**Irish Funds**
Ashford House,
18-22 Tara Street
Dublin 2 D02 VX67
t: +353 (0)1 675 3200

6th Floor,
Square de Meeûs 37
1000 Brussels
t: + 32 (0)2 791 7693

e: info@irishfunds.ie
w: irishfunds.ie

**Delivery via Email**
intltax@finance.gov.ie

Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
D02 R583

7th March 2022

Dear Sir/Madam

**Consultation on a Territorial System of Taxation**

The Irish Funds Industry Association (Irish Funds) is the voice of the funds and asset management industry in Ireland. Founded in 1991, Irish Funds represents fund managers, depositaries, administrators, transfer agents, professional advisory firms and other specialist firms involved in the international fund services industry in Ireland.

By way of background, Irish Funds represents:

- 150+ member organisations;
- 15,000+ funds;
- 17,000+ industry professionals including asset managers, depositories, administrators, transfer agents, auditors, law firms and other specialist firms;
- €6.5 trillion in assets under administration;
- €4.1 trillion in assets in Irish domiciled funds;

While Irish regulated funds do not, for the most part, pay income, corporation or capital gains tax in Ireland (noting that investors will be subject to the tax regimes of their own jurisdictions), many of our members have Irish and non-Irish subsidiaries, joint ventures and branches within their corporate structures and as such, we anticipate that the introduction of a territorial system of taxation could have a significant impact for the industry.

We have set out in Appendix 1 our responses to the questions posed and we are available to discuss these recommendations should that be of assistance.

Yours faithfully,

Aoife Coppinger
Irish Funds

irish funds

**Appendix 1 - Responses to the Questions in the Public Consultation**

**Policy Benefits of Participation Exemption and/or Branch Exemption Regimes**

**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 in the Corporation Tax Roadmap published in September 2018 (and updated in September 2021), Ireland's current system of worldwide taxation, with relief provided by way of foreign tax credits, is deeply complex while also quite generous. This results in a situation where a great deal of effort is needed to apply the rules but, when that is done, they typically result in very little incremental tax being paid to the Irish exchequer. In particular, the additional foreign tax credit for dividends from EU resident companies effectively grants a relief equivalent to a participation relief in many cases already, but in a very complex fashion.

A move towards a territorial system should simplify tax compliance and provide greater certainty for businesses, while enhancing Ireland's attractiveness as an investment location with only a negligible (if any) loss of tax revenue.

It is a broadly accepted principle that in order to operate a territorial system of taxation, anti-avoidance measures must be sufficiently robust to prevent the offshoring of profits which would otherwise be taxable in the jurisdiction in which they arise. There are a number of relevant factors which should result in this risk being reduced to an acceptable level e.g. Ireland's controlled-foreign company regime, the anti-hybrid and anti-reverse-hybrid rules. Interest limitation rules, exit-taxes amongst many other anti-avoidance measures.

The introduction of full participation and branch exemptions for foreign dividends (and other distributions on shares), capital gains on substantial shareholdings, and branch profits would further improve Ireland's reputation as an investment jurisdiction and bring it towards "best in class" status. Ireland has, for some years, been regarded as an outlier in this regard, being the only EU Member State, and one of only five OECD Member States, to lack a meaningful participation exemption regime. Such a move would be welcomed by the international business community, which often point to this as an area where Ireland lacks competitiveness.

Furthermore, the reduction in taxation raised as a result of the introduction of a full participation regime should be negligible. As noted above, foreign dividends are, in practice, rarely subject to further taxation in Ireland in the first place, although there is a significant tax compliance burden for businesses in verifying this position each year. A similar analysis applies to foreign branch profits and capital gains on substantial shareholdings (some of which are already exempt).

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

irish funds

The broad benefits of the move to such a system (assuming dividend participation and branch exemptions are fully introduced also) would be in line with those indicated above, as follows:

- Enhancement of Ireland's competitiveness as an investment jurisdiction: The move to a territorial regime would enhance Ireland's competitiveness as an investment and holding company jurisdiction. The introduction of a complete participation and branch exemption, the absence of which has been a long-standing criticism of international investors, will bring the Irish tax treatment in line with that of competitor jurisdictions. Furthermore it has the potential to further increase the level of substance (and therefore employment) in Ireland;

- Greater tax certainty: Moving to a territorial system, and the associated removal of complex double taxation relief via the credit system, will provide greater certainty to investors as to their annual Irish corporation tax liabilities.

- Reduced compliance burden: A move away from the double tax credit system would significantly reduce the corporation tax compliance burden for multi-national enterprises. This would be particularly impactful for entities which, for regulatory or other reasons, operate a number of foreign branches. This would bring their tax treatment in line with those of similar enterprises headquartered in other EU jurisdictions. There are currently varied mechanisms to obtain double taxation relief depending on the specific fact pattern resulting in layers of administration which is timely and costly for taxpayers. A move to a territorial regime should be less burdensome without adversely impacting the exchequer.; This will create a benefit not just for taxpayers but also for the Revenue Commissioners who administer the system and audit the returns – a less complex system should help reduce pressure on Revenue's resources.

- Removal of adverse tax impact of inadequate information: The requirement to calculate double tax relief can present unique difficulties in the investment funds industry, as the information required to calculate relief may not be easily available in the case of joint ventures or non-controlling shareholdings. This can result in a requirement to pay Irish tax on profits which have already been taxed abroad, but in respect of which it is not possible to acquire the necessary information to compute the foreign tax credit available. A move to a territorial regime should effectively remedy this issue, and should enable investors to more easily avail of the relief to which they are entitled. As above, this should also benefit the Revenue Commissioners as a simpler system should be easier to administer and audit.

**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?**

For certain enterprises, one potential drawback of moving to a territorial system is that they

may lose the ability to utilise foreign branch losses against the profits of the Irish head office. A possible solution to this issue may be to introduce an optional branch exemption regime, similar to that in the UK.

In addition, adopting an exemption regime that has many conditions and/or requires detailed analysis of profit sources (which might originate many levels down in a corporate structure) could disimprove the situation as the current rules (and attendant complexity) would still apply to non-qualifying dividends / gains / profits while new complex requirements would apply to qualifying gains/returns. We consider that a simple, wide-ranging regime is essential.

**Q4. 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?**

Ireland's adoption of the OECD BEPS agenda and the ATAD provisions already implemented in Irish legislation (and those yet to be implemented) means that the existing anti-avoidance framework in Ireland is sufficiently robust, such that a move to a territorial regime should pose little risk to Ireland's tax base.

With regard to the participation exemption specifically, previous discussions on the introduction of a participation exemption regime in Ireland were rejected in the absence of corresponding anti-avoidance rules such as a CFC regime or thin capitalisation rules. Given the introduction of the Irish CFC regime in 2019 in accordance with the provisions of ATAD, the concerns associated with a participation exemption regime are no longer relevant. This position is also supported by the recommendations set out in the Coffey Report.

**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?**

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

**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**

Response to Q5-Q7

As mentioned above, adopting an exemption for foreign source dividends would be a welcome simplification of Ireland's corporation tax code – it would reduce complexity and would enhance Ireland's competitiveness. However, if the reforms were to bring further complexity, that would likely outweigh these potential benefits.

Insofar as participation exemptions for dividends and gains on shares are concerned, in our view both exemptions should have the same qualification conditions (so they are consistent with each other) and that those conditions are clear and easy to administer. The current exemption from gains on shares is a good structure point. However, we would suggest the following changes / features:

- Remove requirement that subsidiaries carry on certain activities (e.g. trading). This requirement is obsolete and difficult to administer in complex group structures and will be difficult to apply to dividends whose source might be from multiple layers down a structure in a group with both 'qualifying' and 'non-qualifying' profits.

- Apply regime to dividends and other distributions on shares.

- Do not limit application to EU/treaty countries – we appreciate that this may exempt dividends and gains on companies in low / no tax regimes; however, we note that the CFC regime (which was not in place when the current exemption was enacted) should address concerns in this regards (and 'blacklisted' subsidiaries would be excluded).

- Where a minimum holding period is prescribed, ensure that exemption can be applied to events arising prior to that condition being satisfied (e.g. dividends being received), so long as the ownership period is ultimately met.

Branch exemption: we are of the view that companies should be provided with the option of an exemption from corporation tax for foreign branch profits irrespective of the branch territory (the profit or loss arising in each branch would be deducted from the Irish company's worldwide taxable profit calculation to give a net amount subject to Irish corporation tax). Potentially, this could be indicated on the Form CT1.

The operation of the branch exemption could, in certain instances, prevent relief from being given for branch losses. Equally, the removal of branch profits from the Irish tax net reduces the amount of relevant profits arising to the company in the calculation of EBITDA for the purposes of identifying any restriction on interest relief under the ILR. As the operation of a branch exemption could therefore result in an increased interest restriction on the Irish company, such an exemption could be at the discretion of the company. Where a company does not opt-in to such measures, the existing regime for branch taxation could remain in place as well as appropriate relief for double tax.

**<u>Interaction with CFC Rules</u>**

**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?**

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

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

Response to Q8 – Q10

The consultation notes that CFC rules are commonly used in territorial systems to prevent the artificial diversion of profits offshore. Accordingly, CFC rules are not an uncommon feature of a territorial/part-territorial tax regime which would include a regime that provides for a participation exemption and/or a foreign branch exemption.

While existing CFC rules could be used to combat non-genuine arrangements arising with foreign branches, amendments to those rules may be needed, in particular the operation of the concepts of "undistributed income" and "relevant distributions" (which do not arise in a branch scenario). We believe that Ireland's CFC rules would not require amendments to cater for the introduction of a participation exemption on dividends.

**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?**

Irish tax legislation already includes significant protections from base erosion through the use of interest deductions, particularly following the introduction of interest limitation legislation (without any removal of pre-existing protections which were already provided for in legislation). The imposition of any further restrictions would add complexity to an already complex set of interacting measures concerning the deductibility of interest. In particular, there are already restrictions on the use of such deductions to only be capable of being deducted against taxable interest and taxable dividends. As a result, we do not recommend introduction of any further restrictions as the interest limitation rules should provide an adequate level of protection against base erosion. By way of example, when the UK introduced a branch and dividend tax exemption, it also introduced interest limitation rules which are similar (albeit not identical) to those prescribed by the EU Anti-Tax Avoidance Directive; no specific additional measures were introduced.

**Exit Tax**

**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?**

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

Response to Q12-Q13

Article 5(1) ATAD1 provides for an exit tax charge in certain circumstances and S627 TCA 1997 imposes an exit tax charge pursuant to ATAD1.

However the existing Irish exit tax provisions have not transposed article 5(1)(a) which imposes an exit tax charge where:

"*A taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third country insofar as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer*".

This is potentially because of the worldwide regime of taxation currently operated in Ireland. In the event that an Irish resident company were to transfer assets to its foreign permanent establishment, the company would retain taxing rights over assets transferred. If a foreign branch exemption were to be introduced, such assets would likely be removed from the Irish tax net and as such, some amendments may be required to existing legislation to take this into account.

In addition, consideration should be given to instances where an exit tax charge may arise on the migration of tax residence from Ireland to another Member State or third country pursuant to S627(2)(c) TCA 1997. Such considerations arise in the context of a potential foreign branch exemption and the manner in which assets in use by the foreign branch are to be taken into account in the computation of any Irish exit tax charge.

S26(1) TCA 1997 provides for the application of the worldwide regime currently in force in Irish law and provides that "*Subject to any exceptions provided for by the Corporation Tax Acts, a company shall be chargeable to corporation tax on all its profits wherever arising*" (profits in this context being read in conjunction with S4 TCA 1997 as meaning "*income and chargeable gains*"). Therefore, for an Irish tax resident company, the Irish tax net extends to include gains made on assets held in Ireland and those held by/attributable to a foreign branch. We would therefore recommend that if a foreign branch exemption is adopted, it should exempt not only income of the foreign branch, but also gains made on a disposal of assets used or attributed to a foreign branch including a deemed disposal under S627 TCA 1997. Finally, any exit tax charge should continue to be subject to the provisions of S627(3) TCA 1997 to allow for an exclusion where Ireland retains taxing rights on a subsequent disposal of assets.

**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?**

As set out in the introduction to the consultation, the legislation governing double tax relief, contained in Schedule 24 TCA 1997, has become more complex over many years in response to changes in policy and to accommodate principles established by European case law. The Coffey Review considered that, instead of moving to a territorial corporation

tax base, Schedule 24 could be simplified on a policy and tax neutral basis.

We do not believe that a review and simplification is feasible or sufficient. Our view is that changing to a participation exemption and branch exemption is preferable to the reform of Schedule 24.

The introduction of CFC legislation in Ireland from 1 January 2019 effectively prevents Irish companies from profit shifting to low tax jurisdictions and paved the way for moving to a territorial system, in line with the BEPS Model and other global tax systems. As mentioned below, the introduction of a participation exemption should not result in any net cost to the exchequer but there will be a real gain to taxpayers in reducing the compliance burden and eliminating unnecessary complexity and uncertainty.

An Irish resident entity is subject to tax in Ireland on worldwide profits and such profits may be subject to tax at source, i.e. in a foreign jurisdiction. Under Irish domestic provisions, relief is available for such foreign tax suffered under the foreign tax system and is set out in Schedule 24 TCA 1997. The first step for calculating the credit allowed for foreign tax suffered is calculated using a formula to establish the "relevant income" of the Irish entity. From a practical viewpoint, this formula is difficult to apply to Irish investment vehicles. This essentially excludes the use of such provisions to a significant amount of Irish vehicles in receipt of foreign dividends, foreign capital gains and foreign branch profits and effectively makes Ireland unworkable from a private equity perspective.

It is important to note that Schedule 24 TCA 1997 has also been subject to a number of changes in recent years, as well as a number of tax appeals, which have only increased the uncertainty as to the operation and applicability of the regime. This highlights two areas of concern with respect to the Irish tax system when compared to our international peer jurisdictions, (i) lack of competitiveness and (ii) uncertainty.

The current foreign tax credit system acts as a disincentive to choose Ireland as a hub for multinational groups. Cross-border structures established in Ireland, in particular, find that there can be significant differences in the timing and measurement of taxable income between head office and branches (e.g. some countries have different rules for the timing of tax deductions for insurance reserves and expenses) resulting in tax uncertainty and complications. Multinationals established in jurisdictions with an exemption system do not face similar issues, which puts Irish headquartered groups at a competitive and operational disadvantage.

We would not expect the introduction of a participation exemption regime in place of the foreign tax credit system to be a significant cost to the exchequer vis a vis the existing foreign tax credit regime. Under the existing regime, where an Irish entity is in receipt of dividend from a foreign jurisdiction, and the tax rate in that jurisdiction is higher than the Irish rate, the foreign tax can generally fully offset the Irish tax liability such that there is no incremental Irish tax arising.

In instances where a foreign jurisdiction's tax rate is lower than the Irish tax rate, the tax pooling provisions provide a means to utilise any unrelieved foreign tax and pool such taxes

together, effectively offsetting tax on other similar forms of income, thereby reducing the overall corporation tax charge in Ireland. As such, any incremental Irish tax arising can generally be mitigated through the use of tax pooling.

The attractions of a participation exemption only increase in light of recent international initiatives which are intended to lead to a minimum rate of tax and the introduction of CFC regime in Ireland. In many instances, the impact of those rules could be that any source country jurisdictions will have borne an appropriate amount of tax. Thus Ireland's movement to a participation exemption is aligned with preventing the use of low-tax jurisdictions to accrue income in a manner which is inconsistent with global tax policies such as BEPS.

We note that a review and simplification of Schedule 24 insofar as it applies to matters not covered under a new exemption regime (*e.g.* interest and royalties) would nevertheless be welcome.

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

**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?**

Response to Q15 & Q16

As set out above, our position is that a simplification is not preferred to a move towards more substantive reform of the treatment of dividends in lieu of an exemption. However, insofar as matters to which schedule 24 applies which would not form part of the exemption (such as royalties and interest) we would suggest the following:

- Consideration of the unilateral and treaty provisions (which overlap extensively).
- Extension of tax-credit pooling reliefs to income and gains from non-treaty sources.
- Removal of separate tax-credit pooling for income sources taxed at both the 12.5% and 25% rate of tax.
- Extension of dividend rules to other distributions on shares.

**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?**

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

irish funds

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

Response to Q17-Q19

The introduction of a branch exemption could result in certain arrangements which are not currently within the scope of Ireland's anti-hybrid legislation (due to the provisions of Section 835AB) falling within scope of the rules. For example, to the extent a foreign branch of an Irish company makes a tax-deductible payment to its head-office, the payment would be regarded as a "disregarded payment" in the context of Section 835AB. A hybridity issue could arise in relation to such a scenario (and others involving branches) where there is a full branch exemption in place if that exemption does not treat tax-deductible payments from the branch to its head-office as taxable income of the head-office (in which case a deduction-without-inclusion mismatch could occur).

Although we do not see any specific risks or synergies in the context of anti-hybrid legislation, it would be crucial that the interaction with anti-hybrid legislation is closely considered, to ensure any necessary amendments are made to deal with examples such as that outlined. Such amendments should seek to maintain the balance between preventing tax regime arbitrage and ensuring that there is certainty in relation to the taxation of cross-border arrangements.

One possible design feature of the regime which could be applied would be to allow optionality regarding whether / when branch profits or foreign source dividends are taxable.

**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 dividend exemption regime and a branch exemption are both aligned with Pillar Two, so we expect there should be overlap in implementing the respective rule sets. From the perspective of the asset management industry, it will be important that there is a sufficient stakeholder consultation process as part of the legislative drafting process, to ensure that the exemptions provided in relation to investment funds take into account the complexities which can be involved in certain fund structures, whilst also satisfying the requirements of the relevant EU Directive.

In terms of potential Pillar Two considerations, it is proposed Under Article 15 of the current draft Directive (on ensuring a global minimum level of taxation for multinational groups in the Union) that dividends received and gains arising on the disposal of shares (except dividends/gains arising in relation to shareholdings of less than 10%) are excluded from the calculation of an enterprise's qualifying income for the purposes of determining whether the minimum tax rate has been paid.

The exclusion of these items would be aligned with their treatment under a full participation exemption, and it is therefore unlikely that the introduction of a participation exemption should have any adverse interaction with Ireland's introduction of the Pillar Two rules in accordance with the Directive. For completeness, we recommend that the 5% ownership threshold in the current exemption for gains on substantial shareholdings is retained generally notwithstanding that this might mean that the exclusion does apply to in-scope tax payers if their participation is between 5% and 10% (or, if that is not seen as desirable, that a 10% threshold apply only to in-scope taxpayers).

Similarly, it is proposed under Article 17 that the financial results of any permanent establishment abroad (i.e. a branch) shall not be taken into account in determining the qualifying income of the main entity. This treatment would be aligned with the treatment of a branch's financial results under a branch exemption, and it is therefore also unlikely that the introduction of a branch exemption should have any adverse interaction with the Irish Pillar Two rules.

**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?**

Many international tax treaties which were negotiated on the basis of the credit method for relieving double taxation, where one or both of the contracting States subsequently moved to a territorial or part-territorial system of tax. To our knowledge those treaties were not amended as a direct consequence. We do not foresee a negative impact in terms of how our tax treaties would operate going forward if Ireland were to move to a participation exemption and/or branch exemption regime. Indeed, because we expect that the regimes would be criteria based, it does not entirely change Ireland's tax regime from a worldwide system to a territorial system. Where the criteria for a participation exemption are not met, the current regime would apply and foreign tax credits should be available in line with the current regime. A move towards a participation/branch exemption would bring Ireland's regime in line with similar international regimes, such as those operated in the UK and Luxembourg (two treaty-partner territories).

**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?**

The consultation lists several possible outcomes. For example, a participation exemption regime could exempt related-party foreign dividends and foreign branch income, a wider participation exemption for gains might be introduced, or a participation exemption could be limited in scope to dividends paid out of trading profits of companies and foreign branch trading income. If a limited exemption is introduced, it would be necessary to retain the Elimination of Double Taxation article in its current form, so that relief could be claimed for

irish funds

double taxation across the contracting States in situations not covered by the exemption. This is consistent with the position when the UK moved to a territorial regime in 2009 and there was no consequential mandate to renegotiate its double tax treaties.

**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?**

We believe it should be possible to deal with this by limiting the scope of domestic exemptions (*e.g.* by not applying them to 'blacklist' jurisdictions).

## Transitional Arrangements

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

Transitional arrangements should have regard to the use of carried forward foreign tax credits from previous years.

## 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.**

Please refer to our response to Q20 above.