") respectively.

Exit Taxes

Q12. 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?

- An ATAD compliant exit tax is aligned with a participation exemption noting that all EU countries that have participation exemption must also have an exit tax regime under ATAD.
- The current exit tax regime should not require material modification to ensure that it is compatible with a dividend participation exemption.

Q13. Please identify how particular design features of the exemption regimes could have positive or negative impacts in this context?

- No comments.

Schedule 24

Q14. 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?

- No. Schedule 24 is a patchwork of various legislative changes to deal with specific issues. It is exceptionally cumbersome and is not fit for purpose. New legislation should be drafted to replace Schedule 24. For taxpayers where Schedule 24 may be more beneficial, it could be possible to include optionality into the tax code so that companies can opt into Schedule 24.

Q15. What in your view are the relevant considerations in terms of any simplification of Schedule 24?

- As noted, Schedule 24 is not fit for purpose, and a simplification of the schedule would only lead to further difficulties for taxpayers in transitioning to a new double tax relief regime.

Q16. 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?

- The regime should provide for greater flexibility for the deduction of unrelieved foreign taxes, i.e. allow a deduction for unrelieved royalty withholding taxes.

Interaction with Anti-Hybrid rules

Q17. 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?

- ATAD compliant anti-hybrid rules are aligned with a participation exemption noting that all EU countries that have participation exemption must also have anti-hybrid rules under ATAD and therefore a participation exemption should not create further risks. In fact, the participation exemption is the natural evolution of the Irish tax code, i.e. introduction of transfer pricing, introduction of a CFC regime, etc.
- On the basis that specific provisions were included in our anti-hybrid rules to allow for our worldwide taxation system some minor modification of the anti-hybrid rules may be required.

Q18. Please identify any specific design features of exemption regimes that could have positive or negative impacts in this context? Please elaborate.

- No comment.

Q19. Please identify any adaptations to Ireland's Anti-Hybrid rules that should be considered in conjunction with a transition to such exemption regimes.

- See above.

Interaction with the Two-Pillar Solution

Q20. 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?

- A participation exemption is the evolution of the Irish tax regime, particularly with the advent of Pillar 2. As such, there is a natural synergy with the introduction of the minimum rate of tax.
- Layering Pillar 2 over Ireland's tax regime which differs from the regimes in the countries driving these changes is likely to cause additional complexity and potential mismatches in applying the Irish tax rules.
- The Pillar 2 rules and the draft EU directive provide that dividends other than short term portfolio dividends are generally excluded for the purpose of the global minimum tax calculation which is consistent with a participation exemption regime.

Ireland's Double Taxation Treaty Network

Q21. Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for Ireland's tax treaties?

- Whilst a short review of each of Ireland's double tax agreements will be required, on the basis that the domestic provisions will limit the charge to tax on dividends and Ireland's treaties provide for double tax relief only against Irish tax charged on the relevant income, profits or gains, it is unlikely that any material amendments to Ireland's double tax agreements would be necessary as a result of the introduction of a participation exemption for dividends. We understand that this was the case when the UK moved to a participation exemption for dividends.

- It will be necessary to retain our double tax relief provisions for circumstances in which an election for exemption is not made.

Q22. 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?

- No comment

Q23. 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?

- No comment

Transitional Arrangements

Q24. Do you foresee impacts in relation to the matters identified above or any other matters related to transitional arrangements?

- No comment

Other Issues

Q25. 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.

- No comment