



**Consultation Paper on Review of Ireland's
Corporation Tax Code**

Deloitte

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Tax Policy Division
Department of Finance
Government Buildings
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VIA EMAIL: ctcodereview@finance.gov.ie

Dear Sirs/Mesdames:

We are pleased to submit comments on behalf of Deloitte in response to your call for public consultation on the review of the corporation tax code. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives and are available to discuss anything in this document, as needed. In the meantime, if you have any queries please do not hesitate to contact either Tom Maguire, Tax partner, or myself on 01-417-2200.

Yours sincerely,

Lorraine Griffin
Partner
Head of Tax and Legal

Contents

Executive Summary	4
Question 1	6
Question 2	7
Question 3	15
Question 4	19
Question 5	26
Question 6	27
Question 7	28
Question 8	29
Question 9	30
Question 10	32

"... the years immediately ahead will be decisive for Ireland's economic future. Several factors, some outside of our immediate power to influence, have helped bring about this situation"

Programme for Economic Expansion, TK Whitaker / Department of Finance, 1958

Executive Summary

The 'Review of Ireland's Corporation Tax Code' represents one of the most fundamental analyses of Irish tax legislation in recent years. The recommendations in respect of increased public consultation, which have given rise to this document, are welcome.

Since the 1950s corporation tax policy has been an important ingredient of our economic success and will remain significant going forward. As one of the world's most globalised economies Ireland has been successful in attracting a significant share of global capital flows and has leveraged a young, educated and English speaking workforce together with open access to the Single Market to position Ireland as a gateway to Europe.

However, since the 2008 global financial crisis international tax policy has evolved rapidly. Governments seeking to combat perceived tax injustice, bolster falling tax revenues and reduce the role of tax competition as a tool for attracting foreign direct investment has resulted in coordinated measures at an OECD level to introduce complex anti avoidance measures and align tax with substance. Initiatives such as BEPS and the ATAD set strict parameters on how corporate tax policy can be further designed and implemented.

Thus corporate tax policy options available to the Government in this new post-BEPS, post-ATAD world will become increasingly limited. Going forward, a key role of the Irish Government will be to ensure that the fine balance between corporation tax competitiveness and compliance with EU law and BEPS rules is maintained. As such increased public consultation between Government, practitioners, industry and civil society will be critical to ensure that the measures being adopted by Ireland are those which will ensure that Ireland continues to remain attractive, and at worst mean we are no less competitive than other nations.

With this in mind please find below a summary of our key recommendations:

- Ireland's GAAR goes beyond that outlined in the ATAD and its test regarding the existence of a tax avoidance transaction is more subjective than that contained in the directive. It is based on a "reasonable to consider" test as opposed to the more factual approach in Article 6(1) of the ATAD. We would argue that the test in TCA 1997 s811C creates additional uncertainty as a result and should be aligned more with the ATAD to ensure competitiveness is maintained with EU partners.
- The ATAD's CFC rules apply two options in article 7(2) for defining a CFC's tax base with each option having its own exceptions. In our view it would be reasonable to adopt both options for our domestic law rather than to adopt an either/or type approach. This is to ensure a more equal treatment between domestic and foreign owned multinational groups and this approach could be supplemented by a whitelist of jurisdictions as permitted by the ATAD's preamble to add certainty of application. To adopt one option over another may favour certain corporate groups over others and such discrimination could not have been the intent of the directive.
- In order to maintain Ireland's competitiveness and from the perspective of the ATAD's exit tax it would be preferable to keep the rate of exit tax on such gains to a maximum rate of 12.5%. This is because the regime is mechanistic in its application and a country's tax rate is a sovereign question. Given companies would have previously invested in Ireland on the assumption that they could legitimately avail of the "excluded company" exemption from the exit tax then consideration should be given to ensuring that only increases in value of chargeable assets that occur post 1 January 2020 should be within the scope of the directive's exit tax i.e. Ireland's existing law should apply to latent gains accruing until 31 December 2019 with the ATAD's exit tax applying to the balance thereafter.
- A mechanistic implementation of the anti-hybrid rules may meet ATAD minimum standards but will create uncertainty for Revenue and taxpayers. Effective anti-hybrid rules might easily add substantial pages of tax legislation which will require detailed scrutiny by fiscal authorities, taxpayers, representative bodies and advisers alike. Increased complexity can bring about increased uncertainty of application and therefore an early formal consultation

on the draft legislation to be used will aid in delivering certainty for all parties. The limited permitted derogations contained in the ATAD should be taken.

- Indeed such level of consultation with draft legislation would be welcome on all aspects of the ATAD's implementation.
- An effective review of the basis and limitations of the current deductibility of interest would be an opportunity to clarify complex, cumbersome rules, set the deductibility formulation in a modern business context, pave the way for a simpler introduction of the ATAD limitations, and reduce uncertainty for taxpayers, fiscal authorities and tax advisers.
- Ireland should adopt a foreign branch profit exemption and foreign source dividend exemption. A foreign source dividend exemption would replace what in practice is an effective exemption. A simplified and competitive system for foreign source dividends would be particularly beneficial for Ireland's attractiveness as a holding company location.
- A broad simplification of TCA 1997 Schedule 24 would be welcome such that the distinction between different categories of income is eliminated (i.e. interest, royalties, etc.). Relief should also be available in respect of any form of foreign tax suffered, irrespective of the type of the foreign tax.
- The removal of "grandfathering" for Transfer Pricing purposes will have a disproportional effect on smaller groups and we recommend that consideration be given to retaining the current provisions until at least 2020. Alternatives to full formal transfer documentation such as the use of safe harbours and retention of the EU SME exemption should be adopted.
- To the extent that Ireland's domestic transfer pricing law is amended as a result of this consultation, we would recommend that consideration be given to reducing the compliance burden placed on the SME sector.
- The changes contained in the 2017 OECD Transfer Pricing Guidelines arising from the OECD Base Erosion and Profit Shifting project are far reaching and are not merely clarification of the existing guidelines. Accordingly, it is imperative that any transfer pricing legislative amendments which may be forthcoming consider the overall impact for taxpayers in terms of dealing with such changes and other tax related changes that will be forthcoming in future Finance Bills and are implemented in a co-operative manner with consultation with industry and a defined roadmap of key changes and proposed implementation timeline in place.

We note Ireland has made strong advances to been seen globally as engaging in "best practice". While engaging in "best practice" is essential to maintain our international reputation, Ireland is a small open economy which is heavily reliant on FDI. Ireland does not operate in isolation and must be conscious of the positions being adopted by competitor nations. It is necessary that a desire to engage in "best practice" does not lead to Ireland agreeing to non-mandatory or more onerous provisions which are contrary to its competitive offering and position going forward.

Question 1

Article 6 of ATAD requires the transposition of a General Anti-Abuse Rule (GAAR) by 1 January 2019. As Ireland already has a robust GAAR, what changes, if any, are needed to ensure this meets the minimum standard required by the Directive?

Article 6(1) of the ATAD notes that *"For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part."*

Ireland's GAAR in TCA 1997 s811C is significantly more detailed than that outlined in the ATAD but we would argue it has a similar objective. It operates to define a tax avoidance transaction (and remove its related tax advantage) as one which, where having regard to, inter alia, the form, substance, and results of the respective transaction it "would be reasonable to consider" that—

- a) the transaction gives rise to, or but for the operation of the GAAR would give rise to, a tax advantage, and
- b) the transaction was not undertaken or arranged primarily for purposes other than to give rise to a tax advantage.

It can be seen that the test in Article 6(1) is that the arrangement had to be put in place with a main purpose of achieving a tax advantage. There are exceptions regarding defeating the purpose of the law and non-genuine arrangements. Ireland's TCA 1997 s811C contains similar exceptions where the tax advantage comprises a relief where its use would not constitute an abuse or misuse of that relief and where the transaction's purpose was to generate business profits.

It can be seen that TCA 1997 s811C goes beyond the ATAD in a number of respects. The test regarding the existence of a tax avoidance transaction is more subjective than that contained in the ATAD given that it is based on a "reasonable to consider" test as opposed to the more factual approach in Article 6 (1). We would argue that the test in TCA 1997 s811C creates additional uncertainty given its reference to "reasonable to consider" as opposed to "reasonable to conclude" and we would argue the latter would be closer in its approach to that adopted in the directive.

Secondly, it can be seen that TCA 1997 s811C will not apply where the purpose of the transaction was to generate business profits. "Business" is defined in a limiting manner in TCA 1997 s811C(1) as meaning "any trade, profession or vocation". This is more restrictive than that outlined in Article 6(1) of the ATAD given that the ATAD allows an exclusion for genuine transactions which can include investment activities. Therefore, it would be preferable to amend TCA 1997 s811C to allow such transactions in accordance with the ATAD.

The objective of the above is to ensure that Ireland is seen as implementing best practice while not impacting its attractiveness vis-à-vis other nations. As noted earlier, Ireland has made strong advances to be seen globally as engaging in "best practice". While engaging in "best practice" is essential to maintain our international reputation, Ireland is a small open economy which is heavily reliant on FDI. Ireland does not operate in isolation and must be conscious of the positions being adopted by competitor nations. It is necessary that a desire to engage in "best practice" does not lead to Ireland agreeing to non-mandatory or more onerous provisions which are contrary to its competitive offering and position going forward.

Question 2

Article 7 of ATAD requires Member States to implement Controlled Foreign Company (CFC) rules by 1 January 2019. What are the key considerations regarding the implementation of CFC rules? In terms of the options for CFC legislation set out in Article 7, what are the key factors in determining the preferred approach for Ireland?

We have set out below the key considerations regarding the implementation of CFC rules by Ireland, together with our recommendations concerning the optionality afforded by Article 7.

As will be seen below it is arguable that the ATAD does not provide a Member State with a binary choice in respect of whether to implement Article 7 (2)(a) (which contains an exception for substantive operations in the CFC country) or (2)(b) (which contains an exception for genuine arrangements without a tax avoidance purpose in the CFC country). Given this flexibility we suggest that a more appropriate option would be the inclusion of both Article 7 (2)(a) and (2)(b) in our domestic CFC legislation which could be supplemented by a whitelist of jurisdictions as permitted by the ATAD's preamble to add certainty of application.

We also recommend the Government use the adoption of CFC rules as an opportunity to extend the broad exemption currently enjoyed by Irish source dividends to a foreign source dividend and introduce an opt in foreign branch profits exemption.

As a general approach we urge the Government to adopt the following objectives on the implementation of CFC rules:

- (i) Providing clear and transparent legislation
- (ii) Establishing rules which are straightforward in application
- (iii) Ensuring sufficient protection for the Irish tax base on any move to exempt foreign profits, which would apply where Ireland adopted a territorial system, or indeed may result from a simplified Schedule 24 TCA 1997 depending on the methodology adopted
- (iv) While avoiding unduly complex or excessive provisions or procedures.

These objectives were highlighted by the UK in a 2007 paper '*Taxation of the foreign profits of companies: a discussion document*'¹, which amongst other issues was concerned with the reform of UK CFC rules. OECD guidance as outlined in the 2015 BEPS Action 3 report *Designing Effective Controlled Foreign Company Rules* is also helpful, and is discussed further below.

Finally, as an overarching comment, we would reiterate recommendations made by us and other industry representatives in the past that Ireland does not operate in isolation and must be conscious of the positions being adopted by other nations.

Our response to this question is set out into the following sections:

- I. A review of the ATAD Article 7 provisions and suggested optionality
- II. A review of Ireland's existing legislation in this area and its interaction with the ATAD Article 7 provisions
- III. Consideration of the adoption of a foreign source dividend and foreign branch profit exemption
- IV. OECD policy guidance on the implementation of CFC rules

I. A review of the ATAD Article 7 provisions

Defining a CFC

Article 7 (1) states that "*the Member State of a taxpayer shall treat an entity, or a permanent establishment of which the profits are not subject to tax or are exempt from tax in that Member State, as a controlled foreign company where the following conditions are met:*

¹ HM Treasury, HM Revenue and Customs 2007

- a) *in the case of an entity, the taxpayer by itself, or together with its associated enterprises holds a direct or indirect participation of more than 50 percent of the voting rights, or owns directly or indirectly more than 50 percent of capital or is entitled to receive more than 50 percent of the profits of that entity; and*
- 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."*

'Associated enterprise' is defined in Article 1 as follows –

"'Associated enterprise' means:

- a) *an entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of 25 percent or more or is entitled to receive 25 percent or more of the profits of that entity;*
- b) *an individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in a taxpayer of 25 percent or more or is entitled to receive 25 percent or more of the profits of the taxpayer;*

If an individual or entity holds directly or indirectly a participation of 25 percent or more in a taxpayer and one or more entities, all the entities concerned, including the taxpayer, shall also be regarded as associated enterprises."

It is worth noting that Article 7 distinguishes between "entity" and "permanent establishment". The term "entity" is not defined in the ATAD, nor is it defined in any of the following tax directives:

- Council Directive 90/435/EEC (the Parent Subsidiary Directive)
- Council Directive 2003/49/EC (the Interest and Royalties Directive)
- Council Directive 90/434/EEC (the Mergers Directive)

Council Directive amending Directive (EU) 2016/1164, i.e. 'ATAD 2' defines a "Hybrid Entity" as "any entity or arrangement that is regarded as a taxable entity under the laws of one jurisdiction and whose income or expenditure is treated as income or expenditure of one or more other persons under the laws of another jurisdiction"

The European Commission defines a "legal entity" as "Any natural person, or any legal person created and recognised as such under national law, European Union law or international law, which has legal personality and which may, acting in its own name, exercise rights and be subject to obligations".² The European Commission Regulations regarding the definition of micro, small and medium-sized enterprises states that "An enterprise is considered to be any entity engaged in an economic activity, irrespective of its legal form".

The BEPS Action 3 Report "Designing Effective Controlled Foreign Company Rules"³ (page 21) notes that "Although CFC rules would appear based on their name only to apply to corporate entities, many countries include trusts, partnerships and PEs in limited circumstances to ensure that companies in the parent jurisdiction cannot circumvent CFC rules just by changing the legal form of their subsidiaries." On balance therefore it appears that "entity" is intended to extend beyond bodies corporate.

² http://ec.europa.eu/research/participants/portal/desktop/en/support/reference_terms.html

³ "Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report" – OECD 2015

Income for inclusion in the tax base

Where a foreign entity is classified as a CFC then the ATAD contains a form of "optionality" within Article 7 (2) on what income should be included within the tax base of the Member State "parent" of the CFC. However, as noted below it may be more advisable to adopt both (2)(a) and (2)(b).

"Where an entity or permanent establishment is treated as a controlled foreign company under paragraph 1, the Member State of the taxpayer shall include in the tax base:

- a) *the non-distributed income of the entity or the income of the permanent establishment which is derived from the following categories:*
 - (i) *interest or any other income generated by financial assets;*
 - (ii) *royalties or any other income generated from intellectual property;*
 - (iii) *dividends and income from the disposal of shares;*
 - (iv) *income from financial leasing;*
 - (v) *income from insurance, banking and other financial activities;*
 - (vi) *income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little economic value;*

This point shall not apply where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.

Where the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying the preceding subparagraph.

or

- b) *the non-distributed income of the entity or permanent establishment arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.*

For the purposes of this point, an arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income."

Option (a) offers a mechanical approach by formally categorising a list of *certain* undistributed incomes (hereinafter referred to as "passive income") which is to be included within the tax base of the Member State "parent", with certain exclusions.

Option (b) offers a somewhat subjective approach which unlike option (a) applies to the *total* undistributed income which should be included within the tax base of the Member State "parent". This has two required elements to be met being income arising from (i) non-genuine arrangements which (ii) have been put in place for the *essential* purpose of obtaining a tax advantage. Meeting one of these elements is not sufficient to invoke the application of the CFC rules in the first instance.

Options (a) and (b) provide for carve-outs from the application of the CFC rules for substantive or non-artificial arrangements respectively. Option (a)'s carve out reads as follows *"This point shall not apply where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances."* A typical dictionary definition of "substantive" is *"having a firm basis in reality and so important, meaningful, or considerable. ..."*. Arguably "substantive" is linked with the reference to relevant "facts and circumstances" and could be construed as requiring the foreign company to have sufficient economic, as opposed to legal, substance in country to enable the carrying on of the economic activity by the company concerned in that country. Therefore, such carve out would be welcomed by Irish companies that have such substantive operations abroad given it is arguably less subjective in its

approach than the carve out contained in option (b) and it focuses solely on passive income. As noted earlier the latter has two subjective elements to be met being income arising from (i) non-genuine arrangements which (ii) have been put in place for the *essential* purpose of obtaining a tax advantage.

Arguably, option (b) with its specific reference to tax avoidance would be closer in approach to that adopted in the *Cadbury Schweppes* case. There the court said at para 54 that the freedom of establishment involves “*the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period ...Consequently, it presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there*”. One can see how this is factored into option (b) and this is further echoed in para 55 which says that “*for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory*”.

The latter is reflective of several ECJ decisions, which note that a national restriction on fundamental freedoms can be justified only where it specifically targets wholly artificial arrangements which do not reflect economic reality and whose sole purpose is to obtain a tax advantage.⁴ The ATAD’s preamble notes that “*It is important that tax administrations and taxpayers cooperate to gather the relevant facts and circumstances to determine whether the carve-out rule is to apply.*” Although tax administrations should work with taxpayers to determine whether the carve out will apply, caution should be taken such that the burden of proof does not lie solely on taxpayers to prove that the carve-out should apply. This is important in light of ECJ rulings as well as a 2007 European Commission document ‘*The application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries*’ which states that “*the Commission considers that burden of proof should not lie solely on the side of the taxpayer and that account should be taken of the general compliance capacity of the taxpayer and of the type of arrangement in question*”⁵, and most recently the European court’s ruling in *Egiom*.⁶

However, and as noted earlier, Ireland adopting option (a) over (b) or vice versa as part of our domestic law may represent some limitation in itself. Therefore, including both options (a) and (b) in domestic law while permitting adherence to the object and purpose of the directive would also ensure there should be no discrimination between companies with and without substantial operations in foreign countries as both company types would have the possibility to demonstrate the non-application of the CFC rules.

Option (a) operates to include certain ‘passive’ type income within the CFC provisions and option (b) operates to include (where it applies) total ‘relevant’ undistributed income within those provisions. ‘Relevant’ income being income which derives from those non-genuine arrangements which have been put in place for the *essential* purpose of obtaining a tax advantage. It is clear therefore that passive income can fall within either option (a) or (b) such that it could be reasonably argued that adopting option (a) or (b) in isolation could be inappropriate for certain companies and indeed Ireland’s competitiveness vis-à-vis other European Members. It is curious that option (a) applies to charge passive income to tax under the CFC rules without applying a tax avoidance test. It could be argued that by allowing controlled foreign companies which carry on substantive operations in a country to be excluded then the absence of a taxpayer’s tax avoidance motive is at least implied within that test. That is not beyond doubt but appears to be a presumption adopted in the ATAD nonetheless. Therefore, it is suggested that a taxpayer company be allowed look to either (a) or (b) depending on their position. In our view it is arguable that such an approach would not interfere with, or would be inconsistent with, the object and purpose of the directive given that certain specific

⁴ See for instance *Cadbury Schweppes Overseas Limited v Commissioners of Inland Revenue, C-196/04*, *Automóveis de Aluguer Lda. v Fazenda Pública, C-282/12* and *Haribo Lakritzen Hans Riegel BetriebsgmbH and Österreichische Salinen AG v Finanzamt Linz, Joined Cases C-436/08 and C-437/08*

⁵ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52007DC0785&from=EN>

⁶ [Egiom SAS, formerly Holcim France SAS, Enka SA v Ministre des Finances et des Comptes publics C-6/16](#)

exclusions apply to each option and there should be no crossover between the exclusions allowed by either option (a) or (b).

Article 7(2) commences as follows *"Where an entity or permanent establishment is treated as a controlled foreign company under paragraph 1, the Member State of the taxpayer [e.g. Ireland] shall include in the tax base...(a) the non-distributed income of the entity [comprising passive income] or (b) the non-distributed income of the entity ... arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage..."*. Therefore, it appears that once the rules apply such that an Irish resident company with a CFC includes income of that CFC in its taxable profits under either options (a) or (b), then the requirements of the directive have been met.

It should be noted that where a Member State is to have a choice between various options then the wording within the directive is deliberate and clear e.g. Article 7(3) notes as follows *"Where, under the rules of a Member State, the tax base of a taxpayer is calculated according to point (a) of paragraph 2, the Member State may opt not to treat an entity or permanent establishment as a controlled foreign company under paragraph 1 if one third or less of the income accruing to the entity or permanent establishment falls within the categories under point (a) of paragraph 2."* It is clear that the second underlined limb of the above outlines a choice and indeed Article 7(4) is equally clear in the existence of a choice when it notes that "Member States may exclude from the scope of point (b) of paragraph 2 an entity or permanent establishment..." that meets certain de minimis accounting measures. Looking again at Article 7(3) and the first underlined limb it can be seen that it refers to the law of the country where the "tax base of the taxpayer" is calculated using option (a); it is at least arguable that reference to "the taxpayer" would not be necessary if option (a) was mandatory in its application; put another way that limb focuses on how the income of a taxpayer is to be computed as opposed to that of the Member State's corporate tax base.

Such optionality is not unusual within our law. For example TCA 1997 s811C (our GAAR) specifically allows a transaction not to be a tax avoidance transaction where it was entered into to generate business profits or to claim a relief in a non-abusive manner. It is not necessary for both exclusions to apply before a transaction is to be treated as other than a tax avoidance transaction. Arguably, the approach there is similar to that in the CFC legislation in that where an Irish resident company has a CFC then whether Article 7(2) (a) or (b) is chosen, then the various options available under (a) or (b) should equally be adopted.

Optionality within the options (a) and (b)

Article 7 (3) states:

1. *"Where, under the rules of a Member State, the tax base of a taxpayer is calculated according to point (a) of paragraph 2, the Member State may opt not to treat an entity or permanent establishment as a controlled foreign company under paragraph 1 if one third or less of the income accruing to the entity or permanent establishment falls within the categories under point (a) of paragraph 2" and*
2. *"Where, under the rules of a Member State, the tax base of a taxpayer is calculated according to point (a) of paragraph 2, the Member State may opt not to treat financial undertakings as controlled foreign companies if one third or less of the entity's income from the categories under point (a) of paragraph 2 comes from transactions with the taxpayer or its associated enterprises."*

The numbering is our own for ease of reference. Article 7 (3) is only applicable for those Member States which adopt Article 2 Option (a). Where an entity or permanent establishment would otherwise be classified as a CFC, Article 7 (3)(1) permits States to provide an exemption from such a classification where one third or less of the income of the entity or permanent establishment derives from the income categories listed in Article 7 (2)(a).

Similarly, where an entity or permanent establishment would otherwise be classified as a CFC, Article 7 (3)(2) allows states to provide an exemption from such a classification where the entity or permanent establishment is a 'financial undertaking' and one third or less of its income comes from transactions with the Member State 'parent' taxpayer or associated enterprise. Again, the income in

question is taken from the income categories listed in Article 7 (2)(a). 'Financial Undertaking' is defined in Article 1 (5).

Article 7 (4) provides for a de minimus threshold:

"Member States may exclude from the scope of point (b) of paragraph 2 an entity or permanent establishment:

- a) with accounting profits of no more than EUR 750 000, and non-trading income of no more than EUR 75 000; or*
- b) of which the accounting profits amount to no more than 10 percent of its operating costs for the tax period.*

For the purpose of point (b) of the first subparagraph, the operating costs may not include the cost of goods sold outside the country where the entity is resident, or the permanent establishment is situated, for tax purposes and payments to associated enterprises."

As with Article 7 (4) Member States may choose to extend this exclusion, but it is not mandatory. We recommend all of the above exceptions are applied in Irish law.

Option (a) also allows the "substantive operations" carve out to not apply where *"the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement"*. In order that Ireland remain as competitive as possible we would argue that such option not be taken as part of Ireland's domestic legislation on the matter and at a minimum for countries with which Ireland has a double tax treaty.

CFC income computation and attribution

Article 8 addresses how the income of the CFC is to be computed. The Article distinguishes between the manner of computation depending on whether Article 7 (2)(a) or (b) is adopted.

Article 8 (1) states that *"Where point (a) of Article 7(2) applies, the income to be included in the tax base of the taxpayer shall be calculated in accordance with the rules of the corporate tax law of the Member State where the taxpayer is resident for tax purposes or situated."* This method is in line with the BEPS Action 3 report. Article 8 (2) states that where Article 7 (2)(b) applies *"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."* This would attribute to the Irish company the level of income which is attributable to the decision making function in the Irish entity used to generate the CFC income. This method of income attribution is consistent with the wording of the preamble to the ATAD *"it is critical that Member States that limit their CFC rules to income which has been artificially diverted to the subsidiary precisely target situations where most of the decision-making functions which generated diverted income at the level of the controlled subsidiary are carried out in the Member State of the taxpayer."* Article 8 (3) goes on to supplement this income attribution provision, stating *"The attribution of controlled foreign company income shall be calculated in accordance with the arm's length principle."*

It would be reasonable to apply OECD principles to the income to be attributed in accordance with the above. It could be possible in an Irish context that where Article (8) (3) applies, the attribution should be computed in accordance with TCA 1997 Part 35A.

II. Impact on Ireland's existing legislation

Existing Irish legislation

TCA 1997 s26 subjects Irish resident companies to corporation tax on their worldwide profits. In other words, Ireland has a residence based or so-called 'worldwide' system of taxation as distinct from so-called 'territorial' systems operated by most other OECD members. In reality jurisdictions' tax systems are almost never purely worldwide nor purely territorial but fall within a spectrum between these two. Most countries referred to as 'territorial' in reality exempt some but not all foreign source income.

TCA 1997 s26 (1) states *"Subject to any exceptions provided for by the Corporation Tax Acts, a company shall be chargeable to corporation tax on all its profits wherever arising"*. Some of the

'exceptions' referred to in s26 (1) include non-resident companies and distributions received from Irish resident companies.

This charge to tax therefore extends to all permanent establishments, operations, arrangements etc. of the company, of whatever nature, and wherever located, provided the company is beneficially entitled to the arising profits. The distinction is drawn where the company is not beneficially entitled to the profits, such as is the case where the profits arise to a company's foreign subsidiary.

CFC regimes have been applied by countries with worldwide systems of taxation in the past, including the UK. The BEPS Action 3 Report acknowledges that there may be distinctions between how countries which have adopted alternate systems of taxation may apply CFC rules "*If a jurisdiction has a worldwide tax system, its CFC rules could apply broadly to any income that is not being currently taxed in the parent jurisdiction and still remain consistent with the parent jurisdiction's overall tax system. If, however, a jurisdiction has a territorial tax system, it may be more consistent for its CFC rules to apply narrowly and only subject income that should have been taxed in the parent jurisdiction to CFC taxation.*"

As current Irish legislation taxes companies on profits wherever arising, if Ireland continues to operate a worldwide system, the implementation of CFC rules need only apply in respect of those relevant entities in which the Irish company has an appropriate share of capital or voting rights, but where the Irish company is not itself beneficially entitled to the profits. This is also in line with the BEPS Action 3 report "*Transparent entities such as partnerships should not be treated as CFCs to the extent that their income is already taxed in the parent jurisdiction on a current basis.*" However the reader is directed to our response to Question 10 regarding potential dividend and branch exemptions.

III. Consideration of a foreign source dividend and foreign branch profit exemption

The above analysis outlines at a high level the changes Ireland must make to incorporate the ATAD CFC rules into our current system of residence based taxation.

As noted in the Coffey report, only 6 out of 34 OECD members impose corporate tax on a worldwide basis. The adoption of CFC rules should be taken as a natural opportunity to consider the merits of moving to a system to exempt foreign source dividends and an exemption for the profits of foreign branches / permanent establishments.

In this regard, it is worth reflecting on the experience of the UK, given that a significant portion of our domestic tax legislation has a common heritage with the UK's and many of the difficulties faced by the UK corporate tax system are shared by our own. The UK has faced significant European challenges to its corporate tax provisions through ECJ rulings such as the *Marks & Spencer* case which provided that losses incurred by a subsidiary in another Member State should be available for offset against the profits in the UK, or *FII GLO* in which the ECJ considered the differing tax treatment between foreign and UK source dividends.^{7 8} The outcome of both of these cases resulted in changes to Irish legislation, which was similar to the British legislation under dispute in the ECJ.

In 2007 a UK government paper set out a package of proposals for modernising and creating a more straightforward regime for taxing foreign profits.⁹ Recommendations in the report included an exemption for certain foreign dividends, reform of CFC rules and anti-abuse interest provisions. A growing body of European case law and the impact of globalisation were drivers of changes to the

⁷ Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue Case C-446/04 <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=66367&pageIndex=0&doclang=EN&mode=lst&ir=&occ=first&part=1&cid=744896>

⁸ http://ec.europa.eu/dgs/legal_service/arrets/03c446_en.pdf *Marks & Spencer case plc v David Halsey (HMTI) C-446/03*

⁹ *Taxation of the foreign profits of companies: a discussion document* – HM Treasury, HM Revenue and Customs (2007)

regime.¹⁰ In 2009 the UK moved to a system for exempting foreign source dividends and subsequently in 2011 the UK introduced an optional foreign branch exemption. These changes reflect the increasing complexity and reduction in tax revenue from a comprehensive worldwide tax system.

The drivers which led the UK to move to offer this exemption-based system are equally applicable now in an Irish context. It is likely that if Ireland maintains its 'worldwide' system, further piecemeal amendments may be required to ensure the tax code remains compliant with EU fundamental freedoms, and over time this could result in a system inevitably more akin to a 'territorial' system. An exemption system is also generally seen as simpler and more attractive by multinational investors than a credit system, notwithstanding the reality that our credit system eliminates double tax in most instances.

Further analysis of the merits of switching to a foreign branch profit exemption system, together with some legislative considerations regarding the implication of same, are set out in our response to question 10.

IV. OECD policy guidance on the implementation of CFC rules

Chapter 3 of the 2015 BEPS Action 3 report also outlines the policy considerations and objectives which underlie CFC rules. These considerations are specifically relevant in the context of the implementation of any CFC rules. These are set out below.

- (i) Deterrent effect
- (ii) Interaction with transfer pricing rules
- (iii) Effectively preventing avoidance while reducing administrative and compliance burdens
- (iv) Avoiding double taxation
- (v) Striking a balance between taxing foreign income and maintaining competitiveness
- (vi) Preventing base stripping

¹⁰ See for instance, *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue Case C-446/04* <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=66367&pageIndex=0&doclang=EN&mode=lst&ir=&occ=first&part=1&cid=744896>
http://ec.europa.eu/dgs/legal_service/arrets/03c446_en.pdf *Marks & Spencer case plc v David Halsey (HMTI) C-446/03*

Question 3

Article 5 of ATAD requires Ireland to have an exit tax in four particular circumstances by 1 January 2020. Ireland currently has an exit tax which will be replaced by the ATAD exit tax. What are the key considerations in transposing Article 5?

Executive Summary

Ireland already has existing exit tax provisions which partially address the circumstances outlined within Article 5. However, Article 5 (1) outlines additional scenarios in which exit tax should apply which are not covered by our existing legislation.

Traditionally exit taxes have caused the following problems for taxpayers: ¹¹

- Cash-flow disadvantage – The tax arises at the date of emigration and not at the date of realisation of any capital gain on the company’s assets.
- Double taxation – Even with the EU harmonisation of exit taxes through Article 5, the migration of tax residence between countries does not automatically result in an uplift in base cost in the ‘immigrant’ State, given that disputes over valuation may arise.
- Tax base disadvantage – No consideration is given to future fluctuations in asset valuations after migration. This means that gains could increase or decrease between the date of departure and actual realisation of the asset, resulting in both the ‘emigrant’ and the ‘immigrant’ State taxing either more or less gains than they would ordinarily have done in the case of an actual realised gain.

Within the confined parameters of Article 5, Ireland can and should make our exit tax provisions as attractive as possible relative to other EU Member States. This could be done by:

- Abolishing or significantly reducing the interest charged on exit taxes which have been deferred by taxpayers; and
- Reducing the effective rate of tax on such gains to a maximum rate of 12.5%.

Overall, the exit charge provisions in the ATAD go beyond those currently existing in Irish law. This would make Ireland less attractive than it was previously, but it must be remembered that this is a disadvantage that will be shared with all EU Members and any communication regarding our exit tax should reference that. The distinguishing point will be the rate of tax applying, and therefore it is in Ireland’s interests to make this as low as possible. This should not give rise to a loss of revenue to the Exchequer vis-à-vis the current regime given the current “excluded companies” provisions that exist within our law result in a reduced application of the exit tax.

Our response to this question is set out into the following sections:

- I. Consideration of the preamble to the Directive
- II. An analysis of Article 5 and corresponding Irish provisions
- III. Consideration of ‘value’ for the purposes of the Article

I. Consideration of the preamble

The preamble to the Directive provides helpful guidance as to the overarching purpose of Article 5.

“Exit taxes have the function of ensuring that where a taxpayer moves assets or its tax residence out of the tax jurisdiction of a State, that State taxes the economic value of any capital gain created in its territory even though that gain has not yet been realised at the time of the exit. It is therefore necessary to specify cases in which taxpayers are subject to exit tax rules and taxed on unrealised capital gains which have been built in their transferred assets.”

¹¹ Exit Taxes: Where to Now? After ECJ Decision in National Grid Indus BV. Shane Wallace and Shane Murphy, *Irish Tax Review*, Issue 2, 2012

Four such cases are set out in Article 5 (1). The preamble goes on to note that *"It is also helpful to clarify that transfers of assets, including cash, between a parent company and its subsidiaries fall outside the scope of the envisaged rule on exit taxation."* This exemption is important in that it clarifies intergroup transfers of assets should not be subject to exit tax rules.

The preamble states that *"In order to compute the amounts, it is critical to fix a market value for the transferred assets at the time of exit of the assets based on the arm's length principle."* As will be seen below, Article 5 (6) specifically defines market value, and Member States retain the right to value assets and address valuation disputes through existing dispute resolution mechanisms *"It is also necessary to allow the receiving State to dispute the value of the transferred assets established by the exit State when it does not reflect such a market value"*.

II. An analysis of Article 5 and corresponding Irish provisions

Charge and timing

Article 5(1) notes that *"A taxpayer shall be subject to tax at an amount equal to the market value of the transferred assets, at the time of exit of the assets, less their value for tax purposes..."* in certain outlined circumstances. Irish law differs in that an exemption applies for certain excluded companies. The exit tax in the ATAD is to apply from 1 January 2020. Therefore, implementation could result in removing the excluded company exception retrospectively for companies that had acquired assets prior to 1 January 2020.

Article 15.5.1 of Bunreacht na hÉireann provides: *"The Oireachtas shall not declare acts to be infringements of the law which were not so at the date of their commission"*. In addition, it may be more appropriate to say that such a retrospective removal of an exemption resulting in a tax charge may be an unjust attack on a taxpayer's property rights. In the Irish Supreme Court decision of *Re Article 26 and the Health (Amendment) (No. 2) Bill 2004* the State had been charging certain people for treatment notwithstanding that they were entitled to that treatment free of charge and the Government introduced a Bill seeking to retrospectively render the charges lawful. The Supreme Court stated: *"...Where a statutory measure abrogates a property right, as this Bill does, and the State seeks to justify it by reference to the interests of the common good or those of general public policy involving matters of finance alone, such a measure, if capable of justification, could only be justified as an objective imperative for the purpose of avoiding an extreme financial crisis or a fundamental disequilibrium in public finances."* Therefore, it is at least arguable that removing an excluded company exemption in respect of gains inherent in assets at the date of introduction would run into domestic law difficulties.

Therefore and given that companies may have invested in Ireland on the assumption that they could legitimately avail of the excluded company exemption from the exit tax then consideration should be given to ensuring that only increases in value of chargeable assets that occur post 1 January 2020 should be within the scope of Ireland's legislating for the directive. It should be noted that this is not a form of "rebasings" the value of the asset but rather preserving the effect of the domestic exemption until such point as the directive is to apply. This should not offend the application and purpose of the directive.

Arguably, a precedent already exists within the Capital Gains Tax code for such an approach. When CGT was enacted in 1975 a provision was brought about requiring that assets held at 6th April 1974 were to be treated as disposed and reacquired at that date in computing the assets' deductible cost for subsequent chargeable gains arising on the disposal of such assets. There were certain exceptions where indexation gave rise to a loss which would not be relevant in this instance. Therefore, a similar provision to that outlined in TCA97 s556(3) could be brought about to TCA97 s627 along the lines of

"For the purposes of Chapter 2 part 20 [and any other provisions of the TCA97 which are amended for article 5 of the ATAD], it shall be assumed that an asset held by an excluded company [as defined in TCA97 s627(2)] on the 31st December 2019, was sold and immediately reacquired by such person on that date, and there shall be deemed to have been given by such person as consideration for the reacquisition an amount equal to the market value of the asset at that date."

As this only applies for the purposes of the exit tax provisions then there should be no disposal for the purposes of the CGT Acts.

Deferral

Article 5 (2) provides several instances where "A taxpayer shall be given the right to defer the payment of an exit tax referred to in paragraph 1, by paying it in instalments over five years". As indicated by the use of the word "shall", Member States are required to introduce this deferral provision.

TCA 1997 s628A provides for a deferral of the charge to tax arising under s627 where a company ceases to be resident in the State. The section provides migrating companies with options to elect to defer the immediate payment of tax arising where a company migrates its residency to another EU Member State or EEA Member State. The immediate charge to tax may be deferred and paid in 6 equal instalments (i.e. over five years) or within 60 days of the disposal of migrated assets. However, in the case of the latter option, all deferred tax is due and payable on or within a period of 10 years from the date of migration.

Ireland is not required to introduce an exit tax where a taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third country that is party to the Agreement on the European Economic Area (EEA Agreement) under our 'worldwide' system given Ireland retains taxing rights over the assets of permanent establishments of Irish companies. As such, no corresponding deferral provision is required. Where Ireland introduces a foreign branch exemption, a deferral for the applicable exit tax should be implemented.

Interest

Article 5 (3) states as follows:

"If a taxpayer defers the payment in accordance with paragraph 2, interest may be charged in accordance with the legislation of the Member State of the taxpayer or of the permanent establishment, as the case may be."

This does not impose a requirement on Member States to charge interest or at what rate the interest should be charged. Whether to apply such interest is at the discretion of the State. This discretion is confirmed by the preamble (section 10) which notes "In those situations, taxpayers should have the right to either immediately pay the amount of exit tax assessed or defer payment... possibly together with interest and a guarantee". Flexibility is granted in the manner interest is charged "interest may be charged in accordance with the legislation of the Member State". The discretionary charging of such interest is also in accordance with CJEU precedent.¹²

TCA 1997 s628A (6) charges such interest. The interest is payable on outstanding exit tax and is due and payable at the same time as exit tax is due and payable, the interest being charged at a rate of 0.0219% per day in accordance with s1080(3). The interest charged is, in our view, punitive given that a deferral of the exit tax is not the late or overdue payment of a tax, to which s1080 generally applies, but companies availing of this relief are effectively penalised as late payers.

Given the existing exit tax exemptions will need to be amended / removed, we recommend interest is not charged such that Ireland's corporation tax regime remains attractive to mobile capital investment.

Tax Debt and Security

Article 5 (3) states as follows:

"If there is a demonstrable and actual risk of non-recovery, taxpayers may also be required to provide a guarantee as a condition for deferring the payment in accordance with paragraph 2."

This provision is also optional. In any event, under TCA 1997 s628A (7) Revenue may require security from a company opting to defer tax where, in their opinion, the deferral of relevant tax poses a serious risk to the collection of the tax.

¹² National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond C-371/10 (NGI)

Article 5 (3) goes on to state however:

"The second subparagraph shall not apply where the legislation in the Member State of the taxpayer or of the permanent establishment provides for the possibility of recovery of the tax debt through another taxpayer which is member of the same group and is resident for tax purposes in that Member State."

TCA 1997 s629 provides a tax collection mechanism from an associated company or a controlling director of a company in the event of default by either the migrating company or its parent company in paying any tax due in accordance with s627. Article 5 (3) therefore appears to disapply the requirement for a guarantee or security where the Member State has the possibility to recover the exit tax due from a related company resident in that Member State. It would therefore appear that s628A (7) should not apply where Revenue can avail of the possibility of recovering the tax debt under s629.

III. Consideration of 'value' for the purposes of the Article

Article 5 (5) states that:

"Where the transfer of assets, tax residence or the business carried on by a permanent establishment is to another Member State, that Member State shall accept the value established by the Member State of the taxpayer or of the permanent establishment as the starting value of the assets for tax purposes, unless this does not reflect the market value."

The preamble to the Directive also states – *"In order to compute the amounts, it is critical to fix a market value for the transferred assets at the time of exit of the assets based on the arm's length principle"*. This is reflected in Article 5 (1) as noted earlier.

An authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries. Article 9 provides:

*"[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."*¹³

Notwithstanding the reference to the arm's length principle in the preamble, "market value" is defined in Article 5 (6) as *"the amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction"* and does not reference OECD guidance. In our view an amended exit tax should be so referenced.

Article 5 (5) is reflective of the commentary in the preamble which states *"It is also necessary to allow the receiving State to dispute the value of the transferred assets established by the exit State when it does not reflect such a market value."* Article 5 (5) and the preamble are somewhat contradictory in that Member States are required to impose market value when computing the deemed proceeds on disposal in accordance with Article 5 (1), but Article 5 (5) implies that this may not be the value imposed by other Member States.

A scenario could arise for instance where an EU tax resident company migrates to Ireland, and a foreign Revenue authority values the migrated asset at a price above that which Irish Revenue might value that same asset. The result of the high valuation for Irish purposes being that any future gain on disposal would be smaller given the increased base cost. This may lead to a dispute between both competent authorities, which could adversely impact the taxpayer.

In keeping with recommendations throughout this report, Ireland should be viewed as an attractive destination for mobile capital. Accordingly we recommend the benefit of the doubt lie with the taxpayer in respect of the higher valuation of assets for Irish tax purposes. A regime which is

¹³ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD. 2017.

perceived as favourable to mobile capital and not unnecessarily punitive would reflect positively on Ireland while adhering to the object and purpose of the ATAD.

Question 4

Article 9 of ATAD originally set out concise anti-hybrid rules applicable to intra-EU payments. In February 2017, the ECOFIN Council agreed an amendment to ATAD, ATAD 2, which extended the hybrid mismatch rules to third countries. ATAD 2 delays the implementation date for the introduction of any anti-hybrid rules to 1 January 2020 and allows a longer period, until 1 January 2022, to implement the elements of the rules which target so-called 'reverse hybrids', a type of hybrid entity that is treated as transparent for tax purposes in the payor jurisdiction and a taxable entity in the payee jurisdiction. What are the key considerations regarding the implementation of the hybrid mismatch rules?

The Consultation Paper notes that Ireland has notified the European Commission that "as our existing interest limitation rules are at least equally effective to the rules contained in the Directive" it is not anticipated that Ireland will implement the ATAD mandated interest limitation rules until 1 January 2024. As a result, the Consultation Paper understandably does not specifically request comments on the implementation of Article 4 of ATAD at this stage. Nevertheless, we believe that concurrent with consultation on the other ATAD mandated rules, consideration should be given to the wider context of Ireland's existing rules on interest deductibility for Corporation Tax purposes. This need for early action is underpinned by the potential for OECD members to agree a minimum standard for Action 4 (interest limitations) which, under the terms of article 11(6) of ATAD, would need to be implemented by the end of the first full fiscal year following agreement of such minimum standard. As the United States recently enacted Tax reform proposals includes provisions equivalent to this, an advanced mandatory implementation date cannot be ruled out.

An effective review of the basis and limitations of the current deductibility of interest would be an opportunity to:

- clarify complex, cumbersome rules,
- set the deductibility formulation in a modern business context,
- pave the way for a simpler introduction of the ATAD limitations, and
- reduce uncertainty for taxpayers, fiscal authorities and tax advisers.

Paragraph 7.2.10 of the Coffey Report cites instances of specific anti avoidance rules which might be reconsidered in the context of the ATAD limitations. We consider that, rather than tinkering with existing provisions, a zero base approach should be adopted.

Interest, by its nature, is a revenue expense and when incurred wholly and exclusively for the purposes of a trade is generally relieved in full for Irish Corporation Tax. Outside a trading context, relief is given only to the extent that an express statutory provision permits relief which remains subject to further limitations.

- These limitations extend not only to the purpose to which the borrowings are applied but also to the form in which they are raised and applied.
- An uncommercial distinction is made between interest and other forms of borrowing cost (e.g. discount or premium), and scant regard is had to whether it is more beneficial to borrow in currencies other than euro.
- The relative advantages of risk management tools such as financial derivatives (i.e. those relating to interest rate and foreign exchange hedging) are, outside treasury operations, reliant on statements of revenue practice rather than statute to determine whether and to what extent relief is available.

In this context, we advocate that serious consideration be given to the broad reform of the Irish Corporation Tax Code provisions dealing with the tax treatment of all aspects of corporate finance. Such legislation need not be lengthy or unwieldy, especially in the context of the impending introduction of ATAD limitations.

Adopting a principles based approach to legislation whereby tax relief is permitted for finance costs measured on an accounts basis where the monies have been applied for any purposes within the business and other commercial purposes of the taxpayer concerned would not extend tax relief in an inappropriate or undue manner. This approach can then be effected subject only to the measurement limitations prescribed in ATAD which provide a bulwark against excessive interest burdens.

The purpose and intended effect of reform in this area would not be to increase the quantum or availability of relief but to bring simplicity and certainty for Revenue, taxpayers and advisers alike. Such clarity should reduce the necessity for private Revenue opinions.

Turning to the necessary ATAD limitations themselves, Finance (No 2) Bill is currently making its way through the UK Parliament and the proposed corporate interest restrictions are contained in Schedule 10 which consists of 155 pages of legislation to implement the provisions of Article 4 of ATAD. By contrast, Ireland's specific provisions dealing with interest consist of a few pages which will likely make it more complex to enact the specific restrictions which ATAD mandates if a comprehensive reform on the taxation of corporate finance is not forthcoming. As Ireland will be legislating in an environment where the quantum of relief is to be limited by reference to fixed limitations based on business income, we believe it should be possible for more concise legislation to be brought forth.

Taking note of the ultimate deadline of 1 January 2024, we would recommend that this process be commenced no later than Spring 2022. In this regard, it should be noted that while article 11(6) of ATAD envisages 2024 as the final deadline, in the event that OECD members agree on a minimum standard for BEPS Action 4 in advance of that deadline, the rules must be introduced by Ireland by the end of the first full fiscal year following agreement of that minimum standard.

Having expanded on the detail of the arrangements to be covered by the anti-hybrid rules through the introduction of the considerably more extensive ATAD 2, it might be expected that the transposition of those rules into Irish law would be a mechanical process achieved via short form legislation as with many EU Directives. While that approach might have the perceived merit of meeting the EU requirements, it would introduce significant uncertainty both for Revenue and taxpayers alike which will not meet the Government's aim of a stable, certain tax system.

The anti-hybrid rules, while ostensibly targeted at complex cross border structures are derived from the OECD BEPS project and will be of general corporate application between associated enterprises. We have set out below our specific recommendations on high level items which will need clarification as part of the drafting process.

Ireland's economy has benefited significantly from

- the transformation of business value chains through WTO-enabled globalisation which naturally span borders, and
- a focus on financial, technology and other services.

By their nature, these sectors are international and reflect Ireland's truly open economy. It is clear that in a commercial world faced with uncertainties such as economic instability, Brexit and numerous similar factors, an ability to take time to analyse and adapt to impending change will lead to less disruption. This will be a long term benefit to Revenue and taxpayers alike.

These rules will have broad application and are not limited to artificial structures and an absence of consultation including draft legislation means that significant avoidable disruption could occur.

Individual points to be addressed

Definition of "associated enterprise"

The anti-hybrid rules are designed to have effect as between related parties like other Anti-Tax Avoidance measures; however, the definition of "associated enterprises" is modified from that subsisting for CFC and other proposed ATAD rules in three ways:

1. 25% test is replaced with a 50% test

The increase in the participation threshold is to be welcomed and reflects the intention that these rules apply in intra group situations.

2. Aggregation of the participation by persons who “act together” of the rights which are respectively held

We recommend that in crafting legislation, it is made clear that “acts together” is construed only in the context of the arrangements which are potentially subject to the anti-hybrid rules, i.e. the individual taxpayers concerned. To the extent that there are unrelated joint ventures or arrangements involving two groups, these should not be taken into account in determining whether they are “associated enterprises”. Additionally, “acts together” should not be taken to mean circumstances where, for example, a shareholders agreement supplements the constitutional documents of the company except and only to the extent that such an agreement binds one party with the actions of another.

3. Definition of “associated enterprise” is widened to include persons who are part of the same consolidated accounting group or where there is a significant influence by one party over the affairs of the other.

The requirement to regard two entities which are part of the same consolidated accounting group as being “associated enterprises” is not unreasonable. The Directive determines that:

“consolidated group for financial accounting purposes” means a group consisting of all entities which are fully included in consolidated financial statements drawn up in accordance with the International Financial Reporting Standards or the national financial reporting system of a Member State

It will be important for the directors to confidently determine the Irish tax position of their companies and thus, in transposing the rules into Irish law, we recommend that the determination, outside of IFRS/Irish GAAP, be restricted by the actual knowledge of the directors and for formal guidance be provided as to what reasonable inquiries need be made by the directors as to the inclusion of the company’s results in the accounts of another person.

This has been addressed by the UK in their introduction of equivalent rules by means of the concept of “*reasonable to suppose*”. In general terms, such a test does not require knowledge of the actual outcome or position, but a rational, justifiable and credible view of the likely outcome or position. Whilst it will depend on context, this supposition should be based on facts and circumstances that are either already established, or which might reasonably be expected to be ascertained.

In relation to “associated enterprises” determined by “significant influence”, we recommend that regard be had to existing provisions such as the concept of “control” in section 432 TCA 1997, for example

“a person shall be taken to have [significant influence] of a company if such person exercises, or is entitled to acquire, control, whether direct or indirect, over the company’s affairs”.

Through the incorporation of well understood statutory language, greater clarity will exist as to its likely interpretation by fiscal authorities and the courts. In our view, it would be inadvisable to legislate for the meaning of “significant influence” outside the “control” concepts existing in Irish law as it would result in uncertainty for revenue and taxpayers alike. This is consistent with paragraph 13 of the preamble to the directive which states:

"Mismatches that, in particular, result from the hybrid nature of entities should be addressed only where one of the associated enterprises has, at a minimum, effective control over the other associated enterprises."

We believe that the incorporation of well-understood existing statutory language would be of benefit to Revenue and taxpayers.

Pre association transactions

The anti-hybrid rules are targeted at intra-group transactions which have the effect of base erosion or profit shifting. We believe this is consistent with paragraphs 12 and 13 of the preamble to the amending Directive:

"In order to ensure proportionality, it is necessary to address only the cases where there is a substantial risk of avoiding taxation through the use of hybrid mismatches."

"Mismatches that, in particular, result from the hybrid nature of entities should be addressed only where one of the associated enterprises has, at a minimum, effective control over the other associated enterprises."

Mergers and acquisitions may give rise to circumstances where companies become "associated enterprises" which was not contemplated when business contracts or arrangements were established. Any business arrangements which may have been in place prior to the business combination would not have been within the scope of the anti-hybrid rules. It would be an undue burden on taxpayers to have to review all business arrangements between heretofore unconnected parties to establish and document their status under the anti-hybrid rules. It would be unlikely that any material tax adjustment would arise in any event.

We recommend that where companies become associated, the anti-hybrid rules explicitly apply on a prospective basis to avoid an undue administrative burden being imposed on taxpayers. This is consistent with the concept that hybridity only be addressed where, at a minimum, effective control exists between the parties. Where transactions predate control, in our view, the hybrid rules should be carved out to avoid undue administrative burden.

Character of the recipient

The Directive's preamble is noteworthy in setting the context and targeting of the rules. It is important that sufficient weight be given to it in crafting domestic legislation to give effect to it. A key example is included in paragraph 18 dealing ostensibly with payments to a hybrid entity or permanent establishment but which should clearly be of relevance also to non-inclusion scenarios:

The definition of hybrid mismatch should only apply where the mismatch outcome is a result of differences in the rules governing the allocation of payments under the laws of the two jurisdictions and a payment should not give rise to a hybrid mismatch that would have arisen in any event due to the tax exempt status of the payee under the laws of any payee jurisdiction.

Irish tax law contains sufficient protections (the "wholly and exclusively rules", transfer pricing regime etc.) to protect the Irish fiscal base. The anti-hybrid rules intended scope is instances where the characterisation of the payment or an element of hybridity in the constitution of the payee which might not be immediately apparent to fiscal authorities.

We recommend that in transposing the proposed rules into Irish law, a clear unambiguous statement is made to the effect that any tax exempt status of the payee under the laws of any payee jurisdiction is not a factor to be taken into account.

Payment characterisation

The outline of the hybrid rules are based on the concept of "payments" although that encompasses most items which might rank for a deduction rather than expressly requiring a payment. It is vital that proper regard be had to the Directive's paragraph 22 in drafting Irish law:

"Differences in tax outcomes that are solely attributable to differences in the value ascribed to a payment, including through the application of transfer pricing, should not fall within the scope of a hybrid mismatch. Furthermore, as jurisdictions use different tax periods and have different rules for recognising when items of income or expenditure have been derived or incurred, those timing differences should not generally be treated as giving rise to mismatches in tax outcomes."

Take for example a situation where two related parties account in different currencies; one may suffer a foreign exchange loss which is not reflected in the accounts of the other as the transaction was in its functional currency. It is vital, for the rules to have their intended effect, that the non-inclusion or double deduction outcome is referable to a hybrid feature rather than an accounting difference. This will take careful drafting and cannot simply be lifted from the Directive.

Hybrid transfers of financial instruments

The tax treatment of stock lending and repo transactions by Irish financial traders is based on a Revenue Statement of Practice first issued in 1999 and currently set out in 4.6.13 of Revenue's Manual on IT, CGT & CT which is currently under review. These relate to transactions involving investment funds, custodians, banks and securities traders which are important to facilitate a liquid securities market and/or permit investors to maximise returns from their assets.

Recognising that the form of such transactions may bring them within the scope of the anti-hybrid rules, the Directive mandates a carve-out from the provisions for certain on-market transfers of financial instruments by financial traders.

We recommend that, in conjunction with the introduction of the anti-hybrid rules, legislation be brought forth to put the practice set out at 4.6.13 on a statutory footing to provide certainty of treatment for the financial market and ensure the orderly operation of the carve-out.

Express derogations permitted under the Directive

Only limited derogations are provided from the anti-hybrid rules, being

- an extension of time to 1 January 2022 for the application of reverse hybrid mismatches and
- the exclusion, until 1 January 2023, of certain securities in the banking sector which have been issued as "loss absorbing" capital and not as part of a "structured arrangement".

We would advise availing of these derogations as we would expect to be the case for the majority of Member States.

Reverse hybrid mismatches

Reverse hybrid mismatches arise where under the laws of an investor jurisdiction there is a false presumption that the investee jurisdiction regards the investee entity as a taxable person. The Directive proposes a radical change to domestic law in relation to the characterisation of such vehicles which will have the effect of different tax treatments being applied to the same legal form depended on the circumstances of its foreign ownership.

Where one or more associated non-resident entities holding in aggregate a direct or indirect interest in 50 per cent or more of the voting rights, capital interests or rights to a share of profit in a hybrid entity that is incorporated or established in a Member State are located in a jurisdiction or jurisdictions that regard the hybrid entity as a taxable person, the hybrid entity shall be regarded as a resident of that Member State and taxed on its income to the extent that that income is not otherwise taxed under the laws of the Member State or any other jurisdiction.

There is a useful carve out for collective investment vehicles but it is not widely drawn:

...shall not apply to a collective investment vehicle. For the purposes of this Article, "collective investment vehicle" means an investment fund or vehicle that is widely held, holds a diversified portfolio of securities and is subject to investor-protection regulation in the country in which it is established.

This will mean consideration of the types of Irish vehicles which are not subject to Irish tax but which might be assumed to be so regarded under the laws of an investor jurisdiction. This will involve a significant effort given the multitude of potential investor jurisdictions. No doubt recognising that this is an area of significant complexity, the Directive permits a deferred implementation date of 1 January 2022 for introduction of the “reverse hybrid” rules. We recommend that Ireland seeks to avail of this derogation to ensure an orderly introduction of the legislation.

Bearing in mind the wide use of “funds of funds” and similar structures, we recommend that in determining whether a fund is “widely held”, regard not be had simply to the immediate owner of its shares or units but also to the ultimate owner of those shares or units. This, we believe, is consistent with the intent of the directive which is to apply these reverse hybrid rules narrowly to closely held structures in the MNC sector.

The funds industry is responsible for a significant number of high value employment positions across Ireland. It will be vital to ensure that sufficient opportunity be given to consider the effect of any necessary changes, and undertake relevant due diligence.

Loss absorbing

“Loss absorbing” capital essentially involves highly subordinated bonds which serve as an additional capital buffer for financial institutions and provide additional security to depositors and similar retail investors. The quasi-equity features (interest deferral, loss of principal etc.) may result in the income/gains on such instruments benefiting from a favourable tax treatment in some jurisdictions.

In order to ensure that such structures are not used to facilitate tax avoidance, the “structured arrangement” exclusion serves to ensure that the anti-hybrids legislation continues to apply where there is a tax motivation.

“structured arrangement” means an arrangement involving a hybrid mismatch where the mismatch outcome is priced into the terms of the arrangement or an arrangement that has been designed to produce a hybrid mismatch outcome, unless the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch and did not share in the value of the tax benefit resulting from the hybrid mismatch.’

The Directive makes clear that this mismatch is not necessarily objectionable and, in the Irish context, we recommend that Ireland adopt the delayed implementation deadline of 1 January 2023 to permit relevant institutions to review their capital bases and ensure that no problematic capital has been issued.

Imported mismatches

Particular attention will have to be paid to the area of “imported mismatches” which extend the consideration of anti-hybrid rules into third countries and matters outside the direct control or monitoring of the Irish taxpayer. While an analogous rule exists within the regime dealing with securitisation companies (section 110(4A) TCA 1997), the broader application of the anti-hybrids rules means that a greater number of stakeholders will be concerned to achieve clarity.

Tax return filing position

An Irish company is required to file corporation tax returns on the basis that they are correct and complete (s.884(5) TCA 1997) and this poses particular issues in the context of the anti-hybrid rules.

Despite the anti-hybrid rules being limited to transactions between “associated enterprises”, it will not always be possible for an Irish company to have actual knowledge of the treatment of the transaction or entities in the tax returns of the other party, i.e. that information will not be within the possession or power of the directors of the Irish taxpayer in their capacity as such. While it might be expected that inquiries can be made of the associated enterprise, if the legislation is to function effectively, some regard needs to be had to the forming of views by the directors and this needs to be incorporated into primary legislation rather than in guidance notes.

In addressing the analogous position under a similar self-assessment regime, the UK Parliament has incorporated a series of tests based up on the standard of “reasonable to suppose”. This is not expressly defined but guidance provided by HM Revenue & Customs following extensive consultation

with taxpayers, advisers and industry bodies is intended to enable taxpayers to meet their filing obligations.

Impact of third country hybrid characterisation

Hybrid entity is defined in the Directive as

"any entity or arrangement that is regarded as a taxable entity under the laws of one jurisdiction and whose income or expenditure is treated as income or expenditure of one or more other persons under the laws of another jurisdiction"

An example of this might be a UK Limited Liability Partnership which carries the inherent characteristics of a body corporate but which is expressly treated for UK tax purposes as akin to a partnership, i.e. the profits and losses are treated as arising/accruing directly to its members.

In determining the application of anti-hybrid rules to such a situation, it is easy to appreciate that account need be taken of the characterisation of the recipient under UK law. It will be important, in framing legislation, that regard be had solely to the characterisation of the entity in the jurisdiction of its establishment or where it is tax resident be taken into account. No account should be taken of its classification in a third country where that classification does not impact on its taxability in its "home" jurisdiction(s). For example, a non-US subsidiary of a US parent has been the subject of a check-the-box election under the US's entity classification rules, such classification would not generally impact upon its taxation in its jurisdiction or establishment and thus would not be of relevance to its treatment as a hybrid entity. Regard to the third country characterisation should be restricted to the category of imported mismatches.

Interaction with other changes

A move to exempt foreign permanent establishments from the scope of corporation tax would have the effect of simplifying the introduction of the anti-hybrid rules as the scope for hybrid outcomes would be much reduced.

Additionally, Irish based companies operating through multinational branch networks (increasingly including large banks and insurance companies which have or intend to base the headquarters of their pan European operations in Ireland) will have to consider the impact of the particular Irish rules on their business structure and operations. To the extent that such foreign branches were mandatorily exempt, it would simplify the anti-hybrid rules. Where an optional exemption is introduced, a full suite of anti-hybrid rules will be of potential application.

The interaction of anti-hybrid rules with any controlled foreign company rules to be introduced will have to be carefully drafted to ensure that they do not lead to a double charge to tax.

Experience in other jurisdictions

It is worthwhile to reflect on recent experience in the UK as it is a jurisdiction with which we share, as acknowledged extensively in Mr Coffey's report, a significant deal of common history with respect to tax legislation. That common history derives not only from pre 1922 legislation but also a (once) common schedular structure and frequent use of the same or similar statutory language.

When implementing its version of the hybrids rules, notwithstanding the extensive resources of HM Treasury, HMRC, the UK corporate sector and the UK tax adviser community, the rules ultimately enacted and effective from 1 January 2017 continue to be amended in the recent Finance Act. Those rules were initially announced in October 2014 involving a substantial consultation period with initial draft legislation (48 pages) published in December 2015 and heavily revised legislation was published in March 2016 (Finance Bill version) and ultimately was enacted in Finance Act 2016. HMRC's draft guidance notes run to 388 pages.

As can be seen from this timescale, a significant level of effort is required of Revenue, the Department of Finance, advisers and taxpayers. If that was compressed into a single Finance Bill/Budget cycle, it is difficult to see that adequate time would be available for consultation and review; the consequent uncertainty would be detrimental to all parties.

Question 5

Following their adoption by the OECD Council in June 2016, the 2017 OECD Transfer Pricing Guidelines are now the appropriate reference point for transfer pricing rules. Recommendation 6 of the Review of Ireland's Corporation Tax Code states that "Ireland should provide for the application of the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8, 9 and 10 in Irish legislation."

When incorporating the OECD 2017 Transfer Pricing Guidelines, what are the key considerations?

The guidance set out in the OECD's 2015 report on Action 8-10: "Aligning Transfer Pricing Outcomes with Value Creation" requires the development of transfer pricing rules which create transfer pricing outcomes in line with value creation.

The Action 8-10 paper which is 186 pages in length results in a substantial revision of the 2010 OECD Transfer Pricing Guidelines ("the 2010 Guidelines"), in particular revised guidance in chapters I, II, VI, VII and VIII. These material changes are included in the updated 2017 OECD Transfer Pricing Guidelines ("the 2017 Guidelines"). The 2017 Guidelines do not incorporate the forthcoming OECD guidance relating to profit splits or related-party financial transactions.

What is evident is that the 2017 Guidelines represents a substantial revision of the 2010 Guidelines with the introduction of new concepts and not merely further clarification of the existing guidance. On that basis, a number of key considerations need to be given in relation to implementing the 2017 Guidelines in Ireland's domestic transfer pricing law¹⁴.

(i) The timing of the commencement of application of the 2017 Guidelines (Action 8-10) for domestic audit purposes.

The OECD view is that the 2017 Guidelines provide more clarity in relation to the application of the arm's length principle. On that basis many tax authorities are using the Action 8-10 principles in audits for open periods. The 2017 Guidelines are in fact a material change. Chapter VI of the 2010 Guidelines is completely updated with Section B introducing new concepts on the right to receive intangible ("IP") related returns. The right to receive IP related returns is based on the functions performed, assets used and risks assumed in the development, enhancement, maintenance, protection and exploitation ("DEMPE") of intangible assets. In accordance with the changes to Section D1 of Chapter I of the 2017 Guidelines, the assumption of risk relating to DEMPE activities, in particular the management and control of risk with respect to those activities is intended to drive the entitlement to IP related returns.

Once Ireland's domestic transfer pricing rules are updated, clarity in relation to which periods the revised law is effective is critical for companies. Companies would have put in place arrangements with a view to adhering to prevailing transfer pricing principles such as the 2010 Guidelines and it is unreasonable to expect that periods up to the time our domestic transfer pricing law changes should be audited using the principles contained in the 2017 Guidelines.

(ii) Interpretation of Action 8-10 principles for domestic audit / Mutual Agreement Procedure cases

The premise adopted by the OECD as contained in Action 8-10 is that members of a multinational group ("MNE") should be allocated compensation for functions performed, assets used and risks assumed. In the context of intangibles, this approach presumes that important functions related to DEMPE contribute to the creation of the value of IP. In order for the legal owner of an intangible asset to be entitled to the returns from exploitation of the intangible, it must perform key DEMPE functions. It is asserted that legal ownership in isolation does not generate the right to all of the IP related return. The conclusion that can be derived from the OECD view upon an initial review of Action 8-10 is that economic returns in excess of a risk-free return are attributable to people functions

¹⁴ As contained in Part 35A, The Taxes Consolidation Act, 1997 ("TCA 1997").

rather than the provision of capital and any excess economic returns should be allocated to companies who have the personnel performing the functions related to the economic activity.

The arm's length principle seeks to align how related parties conduct business and transact with each other with how independent third parties operate. There are numerous examples in practice that can be cited to demonstrate that the providers of capital receive more than a risk-free (or risk adjusted) return for ownership or participation in an investment. For example, the "2 and 20" arrangements that are typically used to compensate private equity fund managers where a 2 percent charge represents an annual management fee on capital deployed and a 20 percent "carry" over a specific return threshold. It is therefore critical that the role of capital is not diminished when considering the new Action 8-10 principles and the role played by companies performing key DEMPE functions is not overestimated.

With respect to the allocation of returns from exploiting IP, an important aspect to consider is that the final Action 8-10 paper does not seek to recharacterise legal ownership of intangible assets from the legal owner. Rather the purpose of the new guidelines is to ensure that members of a multinational group performing important functions, controlling economically significant risks and contributing assets, should obtain an appropriate return reflecting the value of their contributions.¹⁵ It is clear that it is the legal owner of the IP is the party which must consider how to allocate returns to other group companies to adequately compensate those companies for their contributions. To the extent that the Irish company in the group is not the legal owner of the IP, it should not be responsible to perform such allocations. Typically an Irish company may sub-license IP rights from an IP company to exploit in a particular market. Once the Irish company is adequately compensated for its functions, risks and assets, the license fee payment to the IP owner should be respected for Irish tax purposes.

Upon audit, the principles outlined in the Action 8-10 paper as contained in the 2017 Guidelines need to be considered bearing in mind the position of the Irish group company in the entire value chain and the relevant group company which is responsible for allocating IP related returns under Action 8-10. In many circumstances the arm's length return for the Irish company can be determined by way of one of the five OECD approved methods such as the Transactional Net Margin Method ("TNMM") or Comparable Uncontrolled Price Method ("CUP"). This is particularly the case where no DEMPE functions or control over risks is undertaken in Ireland. This consideration is equally applicable when the Irish Competent Authority is dealing with foreign tax authorities where a transfer pricing adjustment is levied outside Ireland which requires the Mutual Agreement Procedure ("MAP") process to be invoked by a taxpayer to avoid double taxation. The Irish Competent Authority therefore needs to be adequately resourced and trained to ensure that Ireland's tax base is protected where such challenges arise. It is acknowledged that increased resources have been allocated to the Irish Competent Authority recently but continued investment is needed with the expected increase in disputes in the years ahead.

Question 6

The Coffey Review recommends that "domestic transfer pricing legislation should be applied to arrangements the terms of which were agreed before 1 July 2010."

What are the key considerations regarding the implementation of this recommendation?

At the time Ireland's transfer pricing regime was announced, Irish Revenue provide a level of certainty to taxpayers that arrangements the terms of which were in place before 1 July 2010 would fall outside Part 35A TCA 1997. With that certainty provided, many groups took the opportunity before 1 July 2010 to document their arrangements in legal agreements and enter into long-term arrangements with affiliates. No timeline regarding the period in which the "grandfathering" would last was provided by Irish Revenue.

The preparation of transfer pricing documentation and supporting economic analysis is a time consuming costly exercise and many groups, especially smaller groups, took this opportunity to put in place arrangements to mitigate such costs and resources which are generally required to have formal transfer pricing documentation in place. In most instances, the transactions that were subject

¹⁵ Paragraph 32, Chapter VI of 2017 Guidelines.

to “grandfathering” were routine in nature such as low risk service transactions. The removal of “grandfathering” will have a disproportional effect on smaller groups and we recommend that consideration be given to retaining the current provisions until at least 2020. This provides adequate time for companies (both larger multinational groups and smaller groups) to review their transactions that were “grandfathered” and consider what course of action needs to be taken to align to transfer pricing principles.

Whilst it is acknowledged that transactions cannot remain “grandfathered” forever due to the change in the nature of business over time, we recommend that alternatives to full formal transfer pricing documentation be encouraged such as the use of safe harbours¹⁶ and retention of the EU SME exemption¹⁷.

Question 7

The Coffey Review recommends that “consideration should be given to extending transfer pricing rules to SMEs, having regard to whether the concomitant imposition of the administrative burden associated with keeping transfer pricing documentation on SMEs would be proportional to the risks of transfer mispricing occurring.”

If Ireland is to introduce transfer pricing rules for small and medium sized enterprises¹ (SMEs) what are the key considerations? Should all enterprises be subject to transfer pricing rules or should the scope of the rules exclude entities below a certain threshold? If Ireland introduces transfer pricing rules for SMEs what would be the appropriate documentation requirements?

“Creating a business friendly environment for existing small and medium-sized enterprises (SMEs) and potential entrepreneurs is one of the EU’s main objectives. The European Commission is working together with the EU countries on developing SME-friendly policies, monitoring the progress in their implementation and sharing best practices.”¹⁸

The SME sector across Europe accounts for over 99% of overall enterprises in the region and the EU considers SMEs and entrepreneurship as key to ensuring economic growth, innovation, job creation, and social integration in the region.

Ireland’s current transfer pricing laws exempt certain SME entities from the requirement to prepare formal transfer pricing documentation¹⁹. Many other parts of Ireland’s tax acts contain reference to the SME exemption to provide a measure of relief from provisions that may otherwise apply²⁰.

The exemption is an EU based exemption - Commission Recommendation 2003/361/EC. In addition, it is the Commission’s overarching commitment to ensure such groups operate in a business friendly environment. As previously outlined, the preparation of formal transfer pricing documentation is an expensive and time consuming burden for smaller groups. Many of these smaller groups have limited resources to devote to complex transfer pricing issues and the availability of the SME exemption provides certainty to such groups in relation to what resources they need to plan ahead for.

The SME exemption is used by many other EU jurisdictions in their domestic transfer pricing laws to provide a measure of relief from the burden of having to prepare transfer pricing documentation. Countries such as the United Kingdom, Denmark, Estonia, Finland and Hungary base their exemption from applying domestic transfer pricing rules on the EU exemption. Any change in Ireland’s approach to SMEs from a transfer pricing perspective disadvantages smaller groups who are striving to expand

¹⁶ For example (i) OECD Action 10 simplified approach for low value adding services and (ii) EU Joint Transfer Pricing Forum guidelines on low risk, low value adding services.

¹⁷ See Question 7 for further discussion regarding the SME exemption.

¹⁸ http://ec.europa.eu/growth/smes/business-friendly-environment_en

¹⁹ Section 835E, TCA 1997.

²⁰ For example: (i) Key Employee Engagement Programme (“KEEP”) in Finance Act 2017; (ii) Section 769R TCA 1997 in relation to the taxation of knowledge development and (iii) Section 494 TCA 1997 in relation to EIIS and Seed Capital relief qualifying companies.

domestically and internationally and the priority should be to ensure such groups can expand without undue additional burdens such as transfer pricing obligations. With respect to related party transactions that SMEs typically enter into – in the main these are low risk transactions where the risk of mispricing and resultant loss of revenue to the Exchequer are low. The resources required to actively audit the sector are considered disproportionate to potential tax yields. Audit resources from a transfer pricing perspective should be targeted at larger organisations with more complex related party transactions.

To the extent that Ireland's domestic transfer pricing law is amended as a result of this consultation, we would recommend that consideration be given to reducing the compliance burden placed on the SME sector. In paragraphs 32-34 of Action 13 on materiality, the OECD recommends that SMEs should not be required to produce documentation that might be expected from larger enterprises. On that basis, any change in our law should ensure that thresholds are introduced and simplified documentation requirements are in place²¹.

Question 8

The Coffey Review recommends that "consideration should be given to extending domestic transfer pricing rules to non-trading income. There is a strong rationale to extend domestic transfer pricing rules to non-trading income where it would reduce the risk of aggressive tax planning. Consideration should also be given to extending transfer pricing rules to capital transactions, having regard to whether such an extension would improve the existing provisions which already apply arm's length values to companies' transactions relevant to chargeable gains and capital allowances."
In relation to the extension of transfer pricing rules to non-trading income, what are the key considerations of this proposal?

The proposition to extend transfer pricing rules to non-trading transactions brings into focus Ireland's two tier corporation tax rate – 12.5% for trading income and 25% for non-trading passive income. When the Minister for Finance announced the planned move to reduce Ireland's standard corporation tax rate in his Budget speech in December 1997 to 12.5%²² and with the introduction of the 25% rate²³, potential transfer pricing implications of having two rates were not a priority consideration. With the introduction of Ireland's formal transfer pricing regime from 1 January 2011, this issue was dealt with by excluding transactions not taxed at the 12.5% rate of corporation tax from Ireland's transfer pricing documentation requirements.

The extension of transfer pricing laws to include transactions taxed at the 25% rate of corporation tax should not be contemplated until up to date guidance on what constitutes "trading" is provided. This is particularly of relevance for companies operating in the treasury/financial services sector and also for companies that own and exploit intellectual property rights as certainty in relation to the treatment of operations, whether taxed at 12.5% or 25%, is one of the considerations given when establishing operations.

As Ireland's tax law does not formally define the term "trade", over the years Irish Revenue have issued guidance on what activities constitute a trade as well as published trading opinions. In addition, the past practice whereby companies could seek a tax opinion to provide certainty on trading status in relation to an activity was helpful but with changes to this process announced in 2014, reliance has now shifted toward existing published Tax Briefings and eBriefs as well as interpretation of case law to consider whether an activity can be considered as a trading activity.

Section 247 TCA 1997 provides for the deduction of charges on income against total profits of a company. Many Irish groups have existing structures in place where funds are on-lent by one company to a second company. In many cases, the income derived by the first company on lending to the second company and the interest expense of the second company do not fall within the scope

²¹ For example, France new rules since the end of 2016 introduced simplified documentation for small and medium groups with annual turnover or gross assets exceeding €50m. French companies that are part of a multinational group in which one entity has annual turnover or gross assets in excess of €400m are obliged to have available full transfer pricing documentation in the form of Master File and Local File.

²² Introduced on a phased basis with effect from 1 January 2000.

²³ Introduced with effect from 1 January 2000.

of Ireland's transfer pricing laws as presently enacted on the basis the income and associated expense is not a Case I or II trading item. To the extent that Ireland's transfer pricing law is amended to include non-trading income, consideration needs to be given to ensuring that no double taxation arises where an adjustment arises to increase/decrease the interest income/expense to an arm's length amount. Section 835G TCA 1997 as currently enacted, provides a measure of relief for transactions between two domestic Irish companies by allowing a corresponding adjustment to avoid double taxation. Amendments to this section would be required where Ireland's transfer pricing law is amended to include non-trading transactions. In many cases where interest as a charge arises, the lending Irish company or "the first named person" as noted in Section 835G(1)(a) would not be taxed under Case I or II of Schedule D. This subsection would need to be amended to include all cases of Schedule D.

The issue of the continued dual rate corporation tax system at this point should be reviewed. The worldwide average statutory corporation tax rate, measured across 202 tax jurisdictions, is 22.96% with Europe having a regional average of 18.35%²⁴. Whilst Ireland's 25% rate may be considered competitive back in 2000, many governments have over time reduced rates to attract investment and ensure continued economic prosperity of their citizens. On that basis, a detailed review needs to be undertaken at this point to consider the merits of moving to a single rate – 12.5% for all income taxable in Ireland.

In relation to extending Ireland's transfer pricing rules to capital transactions, it is important to point out that Ireland's tax laws already contain provisions dealing with the taxation of capital transactions. Part 19 and 20 of TCA 1997 contain provisions relating to the taxation of chargeable gains. Section 547 TCA 1997 deals with the imposition of market value for actual consideration given or received on the transfer of an asset. Section 548 TCA 1997 contains rules for determining market value of assets. Section 549 TCA 1997 contains anti-avoidance provisions where assets are transferred between connected parties. Such transfers are treated as made at market value. Chapter 5 of Part 38 of TCA 1997 also contains legislative provisions where taxpayers are obliged to provide certain information and returns for the purposes of capital gains tax. Section 913 TCA 1997 provides for a statutory obligation on taxpayers to provide information in relation to the acquisition of assets, details of persons from whom assets were acquired and the price at which assets were acquired.

To the extent Ireland's transfer pricing rules are extended to capital transactions, this will result in an undue burden for taxpayers to deal with separate distinct sections of the Tax Acts with resultant costs and resources needed to deal with satisfying the legislation. Existing law in place dealing with capital assets as outlined above are considered sufficiently robust and the imposition of an additional layer of law deemed complex and burdensome to manage is not recommended.

Question 9

The Coffey Review recommends that *"there should be a specific obligation on Irish taxpayers who are subject to domestic transfer pricing legislation to have available the transfer pricing documentation outlined in Annex I and II of Chapter V of the OECD 2017 Transfer Pricing Guidelines to ensure implementation of BEPS Action 13."*

Since May 2016, Annex I and II of Chapter V of the OECD Transfer Pricing Guidelines contain a list of the information which should be included on the master file and local file respectively. When providing for Annex I and II what will be the effects for business?

The OECD Transfer Pricing Guidelines place an emphasis on the need for reasonableness in the documentation process from both the perspective of taxpayers and tax administrations as well as the desire for greater level of cooperation between the parties in addressing documentation issues in order to avoid excessive documentation compliance burdens while at the same time providing for adequate information to apply the arm's length principle in a reliable manner. The OECD Transfer Pricing Guidelines up to and including the 2010 version did not provide for a list of information and documents to be included in the package. However, even with the absence of this list of information and documents, when adopting transfer pricing rules, many countries have provided guidance in

²⁴ Source: taxfoundation.org - Corporate Income Tax Rates around the World, 2017

relation to the type of information required in a transfer pricing report. Irish Revenue have provided such guidance contained in Tax Briefing 07 of 2010 and reproduced in Revenue eBrief 74 of 2017.

In its Action 13 report "Transfer Pricing Documentation and Country-by-Country Reporting" issued in October 2015, the OECD notes three objectives of transfer pricing documentation:

- 1) To ensure taxpayers can give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns;
- 2) To provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and
- 3) To provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction.

The current transfer pricing documentation requirement in Ireland's domestic transfer pricing law is considered sufficiently robust to satisfy the OECD objectives noted above. The new two-tier Master File / Local File approach as promulgated in Action 13 contains most of the key elements that current robustly prepared documentation should contain. Together with other information in the public domain and held by tax authorities on companies from tax filings, it is considered that the imposition of a new set of documentation rules is unnecessary and adds to the compliance burden and cost for taxpayers to adhere to.

To the extent that Ireland's transfer pricing documentation rules are amended to align with the Action 13 two-tier approach, there are a number of important aspects that need to be considered:

- Ireland's current transfer pricing documentation rules allow for counterparty documentation to satisfy requirements under Part 35A TCA 1997. This provision should be allowed to continue to ensure that where related party transactions involving Irish companies are sufficiently documented by an affiliate company in another jurisdiction to ensure that additional cost and burden is not placed upon the Irish taxpayer.
- Not all transactions that occur between related parties are sufficiently material to require full documentation in a Local File. Paragraph 32-34 of the Action 13 OECD report recommends that individual country transfer pricing documentation requirements should include specific materiality thresholds to account for the size and nature of the local economy, the importance of the multinational group in that economy, the size and nature of local operating entities and overall size and nature of the multinational group. Measures of materiality may be considered in relative terms or in absolute amount terms. It is recommended that Ireland align with this approach to the extent Action 13 two-tier transfer pricing documentation is introduced.
- The OECD recommends that SMEs should not be obliged to produce the amount of documentation that may be expected of larger enterprises. As previously discussed, the current position of SMEs under Ireland's transfer pricing regime should continue. However, to the extent that transfer pricing documentation rules are extended to include SMEs, a reduced compliance burden should be placed on such companies.
- In relation to the frequency of updates to transfer pricing documentation, the OECD recommends that documentation be periodically reviewed to determine whether functional and economic analyses are still up to date and that the Master File and Local File should be updated annually. Consideration should be given to providing more guidance on this to the extent Ireland's documentation rules are updated. It is recommended that for Irish purposes, the Master File and Local File should only be updated to the extent there is a material change in the functional and risk profile of the parties to a transaction. In addition, in order to simplify the compliance burden on taxpayers, benchmarking searches should only be required to be updated every three years and not on an annual basis.

Question 10

With the introduction of CFC rules under Article 7 of ATAD, the Coffey Review recommends that "consideration should be given to whether it is appropriate to move to a territorial corporation tax base in respect of the income of the foreign branches of Irish-resident companies and, in respect of connected companies, the payment of foreign-source dividends."

- ***Would moving to a territorial corporation tax base be a positive development for Ireland? What would be the effects for Ireland of such a move?***

The adoption of an exemption for foreign source dividends and foreign branch profits would be positive for Ireland, and would replace what in practice is an effective exemption (due to extensive unilateral credit relief as well as bilateral measure) with an actual exemption. An effective exemption arises where the foreign tax suffered exceeds Irish tax on certain foreign dividends, which is often the case. A simplified and competitive system for foreign source dividends would be particularly beneficial for Ireland's attractiveness as a holding company location.

European tax law requires tax neutrality in respect of the residence of the shareholder. In order to ensure the neutrality in respect of the source of the dividends, many European Member States switched from the (indirect) credit system to the exemption system.²⁵ Ireland did not make this switch, and ensuring our tax code is compliant with European law has led to the current difficulties with Schedule 24. A participation exemption would be a welcome simplification of our system and would reduce needless complexity.

The principal motivation behind any move towards such a 'territorial' system should be to enhance the competitiveness of Ireland's tax regime. However, if the reforms ultimately unveiled involve unnecessary complexity that would probably dilute these potential gains. The proposed exemption system would be simplest if the exemption for foreign dividend and branch profits included as few exceptions as possible.

Some of the enhancements to competitiveness arising from such a move are listed in the Coffey Review, and include:

- Improving the position of domestic firms vis-à-vis the taxation of outbound foreign direct investment;
- Improving the attractiveness of the corporate tax code vis-à-vis the location of holding companies; and
- Reducing what may be a non-trivial compliance burden on domestic outbound investor.

We would also add the following:

- Ensuring those provisions of Ireland's corporate tax code related to the treatment of foreign source earnings are compliant with EU law in a simplified manner; and
- Bringing Ireland's system in line with the majority of EU states

These measures are addressed in turn below.

- Improving the position of domestic firms vis-à-vis the taxation of outbound foreign direct investment;

Many countries adopt a participation exemption to facilitate greater outbound investment.²⁶ The Netherlands, another small highly globalised economy, recognizes that its domestic consumer base cannot self-sustain growth or support economies of scale. International expansion that "is good for

²⁵ Taxation of cross-border dividends in Europe, European Commission, 2008.

²⁶ <https://taxfoundation.org/global-perspective-territorial-taxation/>

the company...is good for the country," will deliver a "positive impact on profits and employment" for the Netherlands. ²⁷

Schedule 24 already in effect ensures a de facto participation exemption for foreign source dividends in most instances and foreign branch profits by its foreign credit mechanisms including credit pooling etc.

(ii) *Enhance Ireland's competitiveness as a location for holding companies*

Ireland is generally seen as an attractive holding company location. ²⁸ However, as mentioned throughout our response, in an increasingly competitive tax sphere Ireland needs to take steps to ensure it remains an attractive location. The Netherlands, Switzerland and the UK are typical competitors to Ireland as a location for ultimate and intermediate holding companies, and each of these jurisdictions offers a participation exemption for foreign-source dividends. The absence of this relief from Ireland is stark.

Various international country guides routinely note that although Ireland does not offer a participation exemption for dividends it does offer credit relief, etc. such that little or no additional Irish tax should be payable. Such a statement is of course fact pattern specific. However, such detailed provisions make Ireland a prima facie less attractive holding company location, as international investors desire the simplicity, familiarity and clarity that a participation exemption affords.

(iii) *Reduce compliance burdens for those companies already operating in Ireland*

The Coffey report notes that "*in practice Irish resident companies with foreign subsidiaries will not pay tax on the profits of such subsidiaries as companies will utilise the pooling of dividends and timing of dividends payments to 'mix' credits from high tax and low tax jurisdictions, retain earnings overseas for reinvestment rather than face a potential Irish tax liability*". At present, there is a multitude of separate mechanisms of relief depending on the source and nature of the dividend, with the result that the application of such rules is timely and costly for taxpayers. See Appendix 10.1 for an overview of the various reliefs. These complex rules arguably are of little consequence to the Exchequer, given they generate little or no additional revenue. In principle, an exemption system should also be simpler and administratively less burdensome for companies to comply with. ²⁹

(iv) *Ensure compliance with ECJ rulings*

Although the ECJ has confirmed in principle in the first FII GLO case that a credit system for participation dividends conforms to treaty principles, substantial changes to Irish legislation have been required as a result of various court rulings (see for instance both FII Group Litigation Order rulings and Haribo amongst others). ³⁰ It is possible that future court challenges may arise as a result of our continued operation of a credit and deduction system which will require further changes to Irish tax law. In anticipation of any such potential challenges we believe that it is easier to achieve compatibility with an exemption system than it is with a credit system.

(v) *Simplification of Ireland's tax code*

A chief argument to date against a participation exemption for foreign source dividends has been the lack of CFC legislation. The introduction of such legislation presents a natural opportunity to

²⁷ Paul Vlaanderen, Why Exempt Foreign Business Profits?, 25 Tax Notes International 1095, 1099 (Mar. 11, 2002)

²⁸ <https://www.taxjournal.com/articles/comparative-analysis-tax-jurisdictions>

²⁹ Taxation of companies' foreign profits, Institute For Fiscal Studies. 2008

³⁰ Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue Case C-446/04 <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=66367&pageIndex=0&doclang=EN&mode=lst&ir=&occ=first&part=1&cid=744896>

Haribo Lakritzen Hans Riegel BetriebsgmbH (C-436/08) and Österreichische Salinen AG (C-437/08) v Finanzamt Linz

simplify the code, whilst ensuring adequate anti-avoidance protection to protect the tax base. The ATAD suggests a GAAR but Ireland already has a more stringent GAAR than provided in the directive.

(vi) *Bring Ireland in line with the majority of other EU Member States*

The majority of EU Member States offer some form of participation exemption for foreign source dividends, and such dividends would ensure Ireland is on an even playing field with other Member States and is not an unnecessary outlier.³¹

- ***To what extent does Ireland’s ultimate choice of how CFC rules are implemented under Article 7 of ATAD impact on the question of moving to a territorial corporation tax base?***

In broad terms, we recommend companies are provided with the option of an exemption from corporation tax for foreign branch profits, irrespective of the branch territory, subject to certain anti-avoidance measures. This would be subject to a number of critical exceptions. Further analysis is set out below, and we also refer to the HMRC consultation *Corporate Tax Reform part 3B: Foreign branch taxation* which contains greater detail.³²

Opt-in mechanism

- Each Irish-resident company would be able to make an election for all of its foreign branches to be exempt from corporation tax. The profit or loss arising in each foreign branch would then be deducted from the Irish company’s worldwide profit calculation to give a net amount that is subject to corporation tax.
- A branch exemption could prevent relief being given for branch losses, and so the regime should be optional. The election will cover only the company making the election, but would apply to all present and future branches of that company.
- Where a company does not opt-in to such measures, the existing provisions for branch taxation should remain in place as well as appropriate relief for double tax. Although these should be simplified in line with other revisions to Schedule 24.

Transitional rule

- A transitional rule could be applied when a company opts in to the branch exemption regime. Under such a rule a company’s branch profits could become exempt as soon as the tax losses of those branches in the immediately preceding pre-determined number years have been matched by profits (except in the case of “large” losses, as explained below). This could help ensure the reforms are affordable, by preserving the Exchequer’s ability to mitigate the cost of loss relief already given in respect of foreign branches. A pre-determined time limit would help manage compliance burdens.
- When a loss arises in the element of the trade carried on in a foreign branch it is currently relievable against the overall trading profits of the company in Ireland. At the same time the overseas territory may allow the losses to be carried forward to be set against future profits to give relief from local taxation. This gives a lesser amount of foreign tax to be relieved against Irish tax on the branch profits and therefore mitigates the cost to the Exchequer of the Irish loss relief.
- The transitional rule could defer entry into exemption to allow this recovery of value following loss relief to continue. It could look back to see what losses have arisen in foreign branches and whether those losses, taken together in aggregate, have subsequently been matched by foreign branch profits. If not, the commencement of exemption for the company opting in could be delayed until they are.

³¹ <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-holdco-matrix-europe.pdf>

³² *Corporate Tax Reform part 3B: Foreign branch taxation, HMRC, 2011*

A treaty-based approach

- We propose an exemption for branch profits as defined by reference to individual treaties. For branches in territories where there is no treaty, the measure of branch profits could be determined by reference to the OECD model treaty.
- Where an Irish resident company has a foreign branch in a treaty jurisdiction, the treaty requires both states to compute the profits that are attributable to the permanent establishment. The Irish computation provides the measure of corporation tax which limits the company's entitlement to credit against corporation tax in respect of the foreign tax. We propose the branch exemption proceed in the same way, with the existing Irish measure of branch profits representing the exempt amount. Where this measure produces a loss, that loss will not be taken into account in the calculation of the Irish company's profits that are subject to tax.
- This approach ensures that, where it applies, exemption will be a complete replacement for credit relief as a means of relieving double taxation. The approach leaves the initial computation of worldwide profits unchanged, but modifies it by exclusion of the branch profit or loss.

Chargeable gains

- A company opting for a branch exemption should prepare a computation of all its chargeable gains and losses in the same way as it currently does. It will then deduct from the total any gain, or part of a gain, attributable to an exempt branch and add back any loss, or part of a loss, so attributable.
- Some specific chargeable gains rules, for example on transfers of assets to a non-resident company will need to be considered in line with the Exit Tax rules discussed earlier in this consultation response.

Capital attribution

- The treaty approach is based on the separate entity principle.³³ This attributes to a branch the profits that it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing independently. The principle provides for the attribution of such equity and loan capital to the branch as it would reasonably be expected to have if it were a separate entity.
- To provide clarity and limit risk regarding over-attribution to exempt branches some principles should be made explicit, including:
 - Attribution should follow an allocation of the company's free capital / free assets based on a factual and functional analysis that takes into account the whole of the company's business. This will include consideration of the funding structure that would be reasonably expected to support the company's business other than those parts of it carried on through its foreign branches.
 - Where a tax treaty is in place the principle above will be subject to the provisions of the Business Profits article of that treaty.
 - If the amounts of free capital or free assets allotted to a branch are in excess of the arm's length range, the amount attributed to the branch will be adjusted to an amount within the limits set by the arm's length range

Additional points

No restriction for non-treaty jurisdictions

- Exemption should still apply in the case of branches in states with which the Ireland has no double taxation agreement. Profits of such branches will be calculated by applying the updated OECD model treaty. The risk to the Exchequer from the artificial diversion of profits to such states which charge little or no taxation on branch profits could be countered by applying CFC concepts to particular income of a company that is attributed to the branch.

³³ Klaus Vogel on Double Tax Conventions, Art. 7 commentary.

Protection against artificial profit diversion

- Profits should not be exempt to the extent that they would have been subject to a CFC apportionment, had they arisen in a foreign subsidiary or other operation, treated as a CFC by Article 7. This principle ensures that branch exemption should not undermine the protection of the corporation tax base afforded by the CFC regime.

We refer to our response to Question 2 in this regard.

The Coffey review lists the several other key design features where such a 'territorial' system was adopted. These are set out below:³⁴

- (i) *Limits to interest deductibility to prevent the erosion of the home jurisdiction's tax base through deductible interest costs of funding foreign investments that yield only tax-exempt income;*

In practice, under current rules companies that wish to borrow to acquire an interest in companies may do so and claim relief for that interest. They may also claim double tax relief for tax suffered in respect of foreign source dividends or foreign branch profits, which will typically result in no additional Irish tax payable.

GAAR provisions could also serve as protection against abusive transactions. We believe these measures cumulatively should allay certain concerns regarding base erosion associated with such borrowings. We also refer to our response to Question 1 for greater detail.

- (ii) *The maintenance of residual tax on foreign income (i.e. a 95% exemption rather than a 100% exemption);*

We recommend Ireland offer a 100% exemption for foreign-source dividends for competitiveness and simplicity.

We also recommend a full exemption from foreign branch profits be provided. A partial exemption system would mean that current excessively complex provisions would remain in existence, defeating the purpose of introducing any such exemption.

- (iii) *whether a participation exemption should be restricted to a certain set of countries, whether countries with which Ireland has a DTA or by reference to another set of criteria*

To maximise Ireland's competitiveness and ensure a clear and simple code, the participation exemption should apply for all foreign source dividends irrespective of whether they are derived from treaty or non-treaty locations. This broad application would help Ireland become more competitive as a holding company location relative to other nations such as the Netherlands, etc.

- (iv) *whether to provide that Irish companies should hold some minimum ownership in a foreign subsidiary to qualify for an exemption for foreign dividend income*

It would be reasonable to apply a minimum ownership test similar to those which apply in existing legislation, see for instance the 5% holding requirement outlined in TCA 1997 s626B or s831. Further, this would relate to unilateral relief that already exists within Schedule 24 which allows a foreign credit for underlying tax paid by the subsidiary.

- (v) *whether to limit an exemption for branch profits to the trading income of branches*

We believe the exemption for branch profits should be extended to all branch income, irrespective of its nature subject to our comments earlier regarding Ireland's position as a treasury hub. CFC rules could be used to combat any non-genuine arrangements.

³⁴ Review of Ireland's Corporation Tax Code, 2017 pg105

- ***The Coffey review recommends that should Ireland not move to a territorial corporation tax base, Schedule 24 should be simplified on a policy and tax neutral basis. Could such a simplification be an appropriate alternative to a territorial corporation tax base, particularly in the context of specific CFC implementation choices? How might such simplification be achieved?***

At present double taxation relief may be granted under:

- A double taxation agreement
- Domestic legislation, e.g. unilateral credit relief or deduction for foreign taxes

Schedule 24 is the domestic legislation that is utilised to determine relief for foreign tax, by way of credit or deduction. The provisions regarding the pooling of credits and deductions are complicated. We propose a broad overhaul of Schedule 24 in conjunction with the introduction of a foreign branch profits and foreign dividend exemption.

Existing provisions

Broadly, the reliefs available to Irish tax resident companies in respect of tax suffered on foreign source income and gains include relief on:

- The receipt of foreign source dividend income;
- The receipt of foreign source interest income;
- The receipt of foreign source royalty income;
- Foreign branch profits;
- The receipt of foreign source leasing income
- The receipt of proceeds from the sale of shareholding in another company by an Irish tax resident company

When considering the taxation of the above income and capital receipts, there are two general principles which must be considered:

- a) Which tax rate should be applied (in Ireland) to amount received by the Irish tax resident company (12.5%, 25% or 33%); and
- b) What relief is available for any foreign tax suffered on amount received.

Regarding principle b) above (computing any relief available for foreign tax), three general points which must always be considered are:

- (i) The source country of the income (i.e. treaty state or non-treaty state), which will impact whether double tax relief or unilateral relief should be claimed. In the case of interest and royalties for instance, the method of computing relief for unilateral relief is different to that used to compute double tax relief.
- (ii) The nature of the income: trading or non-trading.
- (iii) The pooling provisions, if any, available to utilise any unrelieved foreign tax.

The above represents a complex, timely and costly exercise for Irish taxpayers with arguably little corresponding benefit to the Exchequer. A summary of the main principles regarding the taxation of foreign source income is set out in Appendix 10.1.

Recommendation

We propose a broad overhaul of Schedule 24 such that relief would be available for foreign tax suffered by whatever name. This reform should be carried out in conjunction with the introduction of a foreign branch profits exemption and a foreign source dividend exemption. The aim of such a broad overhaul should be to introduce into Irish legislation a best-in-class regime for the relief from double tax.

Key principles of the reform are set out below:

Irish Measure of Foreign Income ("IMI")

We recommend preservation of the existing provisions within Schedule 24 Para 4 to ensure that the credit allowed for foreign tax suffered does not exceed the Irish corporation tax attributable to "that income". That income being the "relevant income" computed in accordance with the Taxes Acts. Consideration should also be given to reviewing relief for foreign tax on case I profits.

Tax type

Relief should be available in respect of foreign tax suffered, irrespective of the type of the foreign tax. At a time when countries are proposing new taxes, such as the Digital Turnover Tax, Excise Tax/Base Erosion Minimum Tax Amount, etc., it is important that Ireland affords appropriate relief to companies such that they do not suffer double tax.

Income Classification

The simplified regime would distinguish between income sources as follows:

- Income taxable as part of the company's trade (i.e. at the 12.5% rate)
- Income taxable as passive investment income (i.e. at the 25% rate)

We recommend that relieving provisions for tax suffered on income from non-EU / non-DTA sources should be no less favourable than those available for EU / DTA source income e.g. this could be made subject to the EU's recently published listing of non-cooperative jurisdictions.

We recommend that no distinction is made as to the class of income, e.g. interest, royalties etc. as is the case under the current system in determining foreign tax credits, pooling, etc.

The removal of differing treatment depending on income classification in our view is the simplest, most efficient manner in which to overhaul the current system. Differing treatment between the various classifications is a core part of the problem practitioners and clients face with the current system.

Pooling

There should be no restriction on the pooling and carry forward of excess credits, with one exception being a restriction on the pooling and carry forward for 12.5% v 25% source income. A form of value based pooling could be applied in such instances.

Appendix 10.1

Income type	Relief	Pooling/carry-forward excess?
Dividends from EU/ treaty country (subject to minimum % shareholdings)	Credit relief	Yes, subject to conditions
Dividends from treaty country where minimum % in treaty not met but $\geq 5\%$	Credit relief	Yes, subject to conditions
Dividend from EU/treaty countries, <5% shareholding	Exempt	Exempt
Foreign branch income trading & non-trading (EU/treaty)	Credit relief	Yes, subject to conditions
Foreign branch trading income only (non-EU/non-treaty)	Credit relief	Yes, subject to conditions
Interest (trading) income from 25% connected EU/ treaty party	Credit relief – need to apportion income	Pooling allowed but subject to conditions/no carry-forward possible
Interest – DTA Country	Credit relief	No
Interest (non trading) – Non DTA country	Deduction	No
Royalties from EU/treaty country (trade & non trade)	Credit relief – need to apportion income	No
Trade royalties from non EU/treaty countries	Credit relief – need to apportion income	No
Non trade royalties from non-EU/non-treaty countries	Deduction	No
Capital gains from EU/ treaty country/specified territory	Credit relief	No



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