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

7 March 2022

Dear Sir/Madam

Subject: Public Consultation on a Territorial System of Taxation

We are writing to you in response to your invitation for submissions on the “Consultation on A Territorial System of Taxation” document as published by the Department of Finance on 22 December 2021.

First and foremost, we welcome the publication of this Public Consultation document. The publication thereof reflects Ireland’s continued efforts to promote a business environment characterised by certainty and clarity, thereby giving confidence and foresight to key stakeholders in a time of unprecedented change in the international taxation arena.

We are of the view that now is the time for Ireland to introduce a comprehensive territorial regime incorporating a broad participation exemption for all dividends and a branch exemption, which is sufficiently flexible to accommodate the diversity of the Irish economy and its corporate tax base. Ireland’s tax system is becoming increasingly (and unnecessarily) complex, particularly in the context of ongoing comprehensive reform in the international tax landscape. The introduction of such a regime would be a significant step in simplifying Ireland’s tax system, thereby enhancing Ireland’s competitiveness as a destination for investment. Ideally, we believe that the new regime should be introduced at the earliest possible opportunity, ideally as part of Finance Act 2022, with a commencement date of 1 January 2023.

Although the introduction of such a regime would be a significant step towards the simplification of Ireland’s tax system, we believe that there is a great deal more that can be achieved by Ireland in this regard. Specifically, given the move to a global minimum effective tax rate under Pillar Two, now is an opportune time for Ireland to review and re-organise its existing schedular system and to widely repeal the higher 25% tax rate for non-trading income (save, potentially, for certain transactions). Consideration should also be given to reviewing the applicability of the

33% CGT to gains derived from business assets and applying the headline corporate tax rate to such gains.

As the leading advisor to a broad base of taxpayers, ranging from indigenous entrepreneurs and Irish-listed entities to foreign-owned multinationals, we can draw on our experience of dealing with complex taxation matters and reflect our concerns and insights with regard to the implementation of additional measures under Ireland's Corporation Tax Roadmap.

We welcome the opportunity to discuss the matters outlined below at your convenience.

Yours faithfully,

Susan Kilty
Head of Tax

*Please note that, in this submission (as is noted in the Consultation Document itself), references to the introduction of a territorial regime in Ireland are references to the introduction, in Ireland, of a participation exemption regime in respect of foreign dividends and foreign branch profits received by Irish tax resident entities. Such exemptions support a territorial corporate tax base (as opposed to a worldwide corporate tax base)*.

***Responses to Consultation Questions***

**Policy benefits of participation exemption and/or branch exemption regimes**

<u>*Question 1:*</u>
*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?*

We are of the view that now is the time for Ireland to introduce a comprehensive territorial system incorporating a broad participation exemption for all dividends and a flexible branch exemption system that will bring Ireland's tax system into line with most of the EU and OECD countries. We believe that the comprehensive reform in the international landscape that is ongoing (and in which Ireland has been a full participant) provides the perfect backdrop against which such a regime should be introduced. We will explain our reasoning in this regard in our answers to the questions asked in the consultation document. We also believe that the new regime should be introduced at the earliest possible opportunity, ideally as part of Finance Act 2022, with a commencement date of 1 January 2023.

The vast majority of other OECD and EU countries already operate a territorial system of double tax relief, and removing this clear competitive disadvantage would be in Ireland's best interests at this critical time in the evolving global tax landscape. In this regard, Ireland is the only EU jurisdiction (and one of only five of 34 OECD jurisdictions) that does not already operate such a territorial system.

It is widely accepted that a move to such a system of double taxation relief, which should include dividend participation exemption and branch exemption provisions, would:

- bring Ireland's corporate tax regime into alignment with global norms;
- simplify Ireland's burdensome and increasingly complex double tax relief mechanism;
- reduce uncertainty and administrative costs, and eliminate year-on-year change of law risk; and
- enhance Ireland's attractiveness as a destination for investment.

Critically, the complexity and administrative burden associated with the calculation of foreign tax credits is viewed as a significant disincentive to using Ireland as a holding company or centralised hub location.

The lack of provision for an exemption for foreign dividends often has the result that Ireland is side-lined in decisions relating to the location of holding companies, where the availability of such an exemption is a distinct advantage for other jurisdictions. It should be noted that this is the case even in the typical scenario where no incremental Irish tax arises.

In the case of foreign branch profits, the problems with the lack of availability of an exemption are practically illustrated in the context of cross border banks and insurers established in Ireland. Such banks and insurers are invariably faced with situations in which there are significant differences in the timing of taxable income between head office and branches (on the basis, for example, that some countries have different rules for the timing of tax deductions for insurance reserves and expenses), resulting in tax uncertainty and complications. Companies in countries with an exemption system do not face this uncertainty and these complications. Irish based banks and insurers with foreign branches have to deal with more complexity than competing businesses headquartered elsewhere.

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 a territorial system for double taxation relief as, in most instances, exemption is effectively in place already through the operation of the foreign tax credit regime. It is generally accepted that the current foreign tax credit system usually results in no incremental liability to Irish tax on foreign dividends or foreign branch profits. The only difference is that the current system requires an exceptionally onerous process with many potential pitfalls in order to validate a “nil additional tax” position. Moreover, the current rules are particularly difficult to manage for groups with joint ventures and non-controlled shareholdings, where access to granular foreign tax credit information can prove difficult to arrange on a timely basis (and in some cases simply cannot be shared with one shareholder for Stock Exchange or similar reasons).

As acknowledged in the consultation document, Ireland has, over the past decade, worked with fellow EU Member States and at the OECD to ensure that its tax system is aligned with evolving international standards. Regarding concerns relating to the possible abuse of a participation exemption and/or foreign branch profits exemption, in our view, all of these measures so taken by Ireland (including the transposition of the EU Anti-Tax Avoidance Directives) provide Ireland with an extremely robust framework to counteract any such possible abuse. The measures already taken by Ireland (including the introduction of CFC rules, an exit tax, the anti-hybrid rules, the interest limitation rule and transfer pricing rules) address many of the risks inherent in a territorial system of double taxation relief by, for example, preventing the shifting of profits to jurisdictions where they are subject to no or very low taxation.

Regarding the pending transposition (via an EU Directive) of the Pillar Two GloBE rules into Irish domestic law, in a Pillar Two context, foreign dividends effectively qualify for a participation exemption, and foreign branch profits (exempt in the hands of the head office) will be subject to a minimum effective tax rate in any event at the local branch level. Consequently, the adoption of a participation exemption and an exemption in respect of foreign branch profits is congruent with Pillar Two.

In light of the above, we would be supportive of the introduction of such a territorial system of double taxation relief. We do, however, wish to point out that careful consideration would need to be given to the design of any new enabling provisions as well as to any potential adjustment of existing provisions (and, indeed, whether any such adjustments are needed). This is necessary to ensure that the revised system:

- facilitates Ireland's competitiveness as an investment location;
- is sufficiently flexible to provide for equitable treatment of all affected taxpayers; and
- balances the needs of affected taxpayers with the protection of Ireland's tax base.

Regarding the necessity for the revised system to be sufficiently flexible to provide for equitable treatment of all affected taxpayers, it is important not to lose sight of the fact that the Irish economy is a diverse one with a multitude of different corporate taxpayers, each with different tax profiles, investment platforms and operations. In this context, there are likely to be certain taxpayers that would be significantly disadvantaged if Ireland were to implement a comprehensive exemption regime that did not make provision for an option to elect out of exemption treatment (and to be taxed in the ordinary course, with credits and pooling available for any foreign taxes that may be due). Consideration would need to be given to the conditions under which relevant elections in this regard would be available, with due regard to both the competitiveness of Ireland as an investment location and the protection of Ireland's tax base.

In any event, on the assumption that certain dividends may not qualify for exemption under a participation exemption for dividends, there will always be a need for a credit mechanism in respect of these dividends. Allowing taxpayers to elect to apply a credit mechanism will therefore not require additional rules (other than those providing for the election itself).

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

Please see our answer to Question 1 above.

We believe that it is worth emphasising that the introduction of an appropriately designed broad based exemption system (that is cognisant of the protections offered to Ireland's tax base by recent international tax reforms) would result in Ireland being a more competitive holding company jurisdiction for both Irish as well as international businesses, and would encourage the expansion of investment in Ireland. Notwithstanding Ireland's success in attracting foreign direct investment over many decades, Ireland has lost out on many investments where the lack of a participation exemption has been a key (negative) distinguishing factor in the competitive analysis of various locations.

*Question 3:*
*Are there any particular drawbacks or concerns for multinational 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?*

Please see our answer to Question 1 above.

In the case of both a participation exemption in respect of dividends and a branch profits exemption, as stated in our answer to Question 1 above, any revised system of double tax relief should be sufficiently flexible so that it provides for equitable treatment of all affected taxpayers. Again, in the context of the diversity of corporate taxpayers in Ireland, there are likely to be some taxpayers that would be at a significant disadvantage if there is no option to elect out of exemption treatment (and to be taxed in the ordinary course, with credits available for any foreign taxes that may be due).

In the case of dividends, this would be the case particularly where the participation exemption is restricted in any way (which is likely to be the case on the basis that there will always be dividends that will not qualify for exemption).

Similarly, in the case of branch profits, certain taxpayers may not be faced with difficulties such as those faced by banks and insurers (as outlined in our answer to Question 1 above), and may be at a significant disadvantage if a branch exemption was not optional (simply as a result of their particular tax profile and operations).

Consideration would need to be given to the conditions under which such elections would be available, with due regard to both competitiveness and avoidance concerns.

*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?*

Consideration should be given to the approach adopted by the United Kingdom, Ireland's closest neighbour and, increasingly, largest competitor for foreign direct investment. In the UK, most foreign dividends received by UK-resident companies are exempt from UK corporation tax. Although the charge to corporation tax on income applies to any dividend (including any foreign dividend), a number of exemptions are available. The criteria to qualify for these exemptions are generally widely drawn with the result that all foreign dividends received by UK-resident companies are exempt from UK corporation tax unless there is tax arbitrage or avoidance at play.

Although the rules are specific to the UK tax regime, the emphasis thereof is on the protection of the UK tax base, with anti-avoidance rules aimed at preventing the diversion of profits from the UK. Thus, qualification for the exemption could be lost in circumstances where certain *indiciae* are present, for example:

- Where the recipient of the relevant dividend has control (through a required level of shareholding, rights and powers) over the company paying the dividend, and the dividend is paid as part of a tax avoidance scheme, one of the purposes of which is to arrange for the dividend to fall into an exempt class of dividends;
- The relevant dividend was paid as part of an avoidance scheme and the shares are not true ordinary shares or are in fact redeemable shares;
- A non-UK resident receives a deduction for the payment of the relevant dividend;
- The payment of the dividend is part of a scheme that involves the making of a payment or giving up a right to income and all or part of the consideration therefore is the dividend.

For non-exempt, foreign source dividends, double tax relief will usually be available on a dividend-by-dividend basis, and it is also possible for the recipient company to elect out of the exemption on a dividend-by-dividend basis (in which case foreign tax credits may be claimed).

In order for dividends to qualify for exemption, there are generally no minimum ownership period and no minimum shareholding threshold requirements.

In the case of foreign branches of UK companies, a UK resident company is generally taxed on its worldwide profits (including profits of foreign branches) with credit relief being given against the UK corporation tax for the foreign tax paid on the profits of foreign branches. However, since 2011, UK resident companies are entitled to elect for profits of their foreign branches to be exempt from UK taxation.

Where the election is made, it applies to the branch's trading profits, investment income connected with the branch, and chargeable gains. The election is made on a company by company basis (i.e. different companies in the same group may make an election independently of each other), made on an "all or nothing" basis (i.e. it applies to all foreign branches of a company, including branches set up after the election is made, for all accounting periods commencing after the election is made), and is irrevocable.

In order to qualify for the exemption, profits must be attributable to the branch for the purpose of establishing entitlement to credit relief in respect of any foreign tax (it is not necessary for foreign tax to have been paid, only that the profits would be attributable for credit relief purposes). Losses of a branch are attributed to the branch according to the same rules and principles as apply to profits, and the effect of branch exemption is to cancel any loss that is attributable to the branch.

As noted above, we believe that the Irish tax system is sufficiently robust that a broad based exemption system with a similar design to that of the UK could be introduced in Ireland without significant risk to the Irish tax base, especially if it contains similar anti-avoidance rules as those in the UK system. The anticipated introduction of GLoBE rules and an internationally recognised minimum level of tax concept in 2023 (on top of the existing CFC and other measures that are already in place) will only further enhance the in-built protections of the Irish tax regime.

**Scope of exemption regimes**

*Question 5:*
*Taking account of the above [i.e. various policy options that may be considered in the adoption of a territorial regime] , what in your view would be the potential impacts of moving to a participation exemption regime as set out in the Coffey Report?*

Please see our earlier answers in this regard.

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

Please see our earlier answers in this regard. In particular, we have previously noted the negative implications of the complexity and administrative burden associated with the calculation of foreign tax credits. A new territorial regime should be designed from a compliance perspective to be straightforward to operate, both for taxpayers and Revenue, and should not

introduce new complexities or administrative burdens which would negate the effect of eliminating the complexities and administrative burdens inherent in the current foreign tax credit regime.

*<u>Question 7:</u>*
*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 discuss below two alternative approaches, i.e. (1) the adoption of a regime similar to that adopted in the UK (our preferred approach); and (2) the use of criteria in existing provisions.

*<u>Preferred approach: the UK Model</u>*

As noted above under Question 4 regarding the approach of the UK, we believe Ireland should introduce a comprehensive territorial regime of double taxation relief similar to that of the UK. We believe that such a territorial regime, if appropriately designed, would facilitate the competitiveness of Ireland as a destination for investment, be sufficiently flexible so as to treat different taxpayers equitably, and would balance the needs of affected taxpayers with the need to protect Ireland's tax base.

The key features of such a regime, and some of the effects of the adoption thereof, would be that:

- all foreign dividends would prima facie be exempt from corporation tax in Ireland, with appropriate anti-avoidance rules to prevent the diversion of income from Ireland.
- to allow for flexibility and ensure that all taxpayers are treated equitably, taxpayers would be entitled to elect out of exemption treatment on a dividend-by-dividend basis (in which case foreign tax credits in respect of the non-exempt dividends would be available as is the case at present).
- in the case of foreign branches, the current worldwide system of double tax relief (i.e. attribution of profits and losses to the Irish head office, with credit being granted in respect of foreign taxes due) should apply, with the option to make an election for branch exemption treatment on a company by company basis. To the extent that misallocation of branch profits or losses is a concern, appropriate anti-avoidance provisions could be considered (obviously with recognition of the steps already taken in recent years).

*Use of criteria in existing provisions to qualify for participation exemption*

Although we are of the view that Ireland should introduce a comprehensive territorial regime of double taxation relief similar to that of the UK, we acknowledge that it is appropriate, in the context of this consultation, to assess other possible approaches. We therefore discuss below an alternative approach (i.e. the use of criteria in existing provisions to qualify for the participation exemption), but wish to point out, for the reasons stated below, that this is not our preferred approach.

Consideration could be given to using criteria already applied for purposes of section 21B (which provides for the reduction of the rate of dividends tax to 12.5%) and/or section 626B (the CGT participation exemption) of the Taxes Consolidation Act, 1997 (TCA 1997) for the purposes of determining whether or not a participation exemption in respect of dividends would be available. Accordingly, the participation exemption for dividends would apply where one or other of certain criteria are met, some of which could include:

- The dividend being received from a company (or subsidiary of a company) that is either listed on a recognised exchange or that is resident in an EU or DTA country (S21B);
- The dividend being attributable to trading activity of the company paying the dividend or is in some way linked to trading activity (S21B and S626B);
- The company receiving the dividend having a substantial shareholding in the company paying the dividend for a certain period (generally, for the purposes of S626B, this shareholding is set at a level of at least 5%, with the relevant period being a continuous period of at least 12 months in the two years preceding disposals contemplated in the section).

The benefit of using some or all of the above criteria would be that they are already set out in Irish law, are well established and clear, and are widely understood. As such, these criteria would likely be seen as being reasonable conditions for a dividend exemption to apply.

It is, however, suggested that limiting the applicability of a participation exemption in respect of foreign dividends to dividends paid only from certain jurisdictions (or, for that matter, to dividends paid out of trading profits) would detract from the competitiveness of Ireland as a destination for investment, in particular versus key competitors like the UK which already have broad dividend exemption regimes. Moreover, these requirements are generally not relevant in the context of preventing avoidance arising from the payment of foreign dividends to Irish companies.

Furthermore, in the context of the payment of foreign dividends to Irish companies, the use of such criteria to determine whether such dividends should be exempt is misplaced. In any event, as a result of the substantial changes to the Irish tax code and the international tax environment over the past decade, there are, in our view, already other measures and safeguards in place to prevent avoidance arising from diversionary practices (such as, for example, the CFC rules, EU blacklist measures, etc), and future changes (e.g. ATAD III, Pillar Two) will enhance these measures and safeguards.

Furthermore, using these criteria would, in our view, not have a significant effect on the removal of complexity and the administrative burden associated with the current system.

Finally, it should be noted that one of the other criteria for the application of S21B is that eligibility for the relevant relief (i.e. effectively a reduction in tax rate to 12.5%) is essentially dependent on whether the distributing company has distributable reserves, and whether the dividend is paid from such reserves. Where this is not the case (i.e. the dividend is paid out of, for example, share premium or is simply paid out of the inherent value of the company), the relief will not apply. We are of the view that this is an artificial distinction (which company law has largely dispensed with), and should not, in any event, be used as a basis for determining whether a participation exemption in respect of foreign dividends should apply or not).

*Benefits of UK approach over use of existing criteria*

The benefits of the adoption of the UK approach (as discussed above) would be that it would address the concerns addressed above in relation to the use of existing criteria, and would allow for the introduction of specific anti-avoidance rules that are relevant and specific to the payment of foreign dividends to Irish companies.

**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?*

Part 35B of the TCA, 1997 (which contains Ireland's CFC rules) implements Articles 7 and 8 of the EU ATAD provisions on CFCs. Generally, these rules are adequately aligned with a territorial system of double tax relief (in this regard, most other EU jurisdictions that operate such systems also adopted these rules).

The above having been stated, we are of the view that one adjustment would be required to the CFC rules should a participation exemption in respect of foreign dividends be introduced. The operation of the CFC rules is such that, where a CFC of an Irish company distributes all of its profits to the Irish company by way of a dividend, no CFC charge can arise as there would be no distributable income for the year in question. In circumstances where the Irish shareholder claims a participation exemption in respect of the dividend (with the result that the dividend is exempt from Irish tax), an anomaly would arise: there could be no CFC charge (if applicable), and the dividend would be exempt from tax in Ireland. Consideration should therefore be given to introducing a rule, the effect of which would be that, to the extent that the Irish company wishes to avail of the participation exemption in respect of the dividend, the dividend income which availed of the participation exemption in Ireland should be treated as undistributed income for the purposes of the CFC rules.

We have, elsewhere in this consultation response, suggested an elective branch profits exemption. Depending on the design of such an exemption, it may also be appropriate to consider the extension of the application of the Irish CFC rules to branch profits (i.e. with the result that, where an entity has elected into the branch exemption regime, an Irish head office would only be taxed in Ireland on unremitted profits of its foreign branches to the extent the profits of the branches would have resulted in a CFC charge if they had been carried on in a subsidiary). Such an approach would be congruent with a territorial basis of taxation generally, as well as with many other recent and imminent reforms and anti-avoidance measures.

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

Please see our answer to Question 8 above.

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

Please see our answer to Question 8 above.

**Interest Charges Associated with Exempt Income**

*<u>Question 11:</u>*
*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?*

We are of the view that interest costs in respect of borrowings used to acquire foreign subsidiaries or to fund foreign branches should not be restricted if the income from such participations were to be exempted. There are a number of reasons for this view:

- There are already many domestic legislative provisions in relation to interest deductibility (such as s247 rules and the new Interest limitation rules that apply to accounting periods commencing 1 January 2022). If the introduction of a territorial system of double tax relief results in further interest restrictions, this would create unnecessary additional complexities from a calculation perspective.

- Under the current worldwide system of double tax relief, the effect of the credit approach is that, even though foreign dividends and branch profits are taxed in Ireland, the application of foreign tax credits invariably results in no incremental tax being paid in Ireland. The primary purpose of the adoption of a territorial system of double tax relief would not be to reduce tax that is payable, but instead to dispense with the unnecessary calculation of such credits where the result would ultimately be the same if an exemption method were applied. In this context, concerns relating to the deductibility of funding costs for investments that yield returns that are ultimately never going to be subject to Irish tax (whether exempt or taxable, but not taxed because of the availability of credits) are misplaced.

- In any event, the primary purpose of allowing for relief in respect of funding costs is to facilitate and encourage investment. Requiring returns in respect of such investments to be brought to account for tax purposes merely because that return would be exempt should only be a secondary issue.

**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?*

As stated in the consultation document, ATAD required EU Member States to impose an exit tax on unrealised gains arising on the transfer of assets from an Irish head office to a permanent establishment in another territory, but this particular measure was not required to be transposed into Irish law (on the basis that it was not necessary, given Ireland's worldwide system of double

tax relief). Whether, and how, such a measure will need to be transposed into Irish law if a territorial stem of double taxation relief is introduced will depend on the relevant rules that are introduced.

Although not strictly within the scope of this consultation, we do wish to point out an anomaly that exists with regard to the participation exemption provided for in S626B and its interaction with the exit tax. This anomaly is best illustrated by way of an example. Assume that, on day 1, an Irish company disposes of all of its participations in foreign companies, and S626B is applied to exempt the gains from these disposals. On day 2, the Irish company migrates, and is not subject to the exit tax. If the same company were to migrate without having first disposed of all of its participations, it would realise a chargeable gain. There therefore appears to be no reason why the exit tax should apply to a migrating company (without the ability for S626B to apply), and it is suggested that this treatment be reviewed in the interests of simplification.

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

These matters are addressed elsewhere in our response

**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 and/or branch exemption regimes? How might this simplification be achieved?*

We believe that Ireland should introduce a participation exemption for dividends and a branch exemption election. Consequently, a full review and simplification of Schedule 24, by itself, would not be sufficient to address the concerns set out elsewhere in our response.

In any event, we are of the view that a simplification of Schedule 24 should not be seen as an alternative to the introduction of a participation exemption in respect of dividends and a branch exemption, but rather as a necessary additional measure (i.e. over and above the introduction of these exemptions) to further simplify Ireland’s tax code (and thereby further facilitate tax certainty and the competitiveness of Ireland as a destination for investment).

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

Please refer to our answer to Question 14 above.

*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?*

We do not believe that a review and simplification of Schedule 24 alone would be sufficient, and that it is, for all of the reasons stated above in our responses to previous questions, necessary to introduce an appropriately designed territorial system of double taxation relief.

The above having been stated, irrespective of the design of such a territorial system, credit mechanisms will always be necessary (in order to deal with situations in which foreign dividends and/or branch profits are not exempt, whether as a result of the exercise of an election or otherwise).

It is, however, suggested that, in order to address competitiveness concerns, the urgent need at this point is the introduction of a territorial system of double tax relief, and that the redesign and/or simplification of Schedule 24 (or the introduction of new, simpler credit relief rules) is a subsidiary issue that may be dealt with independently of - and subsequent to - the introduction of a participation exemption in respect of foreign dividends and/or a branch profits exemption.

Of particular concern would be the following matters:

- The introduction of a pooling regime for royalty withholding tax.
- Simplifications in the re-grossing mechanism to bring it closer to the UK version.
- In certain situations, where the Irish measure of foreign branch profits is zero or negative, the foreign branch may still, applying the principles applicable in the relevant foreign jurisdiction, realise a taxable profit in that foreign jurisdiction (on which foreign tax is payable). However, such foreign tax would not be available for pooling or carryforward in terms of Schedule 24. This appears to be a flaw in the operation of the legislation and overly punitive.
- In calculating profits of foreign branches, an Irish company is required to recompute these profits on an Irish basis for purposes of Schedule 24. This creates additional complexity and often indirectly results in double taxation due to the differences between taxable profits (as determined under Irish rules) and taxable profits (as determined under the rules of the jurisdiction of the branch). An alternative would be to apply the taxable

profits as determined under the rules of the jurisdiction of the branch for the purposes of Schedule 24 (on the basis that this is the amount in respect of which the foreign tax is payable).

The simplification of the credit relief rules, although necessary, should not delay the introduction of the relevant exemptions as a matter of urgency.

**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?*

Foreign branches of Irish headquartered companies are often located in jurisdictions that have also introduced anti-hybrid rules. In the context of Ireland's worldwide tax regime, this creates significant complexity and uncertainty, largely as a result of the fact that all income is dual inclusion income (and all expenses are double deductions). Issues arise where there are significant timing mismatches between the Irish and local bases of taxation, and where losses arise. It is difficult to adjust the anti-hybrid rules themselves to deal with these situations, and the introduction of a territorial regime in this context significantly reduces the inherent complexity, as well as the likelihood of anomalies.

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

This question is addressed throughout our response.

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

As a general matter, the Anti-Hybrid rules are concerned, amongst many other things, with hybrid mismatches arising due to disregarded PEs or due to a different allocation of profits between a head office and a foreign PE. Such concerns would seem 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 in fact aligns Ireland with the type of regime envisaged by ATAD rules (and the ATAD anti-hybrid rules).

**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 into Irish tax law? Are there any potential synergies or risks with the implementation of the two-pillar solution and such exemption regimes?*

Please note that the below discussion is based on the assumption that Ireland implements the EU Directive (as it is currently drafted) for the transposition of Pillar Two into Irish Law.

*Dividends*

Under Pillar Two, net GloBE income adjusts for dividends (which are stripped out of the net GloBE income calculation). As such, there should be no difference between the calculation of net GloBE income for Pillar Two whether a participation exemption in respect of foreign dividends is implemented or not (i.e. under both scenarios, dividends will initially be included but will then be stripped out of GloBE when calculating the ETR).

The starting position for adjusted covered taxes under Pillar Two is the current tax expense in the financial statements. Certain adjustments are then made. For example, adjusted covered taxes is reduced by "*the amount of current tax expense with respect to income excluded from the computation of GloBE Income or Loss under Chapter 3*". As per the above, dividend income is excluded (stripped out) from the Net GloBE income calculation. As such, any current tax on dividends (where a participation exemption in respect of dividends is not implemented) should be deducted from the adjusted covered taxes amount. On this basis, the adjusted covered taxes position should be the same whether a participation exemption in respect of dividends implemented or not (i.e. the current tax on dividends would be deducted from the adjusted covered taxes or there would be no tax in the first place and no adjustment required to the adjusted covered taxes).

*Branches*

Under current rules, an Irish company with a foreign branch includes that branch income in its Irish tax computation. The branch income is taxed at 12.5% or 25%, and foreign tax credits should be available.

Under Pillar Two, the ETR calculation is done per jurisdiction (i.e. if the Irish company has a

French branch, the French branch income will be taxed in France).

Under Article 4 of the Draft EU Directive, a permanent establishment is deemed to be located in the jurisdiction where it is tax resident (in this case, France). On this basis, under Pillar Two, the French branch income would not be included in the Irish net GloBE income. As such, the net GloBE income position under Pillar Two should not differ in an Irish context, regardless of whether a foreign branch exemption is implemented or not (i.e. the French branch income is not taken into account in the Irish net GloBE income and, if an exemption applies, there would be no French branch income in the first place).

As noted above, the starting position for adjusted covered taxes under Pillar Two is the current tax expense in the financial statements. Certain adjustments are then made. For example, the adjusted covered taxes is reduced by "*the amount of current tax expense with respect to income excluded from the computation of GloBE Income or Loss under Chapter 3*". Similar to dividend income above, branch income is also excluded (stripped out) from net GloBE income. As such, any current tax on foreign branch income (assuming a branch exemption is not implemented) would be deducted from the adjusted covered taxes amount. On this basis, the adjusted covered taxes position should be the same whether a branch exemption is implemented or not (i.e. the current tax on foreign branch income would be deducted from the adjusted covered taxes or there would be no tax in the first place if a branch exemption applies and no adjustment is required to the adjusted covered taxes).

**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?*

On the basis that the new regime is designed to improve Ireland's competitiveness as a destination for investment company location while protecting the Irish tax base and to respect the allocation of income, profits and gains under Ireland's tax treaties, we do not see any significant issues arising with Ireland's tax treaties.

<u>*Question 22:*</u>

*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?*

Please see our answer to Question 21 in this regard.

<u>*Question 23:*</u>

*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?*

As mentioned above, on the basis that the new regime is designed to improve Ireland's competitiveness as a destination for investment company location while protecting the Irish tax base and to respect the allocation of income, profits and gains under Ireland's tax treaties we do not see any significant issues arising with Ireland's tax treaties.

**Transitional Arrangements**

<u>*Question 24:*</u>

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

Should a branch exemption be applicable, foreign branch losses will not be capable of being set off against other profits that are taxed in the Irish head office. In the interests of equity, a transitional rule may, however, be needed however for any "final" and otherwise unused losses arising on the cessation of a taxable branch. We understand that EU case law requires that such losses should remain available against Irish profits.

More generally, 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 such circumstances.

**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.*

*Urgency*

As is more fully detailed in our above responses, it is widely accepted that Ireland is out of step with other EU and OECD (and indeed global) jurisdictions in relation to its treatment of foreign dividends and branch profits, especially following the plethora of changes to its tax system over the past decade to address concerns relating to base erosion. Moreover, the lack of a territorial system of double taxation relief has an effect on Ireland's competitiveness as a destination for investment.

The urgency of the need for the introduction of a competitive territorial regime of double tax relief should therefore not be understated. In light of all of the recent and imminent changes in the international tax landscape, many investment decisions (such as those involving the location of a holding company or central hub) are currently being made by investors. These decisions, by their very nature, are invariably made on a long-term basis and are difficult to reverse. In this context, postponing the introduction of such a regime beyond 2023 will likely have long-term adverse effects on investment in Ireland.

The introduction of the regime with effect from 1 January 2023 would therefore be most welcome. This having been stated, the pressures that the Department is faced with in relation to the ongoing work in relation to Pillar Two must be acknowledged. Consequently, at a minimum, a clear commitment should be given so that certainty is provided to investors and businesses that an appropriate regime will indeed be introduced from 1 January 2024 at the very latest.

*Section 626B*

In line with our comments above relating to the scope of a territorial system of double tax relief, we wish to raise a related issue regarding S626B (in any event, many of the comments in relation to this issue are also apposite in the context of considering the scope of a possible territorial system of double tax relief).

S626B allows for an exemption from Irish CGT where a capital gain is made by a company on the disposal of a shareholding in a subsidiary. In order for the exemption to apply the following conditions must be met:

- The Parent company must hold at least 5% of the ordinary share capital for a continuous period of 12 months;
- The subsidiary company must be resident in an EU member state or a country with which Ireland has a tax treaty with;
- The exemption will not apply where the shares in the subsidiary derive the greater part of their value from land, minerals or exploration rights in Ireland (i.e. Irish specified assets); and
- The subsidiary must be carrying on a trade or the business of the parent and the subsidiary as a whole must consist wholly or mainly of the carrying on of a trade or trades.

The trading requirement contained within S626B is viewed internationally as highly restrictive. This is illustrated in the context of asset management and private equity, where international asset managers are currently considering appropriate locations for their operations, with a preference for onshore jurisdictions where they can match their regulated management substance with their asset owning entities. Generally, in a private equity strategy, the asset owning entity will not be a trading entity. In addition, the asset manager may not own a substantial enough stake in the underlying entity to make a determination as to its trading status or the investment itself may not be considered trading (e.g. a wind farm or solar development asset). In this regard, the trading requirement puts Ireland at a disadvantage vis a vis our direct competitors.

Accordingly, we would recommend that the trading requirement of S626B be removed, simplified or limited (e.g. an exemption from the trading requirement for institutional investors). This change would significantly broaden Ireland's reputation for asset managers to establish private equity business' and would be seen as a very positive move.

In addition, we would also recommend that this exemption be available on a worldwide basis, rather than limiting it to gains from shares in companies resident in jurisdictions with which Ireland has a double tax treaty. At a minimum, we would recommend that the exemption is extended to countries with which Ireland has entered into a Tax Information Exchange Agreement ("TIEA"). This would be in line with existing provisions under S21B.