Review of the Corporation Tax Code – Public Consultation,
Tax Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

30 January 2018

Dear Sir / Madam

Consultation Paper on Review of Ireland's Corporation Tax Code

As representatives of the International financial services sector we welcome the opportunity to respond to the public consultation by the Department of Finance on the review of Ireland's Corporation Tax Code.

The international financial services industry employs more than 40,000 people directly in Ireland and accounted for more than €2bn (28%) of corporation tax receipts collected by the Exchequer in 2016. It is also a key driver of economic growth and employment in Ireland. In this context, it is our view that it is important that Ireland continues to maintain the highest standards in international taxation through the implementation of measures agreed under the OECD Base Erosion and Profit Shifting ("BEPS") project and the EU Anti-Tax Avoidance Directive ("ATAD") while at the same time retaining an attractive and internationally competitive corporate taxation environment.

We have set out at Appendix I details of the representative organisations of the financial services industry responding to the above consultation through this letter.

We hope that the comments outlined below in response to a number of questions raised in the consultation process will be of assistance to the Department in your deliberations.

We would be willing to meet with you to elaborate on any of the matters outlined below if that would be of assistance to you at any time you wish.

Question 2: CFC Regime

Design Features

Question 2 asks what are the key factors in determining the preferred approach for the introduction of CFC legislation in Ireland?

Article 7 requires the use of one of two options in designing the regime. Option A (set out at subparagraph 2(a) of Article 7) provides for a substantial activities test which would only subject taxpayers to CFC rules if the overseas subsidiary did not engage in genuine economic activities. There is a logic and consistency to this approach since rewarding and attracting substance based investment has been a central pillar of Irish tax policy for more

than 50 years. The inclusion of a substance based carve-out would also ensure that Ireland would not seek to tax anything other than artificial arrangements. From an EU law perspective this would help ensure that Ireland's rules would be in line with the judgement of the Cadbury Schweppes case. However Option A would be quite complex to apply in practice as it requires a calculation of a CFC's profits under Irish tax rules; in practice this would require multiple assumptions to apply the Irish tax regime to foreign profits.

Option B (set out at subparagraph 2(b) of Article 7) focusses on profits that are artificially diverted from the parent location, which allows Ireland to focus on base erosion of the Irish tax base. Option B is loosely based upon the UK approach to CFC, hence applying such a test keeps Ireland in step with the UK – a key competitor for investment. This test also has the attraction of using OECD Transfer Pricing methodology to limit the allocation of profits to amounts that have been generated by the exercise of significant people functions in Ireland. Helpfully from a compliance perspective this option does not require a detailed analysis of the type of income earned by CFC subsidiaries and does not distinguish in terms of the location of the subsidiary.

In terms of design features of a CFC regime we would see merit in applying Option B as a gateway test but with a carve-out if the CFC can pass a substantive economic activity test in its own right. As we would have serious concerns as to the administrative and compliance burdens (on Revenue and the taxpayer) associated with identifying a CFC in the first instance we would strongly recommend that a white list be drawn up to exclude from scope CFC's in countries that have suitable tax treaties with Ireland and which do not represent a BEPS risk.

Specific Recommendations re CFC Legislation

1. To ease the administrative and compliance burden associated with identifying a CFC the 12.5% rate should be used as the reference Irish rate and Case I principles should be used as the basis of calculating the Irish taxable measure of profits. This approach takes accounting profits under recognised accounting principles as the starting point and inter alia, allows calculation in functional currency avoiding currency distortions
2. It is suggested that where a CFC charge applies, double tax credit relief would be available to the extent that tax has been paid in the foreign jurisdiction.
3. Subsidiaries with both low profits and low profits margins do not pose profit shifting risks. Nor do subsidiaries who distribute the majority of their profits back to Ireland. The Directive itself allows for such carve outs from the CFC legislation and should be availed of by Ireland in framing the CFC legislation
4. A jurisdiction should be looked at in its entirety and not on an entity by entity basis - this is necessary as sometimes it is not possible to align substance and profit generation in the same entity in a location for various non-tax reasons.
5. An exempt period entity level exemption should be adopted as part of the rules to ensure that Irish companies are not unduly penalised in the event of an international acquisition.
6. To the extent that an Irish company acquires an entity or entities that would fall to be taxed under the Irish CFC rules for the first time, a 2 year period should be allowed for the Irish parent company to restructure as necessary before the income of these

entities is brought into the Irish tax net as CFC income. This is a design feature of other CFC regimes.

The very short time period between the finalisation of the legislation for CFC rules and the effective date will mean that companies will not have time to assess the impact of the rules and their interaction with other Irish rules and indeed CFC rules in place in other jurisdictions in advance of the rules coming into force. It is imperative therefore that draft CFC legislation be made available for consultation as early as possible in 2018.

Question 3: Exit tax

General Comment

One of the key considerations for a company when considering investing in a foreign jurisdiction is the cost of exit. While Ireland's current exit tax regime applies a rate of 33% to exit gains there are widely crafted exemptions. We do not expect that Ireland will be able to retain such a broad range of exemptions when ATAD is implemented. As such, in order for Ireland to meet its obligations under ATAD and also retain, in so far as is possible, its relative competitiveness, we have the following specific comments in relation to the introduction of an exit tax regime.

Specific Recommendations re Exit tax

1. A 12.5% rate of corporation tax to the measure of the exit gain where the asset was in use for the purposes of a trade

   We suggest that Ireland apply a 12.5% rate of corporation tax to gains made on the disposal of assets that were in use for the purposes of a trade in Ireland, and that such gains should be computed in the company's functional currency and translated to euro at the average exchange rate for the period of exit.

2. Apply transfer pricing principles in determining the exit gain

   We note that ATAD states at Article 5, paragraph 6 that 'market value' "*is 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*". This seems closely aligned with the arm's length principle set out in the OECD's transfer pricing guidelines. It is therefore suggested that Ireland should follow OECD guidelines for the exit tax definition of market value. This should help to bring some certainty of interpretation to the Irish exit tax regime (as it would follow internationally understood principles) and hence limit instances of differing views between the Irish Revenue and other tax authorities. This in turn would limit the likelihood of double taxation or non-taxation arising from mismatches in view between tax authorities.

3. Apply an uplift in tax basis to the market value of assets when "imported"

   ATAD requires EU Member States to give a step-up in market value (established under arm's length principles) for assets "imported" from another EU Member State. We suggest that this approach is extended to assets "imported" from third countries. We believe that this is in line with Irish tax policy, i.e. to tax only profits and gains arising in Ireland. It also ensures that assets coming into Ireland are not ultimately subject to double taxation, i.e. where the third country jurisdiction applies an exit tax.

4. Broaden the scope of exit tax events to include those set out in ATAD

   Ireland's exit tax regime is currently largely confined to where a company migrates residence out of Ireland. The scope of "exit events" will have to be broadened to incorporate the four events set out in ATAD. This will include the transfer of assets from an Irish head office to a foreign branch where Ireland (as we recommend) adopts a branch exemption system, as the asset would no longer be within the scope of Irish tax.

   ATAD provides for relief from exit taxes in the case of temporary transfers of assets. In our view, Ireland should ensure that its exit tax regime accommodates this flexibility e.g. in the case of transfers to a tax exempt branch to meet prudential capital requirements, for the purposes of liquidity management or in relation to posting collateral related to securities financing transactions.

5. Apply domestic reliefs in determining the amount of the chargeable exit gain

   As the exit tax regime Ireland is required to implement under ATAD will not allow for the same wide range of exemptions as our existing exit tax regime, it is suggested that domestic reliefs such as section 626B, TCA 1997 should be applied to exit gains given that this is not precluded under ATAD. In fact, this is in line with EU principles around the freedom of establishment and settled CJEU case law[1]. It is also broadly in line with Ireland's current exit tax regime as both look to apply a "relevant territory" test.

Question 4: Anti-hybrid measures

General Comment

The Irish tax system does not facilitate the usage of hybrid payments or entities with the possible exception of Section 110 TCA 1997 which was introduced to accommodate the securitisation industry in Ireland. As a result of tax changes introduced in Finance Act 2011 anti-hybrid mismatch principles have already been incorporated into Section 110.

Accordingly little, if any change should be required there. In the context of the introduction of the hybrid mismatch rules more generally, given their inherent complexity we would strongly recommend that an Exposure Draft of any proposed legislation would be made available at least 12 months before the commencement date to allow ample time for public consultation and to enable restructuring of existing arrangements, where necessary, to occur. The legislation should be as clear and unambiguous as possible and detailed implementation guidance should also be provided on the scope and application of the measures. We have seen the recent introduction of hybrid mismatch legislation in other jurisdictions creating a lot of confusion and unintended consequences in the marketplace.

Specific Recommendations re Anti-hybrid measures

1. Clearly Ireland needs to implement the Directive provisions but it does not need to go beyond the framework set out in Article 9 of ATAD and ATAD 2. Change should be confined to payments that are actually hybrid payments, not to mismatches arising on account of the tax system of another jurisdiction or arising from Transfer Pricing adjustments.

[1] See paragraphs 35 – 38 of National Grid Indus BV case C-371/10

2. Any introduction of a participation exemption regime may need to take account of the hybrid mismatch approach e.g. no foreign branch exemption unless the foreign branch is subject to foreign tax

3. Lease receipts will need to be excluded from the scope of the secondary defensive measures to the extent that such lease receipts are already included in taxable income.

4. Permitted exemptions to exclude on market repo transactions, certain loss absorption regulatory capital instruments in the banking sector and defined investment undertakings from the scope of the measures

5. The legislation should treat as included in income payments which are taxed in another jurisdiction in the relevant period even if not taxed upon the same entity as the entity which is considered to be the taxable entity from an Irish perspective

Question 6: Pre 1 July 2010 transfer pricing arrangements

If, as we suggest in response to question 8, Ireland excludes transactions between Irish tax resident companies from transfer pricing, the removal of grandfathering for pre 1 July 2010 transactions is likely to have a more limited impact in practice as most cross-border transactions would have been subject to the transfer pricing rules of the counter-party jurisdiction.

That said, if Ireland decides to apply domestic transfer pricing legislation to arrangements that were agreed before 1 July 2010, it is suggested that this should be done with prospective effect and not require the application of transfer pricing adjustments to past transactions under grand-fathered arrangements.

We suggest that this approach is followed with one exception which is in relation to loan arrangements with a defined loan maturity date which we suggest should not be re-priced until the pre-existing loan agreement has come to an end. It is not generally required that a loan arrangement is re-priced for transfer pricing purposes once the terms and conditions of the loan arrangement remain unchanged and the loan remains in place between the same counterparties.

Any changes to transfer pricing should be announced well in advance to allow taxpayers time to prepare for the impact.

Question 8: Applying transfer pricing to non-trading transactions

In response to the concerns raised by the European Commission and reflected in the Coffey report, we can see that there would be merit in bringing non-trading cross-border transactions within the scope of transfer pricing.

Specific Recommendations re transfer pricing on non-trading transactions

1. <u>Do not apply transfer pricing to transactions between Irish resident parties</u>

   As noted in the Coffey report, it will be important to ensure that no unintended consequences arise as a result of applying transfer pricing to non-trading transactions. These are most likely to arise where transfer pricing is applied within Ireland, i.e. where a transfer pricing adjustment between two members of an Irish

group results in one member receiving a deduction at a rate of 12.5% while another member is taxed at a rate of 25% or vice versa.

It is worth noting that the objective of transfer pricing is to ensure that sufficient profits are reported on a transaction. This is important for the preservation of a State's tax base in the case of cross-border transactions, as related enterprises could report more taxable income in a country with a lower corporate tax rate, a special tax regime, etc. if an arm's length price is not imposed.

Where related parties transact within the tax regime of a country, there is no net gain or loss to the Exchequer where transfer pricing is not applied as the corresponding transfer pricing adjustments should cancel each other out. We therefore consider it appropriate to not apply transfer pricing to domestic transactions between Irish tax resident companies. Many other EU countries apply this approach. For example, the Netherlands has a concept of fiscal unity whereby all intra-group transactions are disregarded and one corporate tax return is filed for the Dutch group. Germany does not generally apply transfer pricing to transactions between German tax resident companies.

It is suggested that Ireland, similar to Germany, should exclude transactions between Irish tax resident companies from transfer pricing. This is subject to the outcome of a German test case[2] before the CJEU at the moment on whether the exclusion of domestic transactions from the German transfer pricing regime is compatible EU freedoms.

In the event that the CJEU finds that excluding domestic transactions from transfer pricing is in contravention of EU freedoms, Ireland could consider applying a 12.5% rate of tax to all corporate income (trading and non-trading), applying the same transfer pricing adjustment to both parties where they are both Irish tax resident (to ensure that a difference in rate does not result in a different adjustment), etc.

2. Extend transfer pricing to measure of market value for capital transactions (CGT and capital allowances) and apply 12.5% tax rate to chargeable gains

   It is suggested that transfer pricing rules should be extended to the measurement of the market value of consideration for disposals of chargeable assets by adopting the OECDs 2017 transfer pricing guidelines. We have stated previously in this response some of the benefits of this in the context of an exit tax regime. We do not propose any changes to chargeable events for Irish tax purposes, except those required under ATAD, i.e. relief should continue to apply on the transfer of an asset between members of the same group, etc. We suggest that a 12.5% rate of corporation tax is applied on taxable chargeable gains made on assets used in a trade.

   It is also suggested that transfer pricing rules should be extended to the measurement of expenditure eligible for capital allowances on assets acquired from non-resident group members where market value is currently applied. Similar to the exit tax provisions, this should help to ensure consistency in valuation between Ireland and other jurisdictions.

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[2] Case C-382/16, Hornbach-Baumarkt AG V Finanzamt Landau. The Opinion of Advocate General Bobek was delivered on 14 December 2017.

If the above suggestion are adopted, it is suggested that Ireland would also adopt appropriate associated documentation requirements as recommended by the OECD to assist taxpayers and the Irish Revenue in supporting market valuations used.

Question 10: Dividend and branch exemption regime

General Comment

In our view the benefit from moving to adopt a territorial regime for the taxation of foreign branch profits and foreign dividends is one of greater simplicity for business together with greater certainty arising on the amount of Irish tax payable on those profits. This would also put the Irish tax system on par with the tax regimes of many other countries without giving rise to a material cost to the Exchequer. The impact on the Exchequer is likely to be immaterial given our 12.5% tax rate and existing foreign tax credit regime.

However, our existing regime is complex and acts as a disincentive to the use of Ireland as a hub or central location either for the conduct of business through foreign subsidiaries or through foreign branches.

Given the imminent introduction of a CFC regime in Ireland there is, in our view, no remaining policy obstacle to moving to an optional exemption regime for foreign branches and a full exemption regime for foreign dividends.

In looking at the alternatives available to put Ireland in a competitive position as compared to other jurisdictions, the best outcome for the financial services sector and the insurance industry in particular would be an optional branch exemption system together with a full dividend exemption.

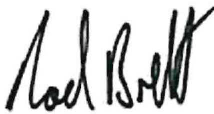
***Specific Recommendations re a* dividend and branch exemption regime**

1. The jurisdictional reach of the participation exemption for dividends and branches should be broad and go beyond the EU/Treaty distinction. The Irish tax regime recognises the importance of substance and it would make sense to take this approach in designing the participation exemption. This could be achieved by limiting the exemption to profits from activities that would qualify as trading activities under Irish tax rules i.e. the exemption would apply to profits of trading branches and dividends from trading subsidiaries irrespective of the location of the branch or subsidiary. This approach would be consistent with the existing rules in Section 21B, TCA 1997 relating to the taxation of dividends.

2. In our view it would be important to retain an option to opt out of the exemption as loss relief can be important, particularly for companies breaking into new jurisdictions or new markets, or for companies with very volatile results such as an insurance company. Where such companies are making losses overall, tax credits do not arise in the current system. In the context of a request to opt in or out of the exemption we realise that this could lead to companies seeking to minimize their tax year over year based on an election in or out of the exemption, therefore we would propose a recapture mechanism whereby an election into an exemption regime could not be made by a company in respect of a branch until it had "made good" any taxable profits that would have arisen had it always been in the regime, i.e. where a company taxed under the current "worldwide" regime had received relief from Irish tax for losses of a foreign branch, it could not elect into the branch exemption regime until the profits taxable in Ireland relating to that foreign branch exceeded the losses that had previously been set against Irish tax.

3. It will also be necessary to amend and update Schedule 24, TCA 1997 as there will be instances where the conditions of the participation exemption are not met or a branch election is not made, in such a scenario the reliefs from double tax in Schedule 24, TCA 1997 will continue to be essential. As part of this process the impact of US tax reform should be considered and the consequential amendments to Schedule 24, TCA 1997 which are required to maintain the competitiveness of the double tax relief system. An example of a change to our existing credit regime is set out at Appendix II.

4. In order to be consistent with the anti-hybrid measures set out in ATAD we acknowledge that the branch exemption would not be available where the branch is not recognised as a taxable presence in the branch jurisdiction.



Noel Brett – CEO
Federation of International Banks in Ireland

Joe Duffy – Chairman
Financial Services Ireland

Kevin Thompson – CEO
Insurance Ireland

Pat Lardner – CEO
Irish funds

Appendix I

Financial Services Ireland

Financial Services Ireland (FSI) is Ireland's only whole-of-industry financial services trade association. A constituent part of Ibec, FSI represents 130 companies across domestic and international banking, insurance, fund administration, asset management, aircraft leasing, fintech, corporate treasury and stockbroking.

FSI's mission is to develop a globally competitive operating environment for all sectors of the financial services industry. This is pursued through analysis and input to policy development in key areas for the sector, including fiscal, regulatory, and skills. FSI also provides services, support and information to the businesses of its members. The affairs of the association are directed by its Executive Board, comprising 12 senior-most representatives across the domestic and international financial services industry.

Insurance Ireland

Insurance Ireland is the Voice of Insurance in Ireland and represents the Irish general insurance, health insurance, life assurance, reinsurance and captive management sectors. Insurance Ireland represents over 130 companies providing insurance domestically in Ireland and internationally from Ireland. Total industry employment is approximately 28,000 people both directly and indirectly with one in four jobs in financial services being in insurance. Our members pay out more than €13 billion in claims and benefits to Irish customers annually and contribute over €1.6 billion in tax to the Irish exchequer each year. In addition Ireland's insurance sector holds assets worth €303 billion.

Insurance Ireland's mission is to represent and enable the development of the insurance sector for its customers, our members and the broader economy.

Irish Funds

The Irish Funds Industry Association (Irish Funds) is the representative body of the international investment fund community in Ireland. We represent fund promoters / managers, administrators, depositaries, transfer agents and professional advisory firms involved in the international funds industry in Ireland, with more than 13,500 funds and net assets of more that €4.3 trillion.

The objective of Irish Funds is to support and complement the development of the international funds industry in Ireland, ensuring it continues to be the location of choice for the domiciling and servicing of investment funds.

Through its work with governmental and industry committees and working groups, Irish Funds contributes to and influences the development of Ireland's regulatory and legislative framework. Irish Funds is also involved in defining market practice through the development of policy and guidance papers and the promotion of industry-specific training.

The Federation of International Banks in Ireland

The Federation of International Banks in Ireland (FIBI) is the principal voice of the international banking and financial services sector in Ireland. An affiliate of Banking & Payments Federation Ireland (BPFI), FIBI represents over 30 member institutions including many of the largest financial service providers in the world.

FIBI's overarching goal is to promote a supportive environment for member institutions focusing on:

- Regulation Management – Proportionality and consistency in the development and application of regulation
- Competitive Environment – A cost competitive environment conducive to good business
- Business Development – Policy and regulatory framework that facilitates expansion in existing operations and attracts new business
- Knowledge Sharing – A framework for efficient dissemination of information to our members
- Promotion of Ireland/IFSC as a location – Active promotion of initiatives that support the development of our members and Ireland as a location for financial services

Appendix II

Foreign Tax credit/deductions in a loss scenario

Double Taxation: Schedule 9FA TCA 1997

The intention of Schedule 9FA was to allow carry forward of unused foreign tax credits. It was intended to achieve foreign tax credit pooling for branches. However, following the amendment of Schedule 24 Paragraph 7(3)(c) by Finance Act 2013 (and prior to this in Revenues' view) it does not achieve this in a situation where tax is paid in a foreign branch but there are tax adjusted losses for Irish tax purposes.

Ireland is competing with branch exemption regimes in other territories (particularly the UK). We understood the intention behind our foreign tax credit pooling regime was to effectively achieve exemption in Ireland for foreign branches where the foreign branches collectively suffer foreign tax in excess of the Irish corporation tax rate. The current legislation is not achieving this.

Revenue Statement of Practice (Foreign Branch Double Taxation Relief 24 June 2014) deals only with situations where Irish tax is **paid before** foreign tax on the same profits. It doesn't deal with the opposite situation where Irish tax is **paid after** the foreign tax. Schedule 9FA was supposed to deal with this; however it doesn't achieve this in all situations.

Schedule 9FA provides for pooling and carry forward of excess foreign tax credits. Based on the formula in Paragraph 9FA(2)(a), the excess foreign tax credits available for pooling and carry forward are calculated by reference to the expense deduction allowed for the foreign tax in question under Paragraph 7(3)(c) Schedule 24 TCA 1997. Section 28 Finance (No. 2) Act 2013 amended Paragraph 7(3)(c) to clarify that the expense deduction available is limited to the Irish measure of the foreign income. Therefore, where no expense deduction is available it follows that there is no excess foreign tax available for pooling or credit.

It is not unusual for a foreign branch to pay foreign tax on its profits where the Irish measure of the branch profits is a loss. In these circumstances no expense deduction will be available for the foreign tax and no credit will be available for pooling and carry forward. This can lead to double taxation and is at odds with the stated intention of Paragraph 9FA which is to treat the foreign branches as a single pool and allow the carry forward of unused foreign tax credits. A good example of this arises with UK branches following the new loss restriction rules announced in the UK. An Irish company in an overall loss position can have a UK branch which is paying tax in the UK because of the new loss restriction rules in the UK. Under current legislation the UK tax paid is not available for credit in Ireland in the year in question (because there is no Irish tax) and is not available for carry forward under the foreign tax credit pooling rules. This leads to double taxation. An example of this double taxation is set out below.

Proposed Solution

This situation could be rectified by amending the formula in Paragraph 9FA(2) so that the credit available for pooling is calculated by reference to the foreign tax paid in respect of the branch rather than the foreign tax for which an expense deduction is available under Paragraph 7(3)(c). In Appendix 2, we have marked up Paragraph 9FA with suggested amendments to achieve this.

Section 28 Finance (No. 2) Act 2013 applies from 1 January 2014 onwards. However, this issue also exists for prior periods given that Revenue's interpretation of Paragraph 7(3)(c) for periods prior to 1 January 2014 was that a deduction for foreign tax was limited to the Irish

measure of the foreign income for those periods also. In order to deal with this issue we suggest that the legislative change referred to in the preceding paragraph and detailed in Appendix 2 would apply from the date that the carry forward of excess foreign tax credits was introduced for branches i.e. accounting periods ending on or after 1 January 2010. We are aware of a number of companies in respect of which this is an issue for 2013 and prior years. Alternatively the prior period issue could be dealt with by way of Revenue e-brief.

Example

Company A, an Irish resident company, has a UK branch which has generated a profit of €100 for 2017. There are losses forward of €100. Loss relief in the UK is restricted to 50% of profits.

UK tax computation	**2017**
Profit for year	100
Losses forward (restricted to 50% of profit)	(50)
UK taxable profit	50
UK tax @ 18%	9
Loss carried forward	50
Irish tax computation	
Profit for year	100
Losses forward	(100)
Tax deduction for UK tax	Nil *(Par 7(3)(c) as amended by Finance (no2) A 2013)*
Irish taxable profit/(loss)	Nil
Excess tax credit available for pooling/carry forward	Nil *(Paragraph 9FA(2)(a))*
Loss carried forward	Nil

In 2018 the UK branch makes a profit of €100.	**2018**
UK tax computation	
Profit for year	100
Loss forward	(50)
UK taxable profit/loss	50
UK tax at 18%	9
Irish tax computation	
Profit for year	100
Less tax loss forward	(Nil)
Taxable profit	100
Irish tax @12.5%	12.5
DTR (UK)	(9)
Irish Tax payable	3.5

Summary position	**2017**	**2018**	**Total**
Profit (after losses forward)	Nil	100	100
UK tax	9	9	18
Irish tax	0	3.5	3.5
Total tax	10	12.5	21.5
Effective tax rate suffered		21.5%	
Expected tax rate		18%	