ATAD Implementation – CFC Feedback Statement

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Introduction

Following the publication of the BEPS reports in October 2015, a decision was taken at EU level to introduce the Anti-Tax Avoidance Directive (ATAD) as part of a package of measures aimed at ensuring a common and co-ordinated approach across EU Member States to the introduction of BEPS anti-avoidance measures.

The first ATAD, presented in January 2016 and agreed by all EU Member States in July 2016, provided for five separate anti-avoidance measures to be transposed on an agreed schedule between 2018 and 2023. This Feedback Statement relates to one of those measures, Controlled Foreign Company (CFC) rules, which are due to be implemented by 1 January 2019.

The Department of Finance held a public consultation on the Coffey Review and the implementation of the ATADs from 10th October 2017 to 30th January 2018. The consultation paper included a question on considerations relevant to the transposition of CFC rules and the majority of the 22 submissions received to the consultation addressed these issues.

Many of these submissions noted the complexity of CFC rules and the significant investment of time that will be required by corporate groups, once the detail of the CFC rules becomes known, to review all subsidiary companies to determine if they are within the scope of CFC rules.

It was therefore a common request that the Department consult with stakeholders to the greatest extent possible in the development of CFC legislation, and provide sufficient advance notice on technical details of the CFC rules to enable companies to comply with the new requirements when implemented.

The Department is therefore publishing this paper to respond to the views expressed in responses to the public consultation and to set out possible approaches to some of the technical aspects of CFC rules.

The views of stakeholders will be important in ensuring that Ireland’s CFC rules, when introduced, meet the standards required under ATAD while also being clear and operable in practice and remaining consistent with Ireland’s long-standing focus on the taxation of activities with substance in Ireland.
Structural Approach

It was confirmed in the Corporation Tax 2018 Tax Strategy Group paper that the ATAD approach attributing undistributed income arising from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage would be adopted for the introduction of CFC rules in Ireland.

The Directive provides that an arrangement shall be regarded as non-genuine to the extent that the CFC would not have owned the assets or undertaken the risks that generated the income if it were not controlled by a company where the significant people functions (SPFs) relevant to those assets or risks are carried out and are instrumental in generating the controlled company’s income.

This approach is consistent with the existing Irish tax policy focus on the taxation of activities with substance in Ireland. It also aligns with long-standing policy in developing anti-avoidance rules based on principal purpose tests.

It must also be noted that, when implementing ATAD, Member States are required to have regard to the EU Freedoms and to ensure that the measures are implemented in compliance with established case law in this area.
Structure and Definitions

1. Article 7(1)(a) – Definition of ‘control’

Submissions to the consultation noted the need for CFC legislation to be clear and unambiguous, to give certainty to taxpayers in implementing the new rules from 1 January 2019.

A key element of the regime will be the definition of ‘control’, particularly as it applies to more complex corporate groups involving both direct and indirect holdings in subsidiary companies.

The control test contained in ATAD Article 7(1)(a) defines ‘control’ in terms of a 50% direct or indirect shareholding or entitlement to profits or voting rights. It also aggregates the holdings/entitlements of ‘associated enterprises’ as defined in Article 2.

Following discussion with European Commission officials as to their understanding of the control test in Article 7(1)(a), the following approach could be used to define “control” for the purposes of a CFC charge:

“control” shall be construed in accordance with subsections (2), (4), (5) and (6) of section 432, as if there were –

(a) included the following after paragraph (c) in subsection (2):

“(d) any part of the issued share capital of the company and thereby control the composition of its board of directors.”, and

(b) substituted the following for subsection (6):

“For the purposes of subsection (2), there may also be attributed to any person all the rights and powers of –

(a) any associated company, within the meaning of [possible definition below], of such person,

(b) any company of which such person has, or such person and associates of such person have, control,

(c) any 2 or more companies of which such person has, or such person and associates of such person have, control,

(d) any associate of such person, or

(e) any 2 or more associates of such person,

including the rights and powers attributed to a company or associate under subsection (5), but excluding those attributed to an associate under this subsection, and such attributions shall be made under this subsection as will result in the company being treated as under the control of persons resident in the State if it can be so treated.”
“a company shall be treated as an “associated company” of another company where –
   (a) one of them, directly or indirectly, possesses or is entitled to acquire not less than 25 per cent of –
      (i) the share capital or issued share capital of the other company, or
      (ii) the voting power of the other company,
   (b) one of them is beneficially entitled to not less than 25 per cent of any profits available for distribution to equity holders of the other company, or
   (c) in respect of those companies, a third person –
      (i) directly or indirectly –
         (I) possesses or is entitled to acquire not less than 25 per cent of the share capital or issued share capital of each of them, or
         (II) the voting power of each of them, or
      (ii) is beneficially entitled to not less than 25 per cent of any profits available for distribution to equity holders of each company.”
2. **Article 7(1)(b) – Effective Tax Rate Test**

Many submissions to the consultation noted the complexity of the test required under Article 7(1)(b) to determine if a company is a CFC, and the resulting administrative burden that it would create. The test, referred to as an effective tax rate test (ETR), requires consideration of whether:

> “(b) the actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or permanent establishment.”

It further states that:

> “Furthermore the corporate tax that would have been charged in the Member State of the taxpayer means as computed according to the rules of the Member State of the taxpayer.”

This requires a hypothetical tax liability to be calculated for the CFC as if it were resident in the parent company jurisdiction and subject to that jurisdiction’s rules on the calculation of taxable profits and resulting tax liabilities.

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<th>One possible approach is to structure the ETR test as an optional exemption. This would retain the ETR test as required by ATAD, but would allow taxpayers the option to defer consideration of the ETR test until it has been determined that the CFC is ‘controlled’ and has undistributed income within the scope of a CFC charge.</th>
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<td><strong>Under this approach, an ETR test could be structured as follows:</strong></td>
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3. Article 7(1)(b) – Calculation of the Effective Rate

Article 7(1)(b) requires a company to re-calculate a hypothetical taxable profit, and resulting tax liability, for the foreign subsidiary company based on the tax rules of the controlling parent company jurisdiction. As noted above, this is a complex requirement, requiring a range of assumptions to be made.

A potential approach to this requirement would be as follows:

“corresponding corporation tax in the State” means the amount of corporation tax which would be chargeable in the State in accordance with [section regarding corresponding chargeable profits] in respect of the controlled foreign company’s corresponding chargeable profits in the State for the accounting period;

“corresponding chargeable profits in the State” means the profits of a controlled foreign company which, applying the assumptions in [section regarding corresponding chargeable profits], would be the controlled foreign company’s profits for corporation tax purposes for the accounting period;

Corresponding chargeable profits in the State
(1) For the purpose of determining the corresponding chargeable profits in the State of a controlled foreign company for an accounting period, it shall be assumed –

(a) (i) that the company is resident in the State at all times during the accounting period,
(ii) if the accounting period is not the company’s first accounting period, that the company has been resident in the State since its first accounting period,
(iii) except where the company ceases to regarded as a controlled foreign company in accordance with this Chapter in the accounting period, that the company will continue to be resident in the State in subsequent accounting periods, and
(iv) where the company was resident in the State in the accounting period immediately prior to its first accounting period, that the assumed residence in accordance with this subparagraph is not continuous with residence in the State immediately before the beginning of that accounting period,

and that the company is, has been and will continue to be within the charge to corporation tax, and its accounting periods, as determined in accordance with [section regarding accounting periods], are accounting periods for corporation tax purposes,

(b) that there is no change in the place or places at which the company carries on its activities,

(c) that the company is not a close company within the meaning of section 430,

(d) where any allowance, credit, deduction, relief or repayment under the Tax Acts is dependent upon the making of a claim or election, that the company has made that claim or election which would give the maximum amount of allowance, credit, deduction, relief or repayment and that the claim or election was made within any applicable time limit,
(e) that the company is neither a member of a group of companies nor a member of a consortium for any purposes of the Tax Acts, and

(f) that the company is not entitled to relief under Part 35 in respect of any amount of income, profits or gains for tax paid on such income, profits or gains under the laws of the company’s territory of residence.

(2) Notwithstanding subsection (1)(b), corporation tax shall be deemed to be charged on the corresponding chargeable profits in the State at the rate specified in -

   (a) section 21(1)(f) in so far as the corresponding chargeable profits in the State consist of profits which would be chargeable to tax under Case I of Schedule D but for subsection (1)(b), and

   (b) section 21A(3) in so far as the corresponding chargeable profits in the State consist of profits which would be chargeable to tax under Case III, IV or V of Schedule D but for subsection (1)(b),

   and the total of such corporation tax shall be regarded as the corresponding corporation tax in the State for the accounting period.

(3) In this section, references to the first accounting period of a controlled foreign company are references to the accounting period in which the company first falls to be regarded as a controlled foreign company in accordance with this Chapter.

(4) Nothing in this section affects any liability to, or the computation of, corporation tax in respect of a trade which is carried on by a controlled foreign company through a branch or agency in the State.
4. Article 7 – The CFC Charge

A key element of the legislation will be the CFC charging provision. It is essential for both businesses and Revenue that this is clear, unambiguous and operable in practice.

The CFC charge seeks to target income of the CFC arising from “non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage”. As noted above, it is required that Member States implement the ATAD in a manner which is compliant with EU law. The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

The following approach to the CFC charge could be considered:

1. Subject to subsections (5), (8) and (9), where in an accounting period –
   (a) a controlled foreign company group has undistributed income, and
   (b) relevant Irish activities in relation to the controlled foreign company group are carried on by the controlling company or a company connected with the controlling company*, and in this section any such company shall be referred to as a ‘chargeable company’,
   a controlled foreign company charge shall be made on the chargeable company for the accounting period, as determined in accordance with section 27, of the chargeable company in which the accounting period of the controlled foreign company ends.

2. For the purpose of subsection (1), a chargeable company shall include a branch or agency of that company.

3. The controlled foreign company charge made under subsection (1) shall be an amount equal to the undistributed income of the controlled foreign company group to the extent that such income can reasonably be attributed to relevant Irish activities undertaken by the chargeable company.

4. The undistributed income to be attributed to relevant Irish activities for the purpose of subsection (3) shall be determined by reference to the amount that would be payable by persons dealing at arm’s length in relation to those activities but the value so attributed shall not exceed the proportion of the aggregate of the undistributed income of the controlled foreign company group that corresponds to the aggregate of the controlling company and the chargeable company’s shareholding in each of the controlled foreign companies in the controlled foreign company group.

[*See point 7 – connected company undertaking SPFs]
(5) **Subsection (1)** shall not apply in relation to undistributed income –

(a) attributable to relevant Irish activities undertaken by a chargeable company under arrangements where –

(i) it is reasonable to consider that such arrangements would be entered into by persons dealing at arm’s length, or

(ii) the arrangements are subject to the provisions of section 835C,

or,

(b) which has previously been assessed to a controlled foreign company charge under this section.

(6) Corporation tax shall be charged on the controlled foreign company charge at the rate specified in –

(a) section 21(1)(f) in so far as the undistributed income attributable to the relevant Irish activities would be chargeable to tax under Case I of Schedule D had it arisen in the chargeable company, and

(b) section 21A(3) in so far as the undistributed income attributable to the relevant Irish activities would be chargeable to tax under Case III, IV or V of Schedule D had it arisen in the chargeable company,

and the amount of corporation tax so chargeable shall be reduced by the amount of any creditable tax as determined by [section defining creditable tax].

(7) Subject to subsection (6), no relief, deduction or set off of any description shall be allowed against a controlled foreign company charge.

(8) This section shall not apply to an asset or risk, whether on an individual basis or taken together as an aggregate, where the increase in the controlled foreign company’s undistributed income as against the undistributed income of the controlled foreign company where it -

(a) did not hold, or had not held, the asset to any extent, or

(b) did not bear, or had not borne, the risk to any extent, is negligible.

(9) (a) This section shall not apply in relation to an accounting period of a controlled foreign company where –

(i) at no time did the controlled foreign company hold assets or bear risks under an arrangement where it would be reasonable to consider that the essential purpose of the arrangement was not to secure a tax advantage, or

(ii) the controlled foreign company does not have any non-genuine arrangements in place.

(b) For the purpose of paragraph (a), an arrangement shall be regarded as non-genuine to the extent that –

(i) the controlled foreign company would not own the assets or would not have borne the risks which generate all, or part of, its undistributed income but for relevant Irish activities undertaken relating to those assets and risks, and

(ii) it would be reasonable to consider that the relevant Irish activities were instrumental in generating that income.
Additional Provisions

Directives, by their nature, are relatively high level documents that leave a certain amount of scope to each Member State as to the detail of how the agreed measures are achieved.

Recital 12 of the Directive provides that, with a view to limiting the administrative burden and compliance costs, it is acceptable for Member States exempt from CFC rules certain entities with low profits or a low profit margin that give rise to lower risks of tax avoidance, and it is proposed to draft the Irish CFC legislation accordingly.

In order to deliver an effective CFC framework, consideration will also be required of additional provisions which, while not expressly required under the ATAD, may nonetheless be necessary to ensure the objectives of the CFC rules are achieved and that it operates as intended in practice.

The Department is therefore considering the following possible approaches to ensure an effective CFC regime.

5. Article 7(2) and Article 8(2) — “Cash Box” companies

Some commentary has noted that the ATAD ‘non-genuine arrangements’ approach may not be sufficient to address ‘cash box’ subsidiaries, for example, where there are cash/capital rich companies with few or no employees in low tax jurisdictions and there are no SPFs in the State relating to the management of those assets.

Article 8(2) of the ATAD, which specifies the manner in which the CFC income to be attributed to the parent company is to be computed, requires that “the income to be included in the tax base of the taxpayer shall be limited to amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company”.

It has been proposed that additional provisions specific to ‘cash box’ companies could be included in Irish CFC legislation, however ‘cash box’ companies may not have SPFs as relevant to this calculation.

Consideration of these issues is ongoing.
6. Recital 12 – Exempt period

Recital 12 of the ATAD states that CFC rules must be a proportionate response to BEPS concerns and provides, inter alia, that the rules may target “income which has artificially been diverted to the subsidiary”.

It was noted in responses to the Coffey/ATAD consultation that CFC rules in some other jurisdictions, in particular the UK, provide an exempt period for newly-acquired subsidiaries, for example following the acquisition of a corporate group. Submissions noted that, as the intention of CFC rules is to discourage deliberate structuring to divert otherwise taxable profits to a low/no tax jurisdiction, it would be appropriate to allow a ‘grace period’ in respect of newly acquired subsidiaries during which the new parent company can reorganise its business to eliminate the CFC if desired.

Should such a grace period be provided, consideration would need to be given to ensuring that it would not be subject to abuse.

A potential option could be to allow a grace period in the form of a conditional exemption – e.g. to provide an exempt period of a maximum of 12 months, subject to the subsidiary company ceasing to be a CFC, or ceasing to have income subject to the CFC charge, in the second year. Where this condition is not met, the deferred CFC charge for the first year would become payable with that of the second year (if any).

(1) In this section –

“exempt period” has the meaning given to it by subsection (3);

“relevant time” has the meaning given to it by subsection (3);

“subsequent period condition” has the meaning given to it by subsection (4).

(2) [CFC charging section] shall not apply in relation to an accounting period of a controlled foreign company where –

(a) the accounting period ends during an exempt period,

(b) the subsequent period condition is satisfied, and

(c) (i) the assets held and risks borne by the controlled foreign company at any time during the exempt period are equal to or less than the assets held and risks borne at the relevant time, or

(ii) the arm’s length value, in the functional currency of the controlled foreign company, of the assets held and risks borne by the controlled foreign company at any time during the exempt period does not exceed such value of the assets held and risks borne at the relevant time.

(3) An exempt period shall begin when a company first becomes a controlling company in relation to a controlled foreign company (in this section referred to as the “relevant time”) and shall end 12 months from the beginning of the exempt period.

...continued overleaf
(4) The subsequent period condition shall be satisfied where –

(a) the controlled foreign company ceases to be regarded as a controlled foreign company in accordance with Chapter 1, or

(b) the controlled foreign company charge does not apply,

in the first accounting period of the controlled foreign company beginning immediately after the exempt period.

(5) Where the accounting period of a controlled foreign company begins but does not end during an exempt period, the undistributed income of the controlled foreign company which arises during the exempt period, as determined on a just and reasonable basis, which would otherwise be subject to the controlled foreign company charge under [CFC charging section], shall be exempt from such charge.

(6) This section shall not apply in relation to a controlled foreign company where –

(a) immediately before the relevant time the controlled foreign company was not carrying on a business except where the controlled foreign company is incorporated or formed at the relevant time for the purpose of controlling one or more companies and an exempt period begins in relation to one or more of such companies at such time, or

(b) a controlling company was subject to this Part in relation to the controlled foreign company on the date the provisions of this Part came into effect.

(7) This section shall not apply in relation to a controlled foreign company where -

(a) any arrangements are entered into,

(b) as a consequence of such arrangements subsection (2) would, apart from this subsection, apply, and

(c) it would be reasonable to consider that the main purpose, or one of the main purposes, of the arrangements is to secure that subsection (2) applies.
7. Article 7(2) and Article 8(2) – Connected company undertaking SPFs

Where an entity is considered to be a CFC, Article 7(2) requires the attribution of certain income linked to ‘significant people functions’ (SPFs) undertaken by the controlling company. Similarly, the computation of the income to be attributed under Article 8(2) states that it “shall be limited to amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company”.

Concerns have been expressed that limiting this definition to SPFs undertaken by a controlling company only could give rise to potential for avoidance of the charge through an arrangement whereby the SPFs are undertaken by a connected company (of the controlling company) which does not meet the ‘control’ threshold for attribution of CFC income.

In view of the broad definition of ‘control’ and ‘associated entities’, which include both direct and indirect ownership/control, it is expected that the scope for such practices would be limited. However it is considered that an approach could be adopted to extend the CFC charge to an entity in the State that carries on SPF activity relating to a CFC of an Irish parent company.

This approach could involve the following definitions:

“SPF” means a significant people function or a key entrepreneurial risk-taking function as construed in accordance with the OECD Report;


“relevant Irish activities” means SPFs performed in the State on behalf of a controlled foreign company group, where such SPFs are relevant to –

(i) the economic ownership of the assets included in the relevant assets and risks of the company or companies in the controlled foreign company group, or
(ii) the assumption and management of the risks included in the relevant assets and risks of the company or companies in the controlled foreign company group;

“controlled foreign company group” means the controlled foreign companies, taken together, of a controlling company;
8. Article 7(1)(b) – Definition of undistributed income

CFC rules attribute the “undistributed income” of the subsidiary company to the controlling company. Consideration of a definition of undistributed income is therefore required, in order to ensure that it is robust and does not facilitate avoidance activities.

The following definition could be considered for undistributed income, to ensure that interposing a holding company and the payment of a dividend to such a holding company would not be effective in circumventing a CFC charge:

(1) For the purposes of this Part, the undistributed income of a controlled foreign company for an accounting period shall be its distributable profits for the accounting period as reduced by any relevant distributions made in respect of the accounting period.

(2) For the purpose of subsection (1), the distributable profits of a controlled foreign company for an accounting period shall be the amount included in the accounting profits of the company which, notwithstanding any prohibition under the laws of the controlled foreign company’s territory of residence or otherwise, are available for distribution to members of the company and which can reasonably be attributed to relevant Irish activities undertaken by a controlling company or a company connected with the controlling company for that accounting period.

(3) For the purpose of subsection (1), a relevant distribution for an accounting period means an amount determined by the formula – A x B/C

where –
A is the amount of the distribution made in respect of the accounting period,
B is the distributable profits for the accounting period as construed in accordance with subsection (2), and
C is the amount of profit, before taxation, shown in the profit and loss account of the controlled foreign company for the accounting period,

and where –
(i) such amount is distributed to –
(I) a person who is, by virtue of the laws of a relevant Member State, resident for the purposes of tax in a relevant Member State which imposes a tax that generally applies to distributions receivable in that territory, by persons from sources outside that territory, or
(II) persons resident in the State,
(ii) such amount is paid or payable during the accounting period or within 9 months after the end of the accounting period, and
(iii) the tax referred to in clause (I) has been paid and has not been and does not fall to be repaid, in whole or in part, to the controlled foreign company or any other person on the making of a claim or otherwise.

(4) For the purpose of this section, a distribution made in respect of an accounting period shall be regarded as being made out of the distributable profits of that period to the extent of that profit and, in relation to any excess of the distribution over that profit, out of the most recently accumulated distributable profits.
9. Miscellaneous Definitions

As noted above, clear and unambiguous provisions will be essential to the operation of CFC rules in practice. The following are a number of definitions which may be used for this purpose.

“arrangement” means-
(i) any transaction, action, course of action, course of conduct, scheme, plan or proposal,
(ii) any agreement, arrangement, understanding, promise or undertaking whether express or implied and whether or not enforceable or intended to be enforceable by legal proceedings, and
(iii) any series of or combination of the circumstances referred to in paragraphs (i) and (ii)
whether entered into or arranged by one or two or more persons –
(I) whether acting in concert or not,
(II) whether or not entered into or arranged wholly or partly outside the State, or
(III) whether or not entered into or arranged as part of a larger arrangement or in conjunction with any other arrangement or arrangements,
but does not include an arrangement referred to in section 826;

“relevant assets and risks” means the assets which a controlled foreign company has, or has had, and the risks which a controlled foreign company bears, or has borne, where those assets or risks would not have been employed or undertaken but for SPFs performed in the State or by a company resident in the State on behalf of the controlled foreign company;

“tax advantage” means-
(i) a reduction, avoidance or deferral of any charge or assessment to tax, including any potential or prospective charge or assessment, or
(ii) a refund of or a payment of an amount of tax, or an increase in an amount of tax, refundable or otherwise payable to a person including any potential or prospective amount so refundable or payable,
arising out of or by reason of an arrangement, including an arrangement where another arrangement would not have been undertaken or arranged to achieve the results or any part of the results, achieved or intended to be achieved by the arrangement;
Next Steps

The issues addressed in this document will continue to be considered by the Department until Friday 28 September 2018. However stakeholders are encouraged to contact the Department at the earliest opportunity in the event of any queries or comments, in order to ensure the timely preparation of legislation for publication in Finance Bill 2018.

Any queries on the material enclosed can be directed to the Department via the original consultation email address: ctreview@finance.gov.ie

Alternatively, responses may be directed by post to:
- ATAD Implementation – CFC Feedback Statement
- Business Tax Team
- Department of Finance
- Government Buildings
- Upper Merrion Street
- Dublin 2
- D02 R583

Freedom of Information

Any interested parties are reminded that such contact is subject to the provisions of the Freedom of Information Acts.