**Insurance Ireland Commentary on Department of Finance Consultation on a Territorial System of Taxation**

**7 March 2022**

## INTRODUCTION

Ireland is a thriving global hub for insurance, captives & reinsurance and Insurtech. Ireland's insurance market is the fifth largest in the EU, and our Reinsurance market is the second largest. Our members represent around 95% of the companies operating in the Irish market, making Insurance Ireland a strong leadership voice for the sector.

Insurance Ireland members are progressive, innovative and inclusive, providing competitive and sustainable products and services to customers and businesses across the Life and Pensions, General, Health, Reinsurance and Captive sectors in Ireland and across the globe.

In Ireland, our members pay more than €13bn in claims annually and safeguard the financial future of customers through €112.3bn of life and pensions savings. Our members contribute €1.6bn annually to the Irish Exchequer.

The role of Insurance Ireland is to advocate on behalf of our members with policymakers and regulators in Ireland, Europe and Internationally; to promote the value that our members create for individuals, the economy and society; and to help customers understand insurance products and services so that they can make informed choices.

## OVERALL OBSERVATIONS

Insurance Ireland welcomes the opportunity to share industry feedback relating to the public consultation on moving to a territorial system of taxation.

An Irish resident company with branches outside the State is taxable on the profits of the foreign branches but with three levels of relief available, i.e.

- There is a credit available for foreign taxes against the Irish tax arising on branch profits.
- There is a deduction available against taxable profits for foreign tax not available by way of credit.
- Where the foreign tax is still not fully utilised, it can be "pooled", i.e. is available against any Irish tax which might arise on other branch profits.

Taking these reliefs together, it is clear that Ireland does not seek to tax foreign branch profits. However, there is a perception that foreign branch profits are taxed. This is an unnecessary complication in reporting consolidated branch/head office profits, as well as complicating the tax filing position.

There has been a clear trend in the insurance industry for pan-EU structures, i.e. insurance groups tend to centralise their insurance operations, ideally in one company with a head office in one location and branches in many different EU countries. This has clearly been driven by regulatory imperatives. Insurance companies with large diverse businesses spread over a number of jurisdictions tend to fare better under Solvency II rules. The resulting capital efficiency can provide a competitive advantage, as compared with a group which has a regulated company in each jurisdiction. For some groups there are also cost and operational efficiencies in such structures. Groups reach their decision on where to locate their EU head office based on a number of factors. Their history in the country, the regulatory environment, ease of doing business, the availability of suitable staff and the cost base are clearly important but clarity in relation to tax is also a factor. A number of significant insurance groups have chosen to locate their EU head office in Ireland.

Once established in Ireland, cross border insurers find that there can be significant differences in the timing and measure of taxable income between the head office and the branches. For example, some countries have different rules for the timing of tax deductions for insurance reserves and expenses. The mismatches cause tax uncertainty and complication which companies in countries with an exemption system do not face. Irish based insurers with foreign branches have to deal with more complexity than businesses headquartered elsewhere in the EU, which operate a branch exemption regime.

The insurance industry in Ireland has long been of the view that an optional branch participation exemption and a simplification of the double tax relief system would be beneficial, and the industry remains of this view. Such a system would be consistent with the taxation regimes which generally apply across Europe. It would be fully compliant with the changes in the Irish tax system as a result of the EU Anti-Tax Avoidance Directive (ATAD).

Conceptually, exempting profits on which there is no Irish tax due to the availability of tax credits should not be a concern for the Exchequer. Therefore, this is a cost neutral effect for the Exchequer.

**Consultation Questions**

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?

Insurance Ireland welcomes such a change, provided that it is implemented in a way which is simple, reduces the tax burden and contains optionality. A jurisdiction which operates a straightforward and simple branch exemption is likely to present its taxpayers with less barriers to the conduct of business in new markets through branches than a regime which imposes a more complex worldwide taxation system.

The adoption of a branch exemption system in addition to an exemption for foreign dividends (alongside our existing exemption from CGT for disposals of significant shareholdings) would equalise more closely the Irish tax position in relation to the taxation of profits arising from the conduct of business through a branch or a subsidiary. This should reduce the potential for discrimination to arise in the case of taxpayers that choose, for largely non-tax reasons, to conduct business through branches rather than subsidiaries and should facilitate more "hearts and minds" of such businesses to be located in Ireland.

Therefore, for the reasons set out above, Insurance Ireland supports the move from the current worldwide system with credit relief for foreign tax to a territorial system of double taxation relief, and particularly the branch exemption proposals (if introduced in a pragmatic way without further complexity or additional administration).

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

The current taxation system, while designed to ensure that Irish tax should not arise on foreign branch profits, is complex and can be opaque and administratively burdensome when compared with other jurisdictions. Simplifying this process and removing some of that burden would potentially support the development of Ireland as an international insurance hub and allow for a more attractive environment for international investment in the jurisdiction.

In addition, with the current system, cross border insurers find that there can be significant differences in the timing and measure of taxable income between the head office and the branches which could lead to double taxation. Moving to a territorial system for branches would remove this.

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?

There are some potential concerns for consideration that Insurance Ireland members have raised and should be worked through as the consultation process continues. There is a potential loss of foreign tax credits under the current law if the firm is in a loss-making position – this is a flaw in the system and could be considered to be a penalty on firms.

Clarity will be needed on how a territorial system would work with non-treaty jurisdictions, particularly on how any exemptions would operate. Where non-treaty jurisdictions adopt the Pillar 2 rules there will be taxation in those jurisdictions at a minimum rate (and even if they do not so adopt, multinationals with operations in non-treaty jurisdictions will be subject to minimum tax on profits of those jurisdictions, either under the Income Inclusion Rule or the Undertaxed Payments Rule)[1].

As such, there should no longer be a compelling reason for Revenue to exclude non-treaty jurisdictions from the exemptions that apply within a territorial system. Even before the application of Pillar 2, the branch exemption introduced in the UK in 2011 was not limited to Treaty/EU members.

Optionality: For maximum flexibility, it is suggested that the branch exemption would be available on a branch-by-branch basis at the election of the taxpayer. Where taxpayers elect out of branch exemption, branch profits would remain taxable as is currently the case, although simplification of double tax relief rules would also be welcome (see below).

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?

We suggest that similar to other jurisdictions such as the UK, there should be an element of optionality for firms in availing of the exemption. Although our strong preference would be for all branches to be included, depending on the ultimate design of the rules certain taxpayers could be in a position where (for example) one branch is exempt but another is not (or is caught under a revised CFC type provision applying to foreign branches). In this circumstance remaining within the tax credit regime could be simpler for both the taxpayer and Revenue. In addition, companies with significant carry forward losses may wish to remain under the current regime, depending on the design of any transitional measures.

Under the UK rules the branch exemption adjustment is calculated with reference to the OECD model tax convention where no double taxation treaty exists. The UK exemption system is not subject to a territorial limitation and applies to all trading profits and capital gains of a branch wherever located.

In addition, the UK system does not require detailed calculation of branch profits under UK rules in order to exempt the profits, instead the starting point of the computation is the ‘head office’ profits. This significantly reduces the administrative burden for taxpayers and gives an

[1] This principle could extend to other areas of the tax system following implementation of Pillar 2 (e.g. SSE / chargeable gains groups)

equitable result on the basis there are strict transfer pricing rules surrounding the allocation of profits between head office and branch in OECD countries. Thus, there are mechanisms available to deal with such situations.

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?

As noted previously and below, there are a variety of administrative benefits for the industry which can lead to increased competitive advantage for Ireland with no cost to the Exchequer.

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

We understand that there were concerns in the past about the introduction of a branch and dividend participation exemption in the absence of Controlled Foreign Companies (CFC) legislation in Ireland and that this could lead to double non taxation. Such concerns should now be allayed by the introduction of relevant legislation and the safeguards we propose in relation to a suggested branch participation system might be built into an Irish branch exemption, as set out below.

The ATAD anti-hybrid provisions are concerned, amongst many other things, with hybrid mismatches arising due to double deductions for the same item of expenditure. Although in principle, companies with foreign branches should not be impacted under the Irish rules (unless there is a hybrid mismatch between the branch and head office, or between branches), certain other jurisdictions implementation of the rules can give rise to a counteraction in a wider range of scenarios.

For example, the UK rules do not allow an ordinary loss to be carried forward, where that loss has arisen in a branch of an Irish company and so is considered a double deduction in both the UK and Ireland (the loss can still be carried forward but must be tracked separately and set against future dual inclusion income only).

Further, the UK rules give rise to a counteraction where a double deduction is set against dual inclusion income where that dual inclusion income does not arise within a specified time period following the double deduction. Significant timing mismatches between the Irish and local branch basis of taxation can arise (as explained above), and thus a counteraction under one or more countries' anti-hybrid rules may occur in a situation which is purely commercial, simply due to the worldwide basis of taxation in Ireland. A move to a branch exemption regime would eliminate this complexity and reduce the probability of unexpected or unfair outcomes.

Further, the ATAD Anti-Hybrid rules (as already adopted in Ireland) should ensure that genuine double deductions, or non-taxation arising from hybridity continue to be counteracted, following the introduction of a branch exemption system.

Again, we also suggest that the optionality of availing of the exemption as set out in our response to Q4 should also be considered.

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

We suggest that the following design elements could be included in a branch participation regime:

*Basic Exemption*

An exemption from corporation tax would be available for profits arising from a trade conducted through a foreign branch in any jurisdiction outside of Ireland. While insurance groups are largely concerned with EU branches, there seems no point in confining this exemption to EU or to double tax treaty countries, given increasingly global business. Relief would not be available against Irish tax for foreign tax on exempt branch profits.

*Capital Gains: Branch Assets*

The branch exemption would extend to profits whether in the form of income or capital, e.g. the exemption would apply to capital gains arising on the disposal of capital assets by the branch.

*Capital Gains: Sale or Transfer of Branch*

The sale, transfer or cessation of a branch would also be exempt from Irish CGT. This would be consistent with exemption for disposals of significant shareholdings which currently applies for subsidiaries and therefore could be achieved by an extension of Section 626B TCA 1997.

*Definition of a Branches*

The branch exemption should be defined by reference to the Irish domestic law definition of "Branch or Agency". The branch exemption would not be available to a branch whose activities did not constitute the conduct of a trade. In this way, profits from passive investment can still be taxed in Ireland with whatever double tax relief is appropriate. The branch exemption would not be available where the branch is not recognised as a taxable presence in the branch jurisdiction, mirroring "subject to tax" rules in the anti-hybrid proposals.

*Head Office / Branch Transactions*

Ireland's Exit Tax regime should tax such transactions on the basis of the ATAD proposals.

*Post Cessation Profits*

Ireland's branch exemption should continue to apply to profits arising immediately after a branch ceases to exist, e.g. to apply to profits arising on the sale of the branch.

*Optional System*

For maximum flexibility, it is suggested that the branch exemption would be available on a branch-by-branch basis at the election of the taxpayer. Where taxpayers elect out of branch exemption, branch profits would remain taxable as is currently the case, although simplification of double tax relief rules would also be welcome.

*Branch Losses*

Where the branch exemption applies, foreign branch losses will not be set off against other profits taxed in the Irish head office. An exception may be needed, however, for any "final" and otherwise unused losses arising on the cessation of a branch. We understand that EU case law requires that such losses should remain available against Irish profits.

*Transitional Measures*

Some transitional measures may be required in relation to branches which have made losses for a number of years prior to the change, where these losses were set off against other profits. It may be appropriate to restrict the exemption for future branch profits in this circumstance. However any restriction on the application of the exemption will be administratively cumbersome for taxpayers and so it is important that any such restriction is time limited.

These design elements will support the reduced administrative burden on firms as well as reducing the complexity and uncertainty of tax treatment due to jurisdictional mismatches.

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?

The CFC rules introduced for subsidiaries should be extended to include foreign branch profits which are subject to exemption. In this way, profits which are attributable to significant people functions in Ireland would remain taxable in Ireland. This should already be the case where the OECD rules on attribution of profits to insurance branches are applied. It is worth noting that in the UK for example, an 'anti-diversion' rule was introduced alongside the branch exemption system which effectively "imports" the CFC rules (with some modifications) into the branch exemption regime. Therefore, if the branch would be caught under the CFC rules were it a separate subsidiary, then it cannot benefit from the exemption. Similar provisions could be introduced in Ireland to address the risk of an exempt branch being utilised for the purposes of avoidance of the CFC rules.

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

In addition to the optionality in availing of the exemption, the key element is that the Irish regime should be no less favourable to other similar jurisdictions.

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

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?

Between existing domestic legislation and the new interest limitation rules, Ireland already has one of the most restrictive regimes in terms of debt funding of all developed insurance markets, which is a potential deterrent to multinational insurance groups investing in Ireland. Therefore, we do not believe any further restrictions should be implemented.

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?

The Exit Tax rules envisage that transactions between head offices and branches should be subject to tax in certain circumstances. This seems to be based on an assumption that branch profits are exempt from tax in the head office, which is not currently the case in Ireland. Introduction of a branch exemption would align the taxation of branches with the Exit Tax rules already in place.

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

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?

Simplification of Schedule 24 is not an alternative to introduction of a branch exemption. As outlined above an optional branch exemption is needed to enable Ireland to complete on an equal footing.

The principal way that Schedule 24 can be simplified is to remove the requirement to recompute foreign branch profits on an Irish basis (i.e. the need to compute the "Irish measure of foreign branch profits should be removed and the branch profits under foreign tax rule should be respected for Schedule 24). This would immediately remove the issue that currently exists whereby significant timing differences arise between taxation of profits in Ireland and the branch location which can give rise to double taxation.

Additionally, there are certain areas where Schedule 24 is not working as intended which can lead to double taxation. In particular, where the Irish measure of foreign branch profits is zero or negative, foreign tax may still be paid on branch profits due to timing differences but this foreign tax is not available for pooling or carry-forward. This is a clear flaw in the system which the industry has highlighted many times in the past.

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

There should be no loss or adverse impact on existing foreign tax credits - the overarching principle is that Schedule 24 should provide an effective exemption for foreign branch profits if sufficient foreign tax has been paid to credit against Irish tax.

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?

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?

See question 6.

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

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

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?

In relation to branches, the regime could be designed in such a way that the exemption for branches in treaty jurisdictions follows the attribution of profits as set out in the treaty. While there may be some issues around non-treaty countries, a potential solution is to utilise the OECD model treaty as a basis, as noted in previous comments.

Overall, a broad adoption of the two-pillar solution should negate risks/concerns and non-treaty jurisdictions adopting such solution should effectively be treated as treaty or good jurisdictions.

A branch exemption would align more closely with the Pillar 2 rules on branches and remove the complexity associated with applying two inconsistent regimes for the purposes of Ireland's domestic rules and the Pillar 2 rules.

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

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?

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?

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

As noted above, for a branch exemption, some transitional measures may be required in relation to branches which have made losses for a number of years prior to the change, where these losses were set off against other profits. It may be appropriate to restrict the exemption for future branch profits in this circumstance.

As outlined in detail above, a branch exemption regime should be optional.

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.

The proposals as set out in the consultation paper should be considered in conjunction with the proposed two-Pillar agreement and the enactment of proposals should not act to increase the compliance burden. Ireland needs to remain competitive whilst retaining certainty of tax treatment.