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Review of the Corporation Tax Code – Public Consultation
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
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30 January 2018

Email: ctreview@finance.gov.ie

Dear Sirs

Public Consultation - Review of Ireland's Corporation Tax Code ("the Consultation")

EY welcomes the publication of Mr. Coffey's *Independent Review of Ireland's Corporation Tax Code* ("The Coffey Review") and the opportunity to participate in the Consultation process.

ABOUT EY

EY is a global leader in assurance, tax, transaction and advisory services with over 247,000 people based in over 730 offices in 150 countries. In EY's tax team we have senior professionals who through their work in EY gain a clear understanding of the subtleties of a range of tax issues and of the complexities of how tax systems interface with one another. In our work as tax advisors for large multinationals, domestic PLC's and SME's we assist our clients on a variety of international tax issues. This work includes assisting clients understand the impact of changes to tax law, including change arising from the OECD[1] BEPS[2] process, and helping those clients in meeting their tax compliance obligations around the world. As such, we feel well placed to comment on the relevant issues and welcome the opportunity to participate in the Consultation.

TECHNICAL BACKGROUND AND TIMING ISSUES

The Coffey Review was announced by the Minister for Finance in September 2016 in an effort to ensure the Irish tax system remains fit for purpose in light of the rapidly changing international tax environment. In particular, the Irish Government has committed to the implementation of new international standards arising from the BEPS project led by the OECD. In part these standards are legally binding on Ireland through European Union legislation, namely the Anti -Tax Avoidance Directive ("ATAD") and the Anti-Tax Avoidance Directive 2 ("ATAD 2").

[1] Organisation for Economic Co-operation and Development
[2] Base Erosion and Profit Shifting

J Bollard, N Byrne, B Cassidy, I Collins, S Connellan, S Downey, J Heffernan, R Henson, E McCallion, K McLoughlin, N O'Beirne, C O'Donovan, F O'Neill, D O'Sullivan, J Ryan, Ernst & Young Ireland.

The Irish firm Ernst & Young is a member practice of Ernst & Young Global Limited. It is authorised by the Institute of Chartered Accountants in Ireland to carry on investment business in the Republic of Ireland.

On the announcement of the Coffey Review, the Minister stated:

> *"We need to ensure that Ireland's corporation tax code meets these new standards while remaining competitive as the economy continues to grow."*[3]

Commitments under BEPS, ATAD and ATAD2 present a challenging timeline, both for the Dáil to enact Irish legislative change and taxpayers to respond, as the following deadline dates illustrate:

Deadline date	Content
1 January 2019	Controlled Foreign Corporation ("CFC") rules
Potentially 1 January 2019	Ratification of BEPS multilateral instrument to amend tax treaties
1 January 2020	Exit tax rules
1 January 2020	Hybrid mismatch rules
1 January 2022	Reverse hybrid mismatch rules
31 December 2020	Transfer pricing changes under BEPS Actions 8, through 10
1 January 2024	Interest expense limitation rules

This represents a substantial program of work in a relatively short period of time for policymakers, Revenue officials, legislators and businesses.

Recommendation: EY strongly recommends that separate consultation processes are pursued on each of the foregoing issues noting the different timeframes involved. This will facilitate a more effective dialogue among stakeholders and thus a legislative outcome aligned with policy objectives, including maintaining competitiveness in a manner which offers stability and certainty, which takes account of the views of business.

OTHER GENERAL POINTS

In October 2013, the Minister for Finance set out Ireland's International Tax Strategy ("the Strategy"), including an International Tax Charter ("the Charter"). Each year since then, the Government has published updates of actions taken in pursuit of the Strategy and Charter. Notably, the Charter states:

> *"Ireland is committed to maintaining an open, transparent, stable, and competitive corporate tax regime.*
>
> *We achieve this by:*
> - *Maintaining a rate of 12.5% on active trading income and 25% on passive non-trading income for all domestic and international businesses;*
> - *Considering any proposed changes to our tax legislation in terms of their impact on sustainable jobs and economic growth."*

[3] Government Motion before Dáil Eireann - Statement by Minister on 7 September 2016

It is important that Ireland maintains its image as having a stable and competitive tax regime in a time of rapid change. The manner in which Ireland implements ATAD and addresses the other matters within the Consultation will have an important bearing on the perception of our regime and commitment to stated policy objectives.

NEED FOR TIMELY CONSULTATION

The Coffey Review recommends[4] pro-active consultation in respect of the proposed measures which are to be implemented in the near term.

Recommendation: EY suggests that each additional measure which is to be introduced should be subject to a detailed consultation process. As part of this consultation process we suggest consideration is given to a phased approach where firstly, policy considerations are debated and secondly, indicative wording for draft legislation and guidance should be shared within an adequate timeframe so as to obtain input from relevant stakeholders. This will:

- better inform policy making
- reduce uncertainty regarding the proposed changes, and
- allow preparations to begin aiding compliance with the new rules.

Due to the complexity of the issues it is not, in our view, appropriate to telescope the consideration of legislative wording into the usual time-frame for scrutiny of a Finance Bill.

STABILITY AND CERTAINTY

EY welcomes the Irish Government's stated commitments to certainty and competitiveness as outlined above. Of course, there are other factors besides BEPS and ATAD contributing to rapid change in the international tax and economic environment. The results of Brexit remain unpredictable. In US tax reform we see the most substantial change to the US corporate income tax code in decades, resulting in a drop in the headline US corporation tax rate from 35% to 21% and a move to a territorial system of tax.

COMPLIANCE COSTS

New rules need to be enforced. This means that the Revenue Commissioners need to have appropriate resources, and taxpayers will have obligations to provide information. A balance is required here, as adding to taxpayers' administrative obligations has an impact on competitiveness.

ATAD adoption in conjunction with the implementation of the vast majority of recommendations as outlined in the Coffey Review are all measures which place an increased burden on taxpayers

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[4] Recommendation 16 in general, and also with specific reference to recommendations covering transfer pricing rules and implementation of ATAD,

operating in Ireland, through increased tax costs and compliance obligations. As such, we need to ensure that Ireland remains competitive and responsive to changing tax landscapes. It follows that new administrative obligations placed on taxpayers should be commensurate with their purpose.

RESPONSES TO CONSULTATION QUESTIONS

The following is an executive summary of our detailed responses and recommendations, set out in the Appendix.

General

We welcome the Irish Government's commitment that the implementation of these actions will not occur before the relevant deadline dates so as to provide policymakers, legislators, Revenue Commissioners and taxpayers with sufficient time to prepare for such updates and also allow time for consultations to be undertaken.

We see no compelling Irish tax policy reason to implement rules which go beyond the minimum standard set down in the directives. We note this is consistent with Ireland's overall position on the OECD BEPS recommendations.

Interest Deduction Limitation Rules

EY notes the Irish Government's position that these rules will not be introduced until 1 January 2024. Ireland already has very strong anti-abuse rules guarding against the inappropriate creation of interest deductions.

The time between now and 2024 should be used wisely to consider the extent to which such existing rules should be retained after 2024, in keeping with the policy objectives of stability and certainty for business and the overall competitiveness of our regime including guarding against unintended double taxation.

We have set out in our detailed commentary a number of important technical issues and policy choices which should be addressed through a detailed consultation process including consideration of the introduction of a notional interest deduction regime.

General Anti-Tax Avoidance Regulations **("GAAR")**

EY notes the Irish Government's position that Ireland's current GAAR is sufficient to meet the minimum standard as outlined in Article 6 of ATAD.

CFC/Territorial System

In line with our recommendation to transition to a territorial based system of tax, EY recommends that the CFC rule be adopted in a manner that is consistent with creating an efficient holding company regime that is simple and does not create unnecessary uncertainty or loss of investor confidence, whilst respecting the text and spirit of ATAD.

The introduction of CFC rules is probably the most significant change to the Irish tax system for tax on multinational profits that has taken place in decades. We believe that consultation on this area should be intensified so as to:

- Develop a clear articulation of Ireland's policy priorities
- Identify what choices amongst the options in ATAD best addresses those priorities
- Provide stakeholders with draft legislation with a view to early identification of issues that may create uncertain or unintended results

At this point we believe it is too early to reduce the thought process to a simple choice between Options A and B[5]. All implications need to be considered so that compliance costs for all parties are kept to a minimum and whatever new rule is enacted does not drive unintended consequences (e.g. creating a disincentive to locate certain functions in Ireland). In this regard it will be important to include a suitable substance-based carve-out in any regime. We recommend that consideration is given to the adoption of a white list which includes all EU partners and other significant trading partners.

We note that ATAD appears to allow for the introduction of both Options A and B and therefore adopting such an approach into Irish law may best fit Ireland's overall policy objectives.

In the Appendix we have drawn attention to various technical matters which require detailed consideration and made a number of recommendations on policy choices available within ATAD. In particular, it will be important to legislate against the possibility of double (or higher) taxation as a result of CFC provisions and the manner in which they interact with the wider tax system.

We believe there is merit in considering Ireland's holding company regime more broadly and whether Ireland's current regime already effectively drives certain activity offshore.[6]

Exit Tax

The amendments required to implement the minimum standards of Article 5 of ATAD into Irish tax legislation will fundamentally impact the current exit tax provisions to reduce flexibility for taxpayers. Therefore it is appropriate to consider whether complementary measures should be introduced which seek to limit the negative impact on competiveness.

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[5] **Options A and B refer to the CFC rule set down in Article 7.2(a) and Article 7.2(b) of ATAD respectively.**

[6] EY will in the near future make a separate submission on such matters, including 'net investment hedging'

In this regard, EY recommends that the rate of Irish tax on the outbound transfer of assets in an exit tax scenario is 12.5%, where the assets which are transferred are trading assets. Indeed, we believe there is considerable merit in this approach outside of the exit tax scenario.

On a transfer of assets to Ireland in circumstances where an EU Member State has applied an exit tax, ATAD provides that the tax basis of these assets should be equal to their market value at the time of transfer. This will require adaptation of the existing 'expenditure incurred' rule in capital gains and capital allowances legislation. Further, EY recommends that this deeming of tax basis should apply to business establishments originating in both EU and non-EU locations.

Anti-hybrid rules

These rules are going to be complex in drafting and more so in their application. The vast majority of Irish taxpayers will not recognise their structures as involving hybrid mismatches, yet imprecisely drafted legislation could still result in these rules biting in unexpected or uncertain ways. Our detailed commentary draws out a number of specific challenges in this regard.

We recommend timely consultation involving a phased engagement on policy objectives followed by the publication of draft legislation, with a view to ensuring the design principles and guidance set out in BEPS Action 2 are fully integrated as part of the drafting process.

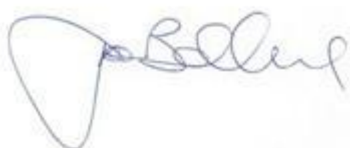
Transfer Pricing

The adoption of the new transfer pricing guidance will increase complexity, uncertainty and the compliance burden for companies, and therefore we recommend that care is taken to minimise these negative impacts, perhaps through the permitted flexibility on implementation date.

This should include sufficient time for companies to prepare for any new requirements. Furthermore, (as we set out in detail under Question 5 below) with respect to the adoption of Actions 8-10, we recommend very clear guidance and clarification by Revenue to provide certainty as to how certain intercompany payments will be treated for Irish tax purposes.

Once you have considered the above we would be happy to discuss same at your convenience. Please contact Joe Bollard (Head of International Tax Services), Dan McSwiney (Head of Transfer Pricing Services) or Kevin McLoughlin (Head of Tax) if you have any questions.

Yours faithfully



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APPENDIX

DETAILED RESPONSES TO CONSULTATION QUESTIONS

THE IMPLEMENTATION OF THE ANTI-TAX AVOIDANCE DIRECTIVE (ATAD)

General

EY agrees with the recommendation of the Coffey Review that Ireland should have regard to BEPS Actions 2, 3 and 4 in implementing ATAD and ATAD2. To the extent that ATAD and ATAD2 are uncertain, we see no compelling Irish tax policy reason to go beyond the recommendations of the BEPS Actions, whilst respecting the spirit of the Directives.

Indeed the Recitals to ATAD and ATAD2 effectively approve this approach[7]. There are a number of other helpful pieces of guidance in the Recitals which are not repeated in the Articles of the Directives, including:

- Confirmation that ATAD is not intended to give rise to double taxation, and that legislation should contain appropriate reliefs (e.g. through credits or deductions) to prevent it[8]
- Exclusions from exit taxes so as to make the compatible with existing EU law, e.g. for transactions between parent and subsidiary[9]
- CFC rule design may pursue a number of possible policy objectives, including a policy to target income which has been artificially diverted from Ireland[10]. In such a case it would then be "critical that [Ireland] 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 [Ireland]."[11]
- CFC rule design may target income categories[12] should contain a substance carve-out exception for all EU residents which Member States can extend to third country residents if they so choose.[13]
- CFC rules can use 'white lists', 'grey lists' or 'black lists'. Third countries may be included in such lists "compiled based on criteria set out in [ATAD]" (although it is unclear what criteria this refers to). EU countries may be included only in white lists compiled on a similar basis.
- Several pages of detailed discussion and guidance on the intended results of the anti-hybrid rules.[14]

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[7] See in particular Recital (27) of ATAD2
[8] ATAD Recital (5)
[9] ATAD Recital (10)
[10] This is a reference to the so-called Option B CFC rule set out in Article 7.2(b)
[11] ATAD Recital (12)
[12] This is a reference to the so-called Option A CFC rule set out in Article 7.2(a)
[13] ATAD Recital (12). See also the decision in Cadbury Schweppes etc Case C-196/04
[14] ATAD2 Recitals (7) to (29)

Article 4 of ATAD sets out interest limitation rules and provides for, inter alia, rules which will restrict the amount of interest that companies can claim as a tax deductible expense. Ireland has informed the European Commission that, as our existing interest limitation rules are at least equally effective to the rules contained in the Directive, we will be availing of the derogation provided in Article 11(6) of the Directive and are therefore not required to implement these rules until 1 January 2024.

General comments

From the effective date of Article 4, taxpayers will be limited in the amount of net interest expense available to set against their taxable profits. The cap is expressed as "30% x EBITDA", but it is clear that for this purpose "EBITDA" is effectively taxable income (and not accounting income) adjusted for interest, tax depreciation and tax.

Crucially, this rule will be applied **after** application of other tests for interest deductibility. The subsidiaries of Irish multinationals are likely to experience the effect of this rule in other countries over the coming years, and this has considerable potential to create double taxation. The experiences of these companies will be useful in framing Irish policy choices in due course.

In summary the policy choices specifically mentioned in Article 4 which require careful consideration in an Irish context are:

- how to deal with group situations
- *de minimis* rules for borrowing costs less than €3 million and stand-alone entities
- grandfathering
- exclusions for long-term public infrastructure projects[15]
- which form of escape clause to apply, either by (a) comparing the company's equity/asset ratio to that of the consolidated group, or (b) comparing the company's interest expense/EBITDA ratio to that of the consolidated group
- which carry forward rule to allow
- whether to allow an exclusion for financial undertakings
- whether to allow the use of financial statements prepared under non-IFRS accounting standards (e.g. US GAAP).

Timing

EY welcomes the Irish Government's position that the interest limitation rules as set out in Article 4 of ATAD do not have to be implemented until 1 January 2024 by virtue of the derogation provided for in Article 11(6).

Recommendations

In the context of delivering tax certainty for business and maintaining the competitiveness of Ireland's corporation tax offering for investors, EY recommends that the interest limitation rules are not

[15] It may be appropriate to expressly state that certain types of projects will fall within that definition aligned with national capital expenditure plans and other private investment in the national interest.

effective before 1 January 2024 (i.e. that there is no early entry into force) consistent with the Irish Government's position on this. Such an implementation timeframe has the following advantages:

- It enables the Irish Government to better focus its resources on nearer term BEPS/ATAD and ATAD 2 related implementation commitments/deadlines
- It allows affected taxpayers, who have made long-term investments on the strength of the existing rules, to plan for an orderly transition
- It allows all stakeholders to learn from the experience of other countries in the course of implementing similar rules.

EY further recommends that prior to 2024 a separate consultation process should be carried out with all relevant stakeholders regarding the content of legislation to implement these rules and to simplify/modernize the existing body of rules regarding interest deductions. As part of this consultation process EY recommends that indicative draft legislation and guidance are shared with these stakeholders outside of the normal period for scrutiny of a Finance Bill.

Some of the key issues EY recommends should be considered as part of this consultation are:

- The interaction of Ireland's adoption of Article 4 with existing targeted anti-avoidance legislation aimed at preventing erosion of the Irish tax base,
- Potential insertion of a notional interest deduction into Irish tax legislation,
- Opportunity for modernization of Ireland's existing interest regime (e.g. rationalisation of interest deduction rules as included in sections 130, 247, 291A and 840A TCA 1997), and
- Maximum flexibility as regards optionality within Article 4 (grandfathering/exemption clauses/exclusions).

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?

We note the Irish Government's position that Ireland's current GAAR rule as provided for in Part 33 TCA 1997 sufficiently meets the minimum standard as required under Article 6 of ATAD and therefore no amendment should be required. EY notes this position, noting that Ireland's current GAAR legislation is expansive and has been the subject of clarification by the Supreme Court.

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?

Importance

The introduction of CFC rules is likely the most significant reform of the corporate tax system affecting Irish-based multinationals since 1999, and certainly since 2003.

The implications of this change for Ireland's competitiveness (both outbound and inbound) must not be underestimated. A policy that is intended to achieve behavioural change can have unforeseen consequences, so legislators must have a clear understanding of the incentives and disincentives they may inadvertently create or change.

Irish-based multinationals have for many years found the credit system for taxing foreign dividends cumbersome and a change to a territorial system (which is now the case for almost every country in the developed world) has always been resisted as Ireland did not have a CFC regime.

Clearly, therefore policy priorities will include:

- Meet minimum standards
- Minimise any adverse impact on competitiveness (for investment in capital or people functions)
- Coherence of Irish tax system in the event of a transition to territoriality (e.g. allowing both regimes to operate side-by-side for a transition period)

Businesses will incur administrative costs in complying with legislation. The Revenue Commissioners will have new responsibilities in administering and enforcing the legislation. Well-informed policy choices and careful drafting offer opportunities to control these costs whilst meeting other policy objectives.

Policy stance

It is important to think of the introduction of CFC rules as a response to the concerns raised through the BEPS process. However, individual countries are entitled to view those concerns through the lens of their own policy priorities. Ireland's corporate tax system has traditionally sought to tax only the profits from activities carried on in Ireland. It has allowed Irish MNCs to have low-taxed passive subsidiaries, whilst limiting the use of such entities to erode the Irish tax base. Policymakers have also consistently stated that the credit system for taxing dividends from foreign subsidiaries needed to be maintained as a back-stop against the lack of a CFC rule.

All of this suggests that, in spite of the formal existence of a credit system, Ireland has never been a country with a 'true' worldwide system, pursuing a policy objective of 'capital export neutrality' as was the case with the United States prior to the recent set of reforms. Rather it is a quasi-territorial

system, primarily concerned with taxing activities that take place within its own borders and directly involving its own residents.[16]

The Recitals to ATAD recognize that the detailed design of CFC rules is a matter for Member States, having regard to their respective policy priorities, but within the parameters set by ATAD. The main variable here is how the policy stance should play on the amount of CFC income to be included in the taxable income of the Irish parent, and ATAD offers two main sets of rules in this regard, referred to herein as Option A (the 'categories of income' approach) [17] and Option B (targeting the separation of CFC income from SPFs in the parent country) [18].

We recommend that Ireland's policy stance should move in the direction of territoriality. It does not necessarily follow that Option B should be the preferred approach. We are aware of a number of countries with territorial systems that have or plan to introduce Option A-compliant CFC regimes.

Critical, in our view, is an ability to design the rules in such a way that there is a suitable substance carve-out so that only 'wholly artificial' arrangements are subject to charge. It is presumed that ATAD does not intend to set a different standard for the substance tests involved in Option A ('substantive economic activities') and Option B (kick out for 'non-genuine arrangements'). In particular we note that ATAD cannot, and explicitly does not, attempt to disturb the fundamental EU freedoms, including the freedom of establishment, which has been expressed as follows:

> *"It is … apparent from case-law that the mere fact that a resident company establishes a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty …*
>
> *"On the other hand a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned."*[19]

Timing

As previously stated, it is important that the introduction of CFC rules is aligned with Ireland's international tax strategy and provides stability and certainty to stakeholders whilst maintaining Ireland's competitiveness. This is of particular importance given tax reform around the world as a result of BEPS, ATAD and ATAD 2 (in Europe) and more recently US tax reform which has seen the US move from a worldwide to a territorial tax system. As the due date for CFC rules under ATAD is 1 January 2019, this is the most urgent ATAD action and attention should be focused on these rules along with the introduction of a territorial system (Question 10) with all other actions dealt with at a later date depending on their due date for implementation.

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[16] See for example the discussion in *Ireland's International Tax Strategy* [Department of Finance, October 2013] at p.6. "All companies operating in Ireland are fully chargeable to corporation tax at the 12.5% rate on the trading profits earned from their Irish operations."

[17] See Article 7, paragraph 2(a) of ATAD

[18] See Article 7, paragraph 2(b) of ATAD

[19] *Cadbury Schweppes plc vs Commissioners of Inland Revenue* CJEU Case C-196/04

There is a lot of detail and complexity in the drafting of CFC rules. As stated earlier, we recommend that consideration is given to a phased approach where firstly, policy considerations are debated and secondly draft legislation and guidance is issued for review in advance of the formal legislative process.

In particular, we note that the timetable set out in ATAD will require CFC legislation to be effective from 1 January 2019. We strongly recommend that this written phase of the consultation process be supplemented by ongoing engagement with stakeholders with a range of views so as to inform an appropriate measured policy design. Time is short and the dialogue needs to begin in time that indicative wording for legislation can be made available well in advance of summer 2018 and in turn taxpayers and professionals have the opportunity to prepare for the changed environment.

Option A and Option B together

Article 7.2 requires an Irish taxpayer that is the parent of a CFC to include in its taxable income an amount computed by reference to either Option A or Option B.

Article 7 does not explicitly require Member States to include only one of the Options in its legislation. We understand that Poland for example has CFC rules which contain elements of both. Recital (12) states that:

> *"Depending on the policy priorities of [the taxpayer's State of residence], CFC rules may target an entire low-taxed subsidiary, specific categories of income or be limited to income which has artificially been diverted to the subsidiary."*

We believe that serious consideration should be given to the possibility that Ireland's policy priorities may best be pursued by allowing taxpayers some form of choice between Option A and Option B so as to:

- Achieve the minimum standard while acknowledging the diverse profiles of MNCs operating in Ireland which typically fulfil important roles in global supply chains (regardless of whether the company is ultimately Irish parented or an FDI investor)
- Manage against creating an incentive to relocate activity offshore with consequential adverse implications for the Exchequer both immediate and longer term

It may be appropriate for an MNC to be required to be consistent in its choice with an ability to switch Options as facts change (e.g. business change on M&A etc).

Option A or Option B

If the conclusion is that it is necessary or appropriate to enact only one of Option A or B, EY recommends that legislative choice between these Options be the subject of further extensive engagement with stakeholders.

We have set out below some design issues for consideration that are specific to each of the Options and issues that are common to both.

Under either Option, the 'gateway test' to determine whether a foreign company is a CFC is the same. It involves a two-step process:

1. Prepare a computation of the foreign company's notional taxable profits under Irish tax rules to determine how much tax it would pay in Ireland if it were an Irish tax resident
2. The figure computed at 1 is compared with the actual corporate tax paid on its profits by the company. If the actual tax paid is less than 50% of the notional Irish tax then the company is a CFC.

In passing we note that the comparison necessarily involves taking a view as to which Irish tax rate – 12.5%, 25% or 33% - applies to the profits in question.

It is useful also to consider the main points in Recital (12):

a. Depending on the policy priorities of the Member State, the CFC rule can target:
    i. An entire low-taxed subsidiary
    ii. Specific categories of income
    iii. Income artificially diverted to the subsidiary
b. The response must be proportionate, therefore a rule on artificially diverted income must precisely target situations where most of the decision-making functions related to the income are in the relevant parent company jurisdiction
c. It is acceptable to limit compliance and administrative costs by entities with low profits or low profit-margins
d. CFC rules must extend to the profits of exempt branches (not currently relevant for Ireland, but potentially relevant if Ireland's territoriality rule were to change)
e. It is permissible to have more stringent rules by using a lower control threshold or a higher percentage of notional home country tax
f. The fundamental freedoms originally set down in the Treaty of Rome must be observed, so a 'substance carve-out' is required for Option A (it is unclear why Option B is not specifically mentioned here) cases involve European Union subsidiaries
g. Member States can choose to extend the carve-out to third countries
h. Cooperation between taxpayers and tax administrations is required to establish the relevant facts to allow the carve-out
i. White, grey or black lists can be used for third countries, compiled based on criteria in ATAD (although these are not apparent). For EU countries, only white lists can be used, compiled on a similar basis.

The substance carve-out is consistent with, and complementary to, Ireland's historic tax policy. Ireland has never sought to be a location for passive income, and has therefore resisted situations where active trading income in Ireland is subject to parent country CFC rules. EU law, and in particular the *Cadbury Schweppes* case, has been helpful in supporting this position. It is therefore appropriate for Ireland to apply the mirror of this treatment in dealing with subsidiaries of Irish multinationals, and to have a broad-based substance carve-out for all subsidiary locations.

EY recommends that Ireland should introduce a white list covering all EU Member States and key trading partners.

Design issues under Option A

Having determined that a foreign company is a CFC the amount of CFC profits to be actually charged to Irish tax is "the undistributed income of the entity which is derived from the following categories":

i. Interest or any other income generated from 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.

Many stakeholders instinctively feel comfortable with the concept that the amount of CFC profits is to be made by reference to Irish tax rules, with which they are already familiar. This is understandable, but there are two main sets of complications which may not be readily apparent. First, the application of existing Irish tax rules may be administratively onerous or have unpredictable results (particularly for capital gains on assets – including cash – acquired in foreign currency, and passive income). Second, some specific and potentially complex rules will need to be written into Irish legislation in order to adapt it for computation of CFC profits and prevent double taxation as referred to in Recital (5) of ATAD.

Some specific examples are set out below:

- Only 'undistributed income' is brought into charge under Option A, and income in this context is net of expenses. Rules will be required to allocate expenses and distributions against the categories of gross income
- Rules will be required to determine how quickly income must be distributed in order to escape being treated as undistributed
- Rules will be required to determine the tax treatment of income that is in fact distributed either so as to escape a CFC charge or having suffered a CFC charge (Article 8.5 deals with only the latter case, and this rather simplistically by supposing the distribution is direct to the ultimate parent)
- The entity may be subject to corporate law or other legal restrictions on distributing its profits
- Rules will be required to provide relief for third country withholding taxes borne by a CFC, which will be particularly complex for withholding taxes on interest and royalties
- Rules will be required to allow for the exclusion of profits arising on the sale of the business of a foreign branch (see Article 8.6)
- Some adaptation of the existing double tax relief rules will be required to give credit for the tax actually paid against the Irish tax on the CFC charge
- Consideration is required to address the treatment of a CFC charge levied by an intermediate holding jurisdiction

- It will be necessary to work with accounts prepared under different accounting frameworks and perhaps in different languages in order to be able to make the individual judgments that need to be made on each item appearing in the accounts
- The greater the volume of transactions in the foreign entity, the great the volume of 'micro-judgements' required to prepare (or audit) the return
- It may not be straightforward to determine which Irish tax rate applies
- Application of Ireland's capital gains regime to foreign currency transactions, without the ability to default to use of the entity's functional currency would effectively result in computation of gains and losses by reference to foreign exchange movements against the euro, not bearing any relation to the entity's true economic position. For a non-trading CFC this would in principle extend to every movement in and out of the entity's bank account.
- There is potential for multiple layers of taxation where a CFC makes a payment that would not be deductible under Irish tax principles[20] but whose receipt is taxable in another jurisdiction, including Ireland. As Recital (5) makes clear, ATAD is not intended to create such double taxation, so a special rule would need to be written to cater for it.
- Some means would need to be found of addressing dividends paid between foreign subsidiaries, including the allocation of foreign tax credits. This will be particularly acute for dividends paid within the same country, particularly having regard to group treatment of losses etc.
- A variety of pieces of Irish legislation appear unsuitable for application to a foreign subsidiary (e.g distribution and franked investment income provisions), or specifically limit their application to Irish residents, and detailed review of these would need to be undertaken as part of the legislative process
- Legislators for future changes in Irish tax law may need to address the situation that arises where the new law needs to be applied for CFC purposes
- The terms used in ATAD to describe the categories of income will need to be defined for Irish tax purposes, notably we recommend clarity on the following items:
    - Confirm that "royalties" should not extend to intellectual property embedded in goods or services
    - "Income from disposal of shares" appears to be intended to include items that would be classified as capital gains under Irish tax law, but it is not clear whether this extends to, for example options and convertible loans (which might qualify for exemption under s626C if held by an Irish resident)

Option A provides for an exclusion for entities that carry on "substantive economic activities". EY recommends clarity in the form of unambiguous guidance as to what constitutes "substantive economic activities" from a CFC perspective, given there is no existing well-understood definition of this term. Possible starting points for such guidance include the *Cadbury Schweppes* case, and Irish Revenue's existing body of guidance on what constitutes 'trading' for Irish tax purposes. Arguably there is minimal difference between the two standards, and the latter could be used as a starting point.

Member States can choose whether the exclusion (for CFCs that carry on substantive economic activities) should apply to all CFCs, or only those resident/situated in an EU/EEA territory. EY

[20] For example it might be very difficult for a foreign company to meet the detailed conditions of s247 – even leaving side the point that s243(6) prevents a non-resident from obtaining such a deduction

recommends that if Option A is to be adopted, it would be inappropriate and inconsistent with wider Government policy to adversely discriminate against investment in non EU/EEA markets.

In summary, the following items would need to be addressed if Option A were to be pursued:

- Adaptation of Ireland's existing rules on capital gains, allowing companies *inter alia* to compute capital gains in functional currency;
- Inventory of other items in Ireland's corporate tax code that require adaptation when applied to a CFC so as to minimize administrative complexity for taxpayers and Revenue alike;
- A rule allowing for an exemption on receipt of 'previously taxed income' (i.e. amounts that have already been subject to Irish tax through a transfer pricing adjustment, the CFC regime before being distributed either to an Irish parent or another CFC), tax paid by the CFC including withholding tax suffered
- The chargeable profits should be limited to those which the CFC is permitted to distribute under the applicable corporate law.

Design issues under Option B

Under Option B the amount of income of a CFC to be included in the Irish parent's taxable profits is:

> *"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.*
>
> *For the purposes of this point, an arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity 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."*[21]

And also stated as:

> *"amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company. The attribution of controlled foreign company income shall be calculated in accordance with the arm's length principle."*[22]

Adherence to the arm's length principle indicates a broad consistency with the wider BEPS Actions' objective of better alignment of profits with the substance and people that generate those profits. The use of the arm's length principle also means that the computation is by reference to criteria that are well understood internationally, as distinct from the specific technical rules of individual jurisdictions.

Implicitly, therefore, the people functions are already rewarded by application of transfer pricing rules before the need to apply CFC. This model also seeks to avoid multiple layers of CFC charges by

[21] Article 7.2(b)
[22] Article 8.2

finding the SPFs in a single location, although that is only successful if Option B is applied by the relevant intermediate holding jurisdiction(s) as well as the parent.

Option B is stated as being more consistent with a tax regime that applies the territoriality principle, although as previously stated we do not think this necessarily follows.

Again, Option B comes with its own set of issues to be faced if it were to be implemented into Irish law, notably:

- There is a potential attraction for taxpayers who are willing to simply compute their chargeable profits under Option B without applying Irish tax rules, but the 'gateway test' does not appear to permit this. Perhaps taxpayers could be allowed to elect for particular subsidiaries to be treated as CFCs so as to avoid the need to apply Irish tax rules where the actual CFC charge does not in fact require such computation
- Issues with distributed and undistributed profits as with Option A
- Allocation of taxes paid to profits computed by reference to the arm's length principle, which is itself subject to potential uncertainty in its application in Option B, but otherwise similar double taxation issues as Option A
- The connection to SPFs in Ireland may imply that the income should be taxed at 12.5%.
- It may be conceptually difficult to apply this approach to capital gains. The use of a white list as referenced earlier may be a suitable means of practically dealing with this complexity in the majority of cases.

We believe that some stakeholders may feel more comfortable with Option B if it specifically included an exclusion for "substantive economic activities". For the reasons we have alluded to, it may technically not be necessary, but equally we do not see how it can be permissible for Option B to infringe on the fundamental freedoms under EU law.

Design issues common to both Options

Conceptual framework

A decision is required as to the particular mechanism that brings the CFC income into the charge to Irish tax, whether by way of deemed dividend, deeming the income to be income of the Irish parent, or some other means. A careful choice on this point may assist in solving some of the other drafting complexities identified above. We note that BEPS Action 3 contains a helpful discussion of the issues arising.

Compliance Costs

It is very important that the introduction of CFC rules involves a proportionate administrative burden and compliance cost on companies within the rules. As Ireland's, corporation tax regime is reported on a self-assessment basis with the burden on the taxpayer to file a true and correct return, the CFC requirements should, for example, be dealt with through the annual tax return without the need for separate testing events during the year.

Some thought is required as to the disclosures that may be required as to CFC on the tax return of the Irish taxpayer, and such disclosures should be limited to those necessary to give proper effect to the regime. In this regard, there is a particular issue that arises in connection with Option B, which is that it may be easier for a taxpayer to determine that a given subsidiary has no chargeable profits as computed under Article 7.2(b) than it is to prepare the full computation to support whether it meets the CFC condition in Article 7.1.

Revenue authorities will also have a concern to ensure that the new rules are capable of being enforced without creating a disproportionate drain on resources. As noted above, we remain to be convinced that Option A necessarily results in less work for the Revenue Commissioners.

Subject to the above points, we strongly recommend that the information which taxpayers are required to disclose should be limited to a listing of the CFCs and their computed chargeable profits resulting in an actual CFC charge.

M&A

EY believes that consideration should be given to appropriate means of providing a reasonable period for companies to integrate acquired business before the application of a CFC rule similar to the approach applied in certain other jurisdictions.

White List

Recital (12) of ATAD concludes with the following text:

> *"It should be acceptable that, in transposing CFC rules into their national law, Member States use white, grey or black lists of third countries, which are compiled on the basis of certain criteria set out in this Directive and may include the corporate tax rate level, or use white lists of Member States compiled on that basis."*

We believe that a simple white list, focused on EU countries and other key trading partners for substantive investment by Irish-parented groups, would have the advantage of simplifying administration for both taxpayers and Irish Revenue. The list could perhaps be added to or qualified over time as Irish policymakers develop wider knowledge of other relevant jurisdictions.

Multiple Tiers of CFC's

Where there are multiple tiers of CFC's there is a risk of double (or greater) taxation as a direct result of these multiple tiers or indirectly through the application of Irish rules. The CFC legislation should be carefully drafted and the interaction with existing Irish legislation considered to ensure there is no such double taxation. Arguably this issue is less acute with Option B given the reference to the location of the significant people functions but the possibility of double taxation through a primary transfer pricing inclusion and a CFC charge should be addressed. Giving primacy to the transfer pricing inclusion via exemption from CFC charge may be a suitable approach.

Building a better working world

Capital Gains

ATAD would appear to include capital gains on the disposal of shares within the CFC income. As Ireland provides for an exemption in relation to the disposal of qualifying shares and similar assets we recommend that capital gains on disposals which would qualify for Ireland's substantial shareholding exemption if the disposal was directly by an Irish resident are expressly excluded from the CFC rules.

As stated above a white list may simplify many of the practical complexities in this area.

Rate

This is relevant in two respects. First, in testing whether an entity is to be treated as a CFC under article 7.1, and second in determining the amount of Irish tax payable on the chargeable profits computed under article 7.2.

Ireland's corporate tax code currently provides for a 12.5% "trading" rate and a 25% "passive" rate, as well as a 33% rate for chargeable gains. There are different rules for calculating the profits chargeable to tax for each rate/case of tax. We welcome confirmation on which rate and calculation rules will be used for the purposes of this test.

We have some comments in this regard.

Article 7.1 is deliberately worded so as not to refer to the statutory rate, but to the actual corporate tax that would be paid by the entity if it were Irish resident. In part this is intended to guard against a low effective tax rate being achieved by a CFC through artificial deductions.

For the purposes of Article 7.1 it would seem difficult to argue that anything other than a recomputation under Irish rules (or perhaps a suitably adapted version of Irish rules) will suffice. Article 7.2 is less prescriptive and refers only to the "tax base" without referring to the rate. Having said that, we do not believe it would be within the spirit of the Directive (nor indeed achieve its purposes) if it were to be implemented in a way that allowed passive income to benefit from a lower rate if earned overseas than if earned by an Irish resident. Nonetheless, we do believe it is appropriate to recognise – at least if Option B is selected – that the linkage with significant people functions in Ireland may mean that the 12.5% rate would be available if the income were earned by the Irish entity carrying out the significant people functions. For example, if the activities would be regarded as a trade under Irish tax principles, and is supported by significant people functions in Ireland, then the trade should **not** be regarded as one carried on wholly abroad and taxable at 25%.

Exclusion

Article 7.4 of ATAD provides the ability to provide an exclusion from the CFC rules of entities that are below a minimum threshold. To ease the administrative burden and costs for such businesses we recommend that Ireland adopts this exclusion.

Tracing

Detailed consideration will need to be given when drafting the legislation as to how credit for tax paid on dividends, disposals of subsidiaries by the CFC and foreign tax paid on CFC income at a first tier and any intermediary tier are treated and traced in the CFC rules – at least under Option A.

We appreciate that this letter contains a lot of detail around the CFC rules and given that this is the most time sensitive ATAD item we would be happy to meet at your convenience to discuss the items set out above.

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?

General comments

The four particular circumstances in which Ireland will require the exit tax are:

1. An Irish company transfers assets from its Irish head office to its foreign branch such that Ireland no longer has the right to tax the assets
2. A foreign company transfers assets from its Irish branch to its foreign head office or to another foreign branch such that Ireland no longer has the right to tax the assets
3. An Irish company transfers tax residence to another country (except to the extent that assets remain in an Irish branch)
4. A foreign company transfers the entire business of its Irish branch to another branch such that Ireland no longer has the right to tax the assets (note that this does not include a transfer to the head office).

Items 1 and 4 will require attention as current capital gains rules (as distinct from capital allowances rules) would address such a transaction only if preceded by a group transfer.

Item 2 should not arise under Ireland's current tax system, but would need to be addressed in the event that Ireland were to move to a branch exemption as part of an initiative on territoriality.

Item 3 will clearly require amendment to Ireland's existing exit charge.

Timing

Article 11 of ATAD stipulates that Member States may apply a derogation to defer the implementation of the laws necessary to comply with Article 5 of ATAD until 1 January 2020. EY welcomes the Irish Government's policy in relation to the implementation of outcomes arising from BEPS and in particular that the implementation of the exit tax rules should not become effective until 1 January 2020.

Rate

In order for Ireland's tax legislation to comply with Article 5 of ATAD, the current 'exit tax regime' will have to be amended to remove a key exclusion from this charge for a 'relevant company, and therefore gains from all "exit tax" scenarios will be subject to tax at a rate of 33%. Ireland's comparatively high capital gains tax rate of 33% is a real concern for investors and can act as a barrier for businesses wishing to locate operations to Ireland.

To maintain Ireland's competiveness in an international context, complementary measures should be introduced which would seek to limit the adverse impact of this change. In this regard, EY recommends that a gain triggered on an "exit tax" event on the disposal of assets which are used by a

business in Ireland for the purposes of their trade (we understand that there may be policy reasons to consider a carve out for real estate assets) should be subject to the standard corporation tax rate of 12.5% as opposed to the current capital gains tax ("CGT") rate of 33%. Indeed, it is our view that the 12.5% rate should apply to all disposals of such assets, not just the deemed disposal applying on an exit.

Symmetry of Tax Basis

Article 5.5 of ATAD requires that on a business from another Member State establishing in Ireland, the exit charge in that Member State should be mirrored by Ireland allowing a tax basis equal to the market value of such assets at the transfer date. This will require a significant adaptation of our existing capital gains and capital allowances rules[23], which normally require 'expenditure incurred'. Whilst Article 5 of ATAD addresses the intra-EU transfer of assets, EY recommends that Ireland provides for a similar treatment in tax basis on the establishment of businesses from all countries, i.e. both EU and non-EU sources, in line with Government policy that Ireland is supportive of global trading with both EU and non-EU countries in diversified markets and seek to support the maintenance of Ireland's competitive corporate tax regime.

Refinement of Ireland's tax depreciation regime to comply with Article 5.5 provides an opportunity to make other simplifications to the regime, e.g. extending tax depreciation availability where assets are acquired for share consideration and certain other transactions.

Market Value

As discussed above, Article 5 provides for a step-up in tax basis equal to the market value as determined in accordance with the disposing Member State laws. EY would welcome clarity / guidance in relation to the documentation requirements which Ireland should require on an inbound acquisition of assets in order to support the market valuation applied.

[23] Although Article 5.5 does not expressly refer to tax depreciation, it does use the expression "starting value", meaning that it is value that will change over time. The principle of symmetry, albeit at tax written down value is also evident in the Mergers Directive.

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?

General comments

BEPS Action 2 on hybrids is highly technical measured response to a very complex issue. The interim report ran over 2,000 pages, and the final report ran to 169 pages excluding detailed examples. ATAD 2 inserted just two pages of definitions and a page of rules into ATAD. It is important that these three pages are not read in isolation – in particular because more precise wording is required for the definitions.

We note in particular that ATAD contemplates that the Recitals to ATAD 2 should be read as a guide to what is intended, and indeed that Recital (27) states:

> "*Member States should use the applicable explanations and examples in the OECD report on Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report as a source of illustration or interpretation to the extent that they are consistent with the provisions of this Directive and with Union law.*"

Further, the Coffey Review also recommends[24] that Ireland should have regard to the recommendations of Actions 2, 3 and 4 of BEPS whilst implementing ATAD.

In passing, we also note that ATAD 2 seeks to address branch mismatches which were not addressed by the BEPS reports discussed above, but have since been the subject of a further Action 2 Report from the OECD. As this was issued after the preparation of both the Coffey Review and ATAD 2, we believe it is also appropriate to have regard to this document in transposing ATAD and ATAD 2 into Irish law.

The use of hybrids – at least as generally understood – by Irish taxpayers is relatively uncommon, and is clearly not part of the competitiveness of the Irish tax regime. It might therefore be tempting to assume that anti-hybrid rule can be safely introduced into the Irish tax code without fear of competitive disadvantage.

However, we do see a danger of a set of rules which are imprecisely targeted so as to create uncertain or unexpected results.

[24] Recommendation 12)

We therefore recommend that careful drafting, including consultation involving indicative legislative wording, needs to take place over the period up to 1/1/2020, when most of the rules must take effect. Some examples of the lack of precision in the wording in ATAD 2 follow:

- *"Deduction without inclusion"*. The definition in ATAD 2 does not explicitly recognise the guidance in BEPS Action 2[25], to the effect that a payment under a financial instrument should only give rise to a hybrid mismatch if the mismatch arises due to the terms of the instrument rather than the status of the payee. By extension, anomalies will inevitably arise from attempts to distinguish between payments to a payee jurisdiction that does not have a tax system, one that has a tax system with a 0% rate, or one with a very low rate. Such scenarios are better dealt with by a rule that specifically targets such situations rather than an anti-hybrid rule.

- *"Hybrid entity"*. This rule is insufficiently specific as to the jurisdictions involved, and ought to specify the payee jurisdiction, as does BEPS Action 2. Indeed we note that Recital (17) of ATAD2 states:

  > *"… a payment should not give rise to a hybrid mismatch that would have arisen in any event due to the tax exempt status of payee under the laws of any payee jurisdiction."*

- *"Structured arrangement"*. This definition is common to both ATAD 2 and BEPS Action 2. We are already seeing uncertainty in countries which have implemented these rules and have not made explicit what level of evidence will be sufficient to determine whether the taxpayer:

  > *"could reasonably be expected to be aware of the hybrid mismatch"*

  Or indeed what is meant by:

  > *"did not share in the value of the tax benefit resulting from the hybrid mismatch."*

  For example, is this test breached merely by paying a slightly lower interest rate than is offered by other lenders?

Timing

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'.

As outlined above, EY welcomes the Irish Government's policy in relation to the implementation of outcomes arising from BEPS and in this case that the introduction of anti-hybrid rules should not become effective until 1 January 2020.

EY also welcomes Mr. Coffey's view outlined in his review of Ireland's corporation tax code, that "detailed technical consideration will be needed by Ireland to identify how anti-hybrid rules can best

[25] Recommendation 3 - see for example Appendix A at p.154

be implemented into Irish domestic law", given that the proposal is complex and transposition is likely to be challenging.

Therefore, whilst we would expect policymakers to focus their immediate efforts on CFC rules and other items for implementation on 1 January 2019, we also believe that the inevitable complexity of the anti-hybrid rules means that some preparatory work on these will also need to begin during 2018.

Hybrid Mismatch Rule: Design Considerations for Ireland

While the number of hybrids (as defined) involving Ireland, should be relatively low, the ability of Irish taxpayers to deduct intragroup payments may be inadvertently impacted in a number of circumstances under the provisions of the Directive.

It is important that the legislation that is introduced does not penalise routine and non-abusive payments in typical supply chain structures as this could lead to the need to revise routine supply chains which is costly and could result in activities and jobs being moved out of Ireland. Of particular importance in the design of the rules will be the drafting and guidance as to the definitions of "structured arrangement", "imported mismatch", and "deduction without inclusion".

Recommendations

Given the extended timeline of 1 January 2020, EY recommends that focus should remain on the more pertinent issues at hand, such as CFC legislation (to be implemented by 1 January 2019), with anti-hybrid rules to be dealt with cohesively post 2019.

To re-iterate Mr. Coffey's view as outlined above, it is also imperative that effective consultation ahead of any law change is provided for. The rules regarding anti-hybrids are particularly complex and therefore in order to help maintain Ireland's competitiveness and minimise the impact of the transition process for both business and Revenue, EY recommends that draft legislation and guidance is provided in a timely manner on which input is sought from investors and other interested stakeholders, ideally in the form of a separate standalone consultation, well in advance of finalising anti-hybrid rules to be transposed into Irish domestic law.

Such a consultation should also provide the Irish Government with an opportunity to canvass investors and stakeholders in relation to their specific experiences with foreign tax authorities (such as the UK) in the context of interpretations used and approaches taken by them when introducing anti-hybrid rules.

The implementation of Actions 8, 9 & 10 of the OECD BEPS Package

Question 5:

Following the 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 Action 8, 9 and 10 in Irish legislation."* When incorporating the OECD 2017 Transfer Pricing Guidelines, what are the key considerations?

Timing

EY agrees that Ireland should indeed provide for the application of the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8-10 in Irish legislation. In the context, however, of ensuring that existing investors have sufficient time to take any necessary remedial action to ensure better structural alignment from a broader BEPS perspective, EY recommends that the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8-10 are not incorporated into Irish legislation until the deadline suggested in the Coffey Report (i.e. legislate as late as is commensurate with Ireland's commitments under the BEPS project, noting the OECD review in mid-2020). Such an implementation timeframe should enable the Government to better focus its resources on nearer term ATAD related implementation commitments/deadlines. It will also provide more time to gather experience on the operation of the 2017 Guidelines in other countries.

Furthermore, and consistent with the "certainty and stability" objectives outlined in Ireland's International Tax Strategy, EY recommends that any such incorporation of the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8-10 is expressly prospective in nature such that the OECD 2010 Transfer Pricing Guidelines would continue to apply for tax accounting periods preceding any amendment to Section 835D TCA 1997. Any retrospective amendments would almost certainly be perceived by investors as an unwelcome and adverse change in policy direction by the Irish Government, and would in our view run counter to Ireland's longstanding and hard won reputation for offering investor stability and certainty.

In relation to the drafting of any proposed changes to Section 835D TCA 1997, EY recommends that input should be requested from investors and other interested stakeholders, ideally in the form of a separate standalone consultation that could also cover matters such as implementation timing. Such an engagement process should further help ensure that there are no unforeseen or unintended consequences arise from any new legislation. Furthermore, such a consultation should provide an opportunity to canvass investors and stakeholders in relation to their specific experiences with foreign tax authorities in the context of interpretations used and approaches taken, information which could prove invaluable in terms of Ireland successfully defending against future foreign tax authority challenges.

Recommendations

Section 6.3.10 the Coffey Report summarises Ireland's position with respect to the deductibility of royalty payments paid to a foreign IP company and then Section 6.3.11 outlines potential

deductibility concerns (arising by virtue of the potential application of Section 835C (2)(a) TCA 1997) in the context of royalties paid to a foreign IP company that does not necessarily have a suitable Development, Enhancement, Maintenance, Protection, Exploitation ("DEMPE") profile. A potential consequence of the latter would be that there could be excess profits attributed to Ireland in certain scenarios (assuming that Ireland does not have an appropriate DEMPE profile), an outcome that is noted in the Coffey Report as being "not in line with the key objective of BEPS Actions 8–10 to align transfer prices with economic substance".

In the context of ensuring minimal investor uncertainty with regard to the foregoing deductibility concerns and in terms of ensuring that outcomes do not arise that run counter to BEPS Actions 8-10, EY recommends that detailed guidance should be published by Irish Revenue in advance of any new legislation becoming effective, with prior input from investors and key stakeholders via a detailed consultation process. Within such Revenue guidance, it is recommended by EY that there is included a clear set of criteria to be consistently applied in the context of determining the deductibility of intra group payments including royalties payable to foreign IP holders. The inclusion of a number of specific examples may be helpful in this regard, for example covering royalties payable to foreign IP holders with different DEMPE profiles.

EY believes that the publication of such detailed Revenue guidance (including detailed examples covering commonly used investor structures) would help minimise the level of Revenue resources required to audit and enforce Ireland's implementation of BEPS Actions 8-10.

In a related vein, and in the context of furthering investor certainty, EY believes that a welcome move would involve Revenue outlining its proposed audit strategy in relation to the enforcement of any new legislation bringing BEPS Actions 8-10 into force. Such transparency should further minimise the level of Revenue resource required in an audit context as investors, armed with detailed Revenue guidance and knowledge of key audit protocols, would be further encouraged and motivated to operate within clearly defined parameters.

EY recommends that Irish Revenue ensure that it has sufficient resources available to facilitate APAs concerning transactions in which the application of BEPS Actions 8-10 is applicable. Consideration should be given to putting APAs (including unilateral APAs) on a statutory footing.

Whilst noting the investment in capacity already made, EY recommends that further investment needs to be made with respect to the capability of Ireland's Competent Authority particularly in light of the anticipated direction of travel regarding international controversy and disputes pertaining to cross border activity. In this regard, EY believes that Ireland must very clearly demonstrate that it has both the capability and desire to protect taxpayer rights in scenarios where foreign tax authorities overstep jurisdictional boundaries and/or impose unilateral charging provisions that are inconsistent with bilateral treaties already in force.

Counterparty documentation – EY recommends that Irish Revenue continue to respect the validity of well-established approaches followed by foreign tax jurisdictions (e.g. under US Treasury Section 482 Regulations).

Additional Considerations Regarding Ireland's Domestic Transfer Pricing Rules

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 legislation.

Timing

EY recommends that the timing of the introduction of any legislation which seeks to apply transfer pricing rules to arrangements the terms of which were agreed before 1 July 2010 should be aligned with the deadline date for the other transfer pricing recommendations (i.e. as late as is commensurate with Ireland's commitments under the BEPS project, noting the OECD review in mid-2020) to provide certainty to Irish taxpayers.

Recommendations

EY notes the practical difficulty in re-pricing historical transactions which could be proposed to fall within the scope of transfer pricing regulations. Revenue should consider practical data availability limitations in ex post pricing resulting from implementing this proposal.

If adopted, EY recommends that reasonable notice is provided to all stakeholders so that they can put documentation in place, and / or review existing arrangements, in light of the potential impact for groups in respect of agreements which have been in place prior to the commencement of Irish transfer pricing rules.

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 enterprises 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?

Recommendations

The recommendation to extend transfer pricing rules to SMEs, in our view, is an unwelcome move in light of Ireland's competitiveness as it raises the possibility of additional costs for business in restructuring existing arrangements, and ongoing compliance.

Due to the complexities of transfer pricing and high administrative burden associated with transfer pricing document retention as well as the fact that these groups typically do not operate cross border, an extension of these rules to SMEs would not, in our view, be proportional to the risks of transfer mispricing occurring.

EY note that an SME exemption is recommended at para 5.3.3 of the 2017 OECD Transfer Pricing Guidelines, stating that "in order not to impose on taxpayers costs and burdens disproportionate to the circumstances, it is recommended to not require SMEs to produce the amount of documentation that might be expected from larger enterprises."

Accordingly EY recommends that the exemption for SMEs as currently provided for in Part 35A TCA 1997 is retained.

However, where it is decided to adopt these rules into tax legislation, EY proposes other mitigating factors to be introduced, such as an intercompany transaction threshold, recommended at para 5.32 of the 2017 OECD Transfer Pricing Guidelines, or a transfer pricing 'light' report which reduces the compliance burden on these taxpayers.

In addition, the timing of the introduction of same should be aligned with the deadline date for the other transfer pricing recommendations (i.e. as late as is commensurate with Ireland's commitments under the BEPS project, noting the OECD review in mid-2020) to provide certainty to Irish taxpayers.

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 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?

In relation to the extension of transfer pricing rules to capital transactions, what are the key considerations of this proposal, bearing in mind existing market value rules?

Timing

The timing of the introduction of any legislation which seeks to apply transfer pricing rules to non-trading income and capital transactions should be aligned with the deadline date for the other transfer pricing recommendations (i.e. as late as is commensurate with Ireland's commitments under the BEPS project, noting the OECD review in mid-2020) to provide certainty to Irish taxpayers.

In addition, it is recommended that detailed consideration and consultation should take place, involving indicative draft legislation and guidance on which input is sought from relevant stakeholders before any final decision on implementation of same.

Non-Trading Transactions

The extension of Ireland's transfer pricing rules to non-trading transactions, if legislated for, will significantly impact corporates that have financing activity in Ireland.

In light of this, EY recommends that a grandfathering period is introduced to allow corporates who have intra-group debt involving Irish entities to review and restructure their operations. EY again urges Revenue to recognise the practical data availability limitations in ex post pricing.

It is also imperative that the domestic aspects are properly addressed so that instances of double charges and adverse tax rate arbitrages do not arise.

A key consideration, as referenced in the Coffey Review is the domestic rate arbitrage that may arise where a non-trading Irish tax resident cash-pool lender (Company A) extends a loan to a trading Irish tax resident company (Company B). In such a scenario interest income on the loan is taxed at 25% in the hands of Company A, however the corresponding deduction for Company B is only available at 12.5%.

Recommendations

EY recommends that the complexities of domestic rate arbitrage are addressed up front and any amendments made to Irish tax law are done so in tandem with the updated transfer pricing rules.

In addition, EY recommends that a public consultation should be undertaken with provides key stakeholders with draft legislation and guidance in advance of the implementation to reduce uncertainty and inform policy making.

We also believe that the scope of consultation in this area should include consideration of the introduction of a notional interest deduction with a view to maintaining Ireland's competitiveness and achieving coherence in Ireland's response to the ATAD changes.

Capital Transactions

As highlighted in the Coffey Review, whilst Irish tax legislation does not provide for transfer pricing rules on capital transactions, Sections 547-549 TCA 1997 relies on the concept of "market value" for the purposes of calculating chargeable gains on the disposal of assets between "connected parties". EY does not support the extension of transfer pricing (arm's length) rules to capital transactions as there are existing fair market value and arm's length tests already applied to the transfer or receipt of capital assets. Specifically, for example, section 547 TCA 1997 imposes market value on the transfers of assets for capital gains tax purposes and section 291A (7) (b) TCA 1997 which imposes an arm's length basis for expenditure incurred on specified intangible assets.

Recommendations

EY does not support the extension of transfer pricing rules to capital transactions, as there are existing domestic Irish tax rules which already provide for pricing requirements that are similar to the arm's length concept. This extension would likely place an incremental burden on taxpayers who would be required to allow for the potential application of existing domestic tax rules on capital transactions with the new transfer pricing rules.

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 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?

Timing

EY highlights the additional compliance burden the introduction of this provision would place on Irish Headquartered SME's. The timing of the introduction of any legislation which requires such taxpayers to prepare such documents should be aligned with the deadline date for the other transfer pricing recommendations (i.e. as late as is commensurate with Ireland's commitments under the BEPS project, noting the OECD review in mid-2020) to provide certainty to Irish taxpayers.

Recommendations

EY recommends the following:

- OECD set of common criteria in Annex I and II of the Guidelines for Master and Local Files, should be adopted as the content standard for transfer pricing documentation in Ireland,
- The revenue threshold for Master File requirements in Ireland should be the same threshold used for Country by Country Reporting,
- Master and Local File requirements should be upon written request by Revenue rather than imposed as a mandatory filing requirement,

<u>The effects of moving to a territorial corporation tax base and of reviewing Schedule 24 of the Taxes Consolidation Act 1997 to effect a policy and revenue neutral simplification of the computation of the foreign tax credit</u>

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?

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?

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?

General Comments

Ireland's current worldwide system provides for the availability of foreign tax credits for taxes suffered in foreign jurisdictions against the Irish tax arising on same. This credit mechanism is legislated for under Schedule 24 TCA 1997, which has been subject to numerous legislative amendments in light of policy changes and to take account of judicial decisions. As a result of same, the legislation is now highly complex.

In addition, a worldwide system of calculating tax credits creates a significant administrative burden for taxpayers with significant compliance costs. It is recommended in the Coffey Review that consideration be given to reviewing Schedule 24 TCA 1997 to effect a policy and revenue neutral simplification of the computation of the foreign tax credit for all forms of foreign income. However, even where the current legislation is simplified the additional compliance/administrative burden remains.

Timing

Given the interaction with CFC rules, we recommend that the decision to move to a territorial system is aligned with the introduction of the CFC rules and legislated for together.

Recommendations

As referenced in the Coffey Review, 28 of the 34 OECD Member States currently impose corporate tax on a territorial basis with the remaining 6 adopting a worldwide tax basis. In addition, the US has shifted to a territorial basis of tax late last year. The current worldwide basis of tax in Ireland acts as a

key impediment to Ireland's holding company regime in an international context. A world class holding regime is important to competiveness in a post BEPS world to ensure that senior business executives chose to locate to Ireland. As such, EY recommends that a move to a territorial basis of tax is a necessity.

Appropriate transitional rules where both systems operate side by side for a limited period may be appropriate.