Consultation on Coffey Review

KPMG Response

30 January 2018

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Consultation paper on review of Ireland's Corporation Tax Code
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Dear Sirs

KPMG response to Consultation on Coffey Review

We are pleased to enclose our submission in response to the public consultation by the Department of Finance on the review of Ireland's Corporation Tax Code.

Ireland's corporation tax regime has formed an important part of Ireland's policy initiatives which serve to attract and retain foreign direct investment (FDI) as well as making Ireland an attractive location for domestic entrepreneurs to conduct business through corporate entities. KPMG acknowledges the continuing importance to Ireland of ensuring that its corporation tax regime maintains its competitiveness from an international perspective whilst aligning the regime with international developments emerging from the OECD's project on Base Erosion and Profit Shifting (BEPS) and related initiatives under the European Union (EU) Anti-Tax Avoidance Directive (ATAD).

We have responded to all of the questions in the consultation and grouped our responses into three areas:

- Ireland's implementation of anti-BEPS measures contained in ATAD,
- Recommendations for consideration in relation to Ireland's transfer pricing regime as set out in the Review of Ireland's Corporation Tax Code by Seamus Coffey, and
- Considerations relating to the adoption of a more territorial regime for taxation of foreign profits together with suggestions related to simplifying Ireland's existing regime for granting double tax relief.

In overall terms, we consider that Ireland's corporation tax regime is well positioned to meet the new requirements for corporation tax regimes. However, like any other jurisdiction, Ireland faces challenges in adopting these measures and knitting them into its existing regime in a manner that is experienced by business as an evolution and not a revolution in approach. Certainty of tax outcomes promotes and sustains investment by business.

In framing our responses, we believe have balanced the requirement for Ireland to align its regime with these new international standards with implementation changes that should be experienced as an organic evolution of the regime. We have also looked ahead to test how the combined effect of our suggestions across these three areas could work in the overall context of Ireland's corporation tax regime.

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Preface

Envisioning Ireland's future tax regime

KPMG welcomes the opportunity to respond to this consultation on recommendations set out in the Coffey Review of Ireland's Corporation Tax Code.

KPMG is the largest provider of business taxation advice in Ireland. We have drawn on our experience of providing advice to businesses across a range of sectors to provide in-depth comments in response to the consultation questions.

The consultation address a series of complex matters which will be of fundamental importance in shaping Ireland's future corporation tax regime.

Our responses set our suggested approaches to:

- ***Adopting complex measures set out in the European Union (EU) Anti-Tax Avoidance Directive (ATAD) in a manner which represents a best fit for Ireland's tax existing tax system.***

  The complexity of adopting ATAD measures into Ireland's tax regime arises in part because of the judgments necessary to apply general provisions in the Directive in a manner that meets a minimum standard of providing equivalent protection. Our analysis considers how this standard of protection might operate, in practice, when ATAD measures are applied in the wider environment of Ireland's tax system and interact with protections already in Ireland's regime.

  Through a series of suggestions related to each ATAD measure, we have made recommendations on implementing the measures in a manner that we believe fits Ireland's corporation tax regime and is aligned with existing protections in Ireland's tax system.

  We believe that our suggestions, if implemented, should preserve the relative competitiveness of Ireland's tax regime post adoption EU-wide of ATAD measures while meeting the required minimum standard of protection.

  We have attempted to identify implementation approaches and legislative changes that build on concepts already familiar to business and to Revenue. This is so that the measures could be understood in their application and provide for certainty of outcomes once they are in effect.

- ***Ireland's transfer pricing regime***

  We foresee that transfer pricing will become a more central part of Ireland's corporation tax regime providing both protections for Ireland to assert its taxing rights on profits arising from international trade by Irish based businesses as well as protecting its domestic tax base.

- ***Framing a tax regime which offers greater simplicity to taxpayers operating in an international environment***

  Adopting a foreign branch exemption regime which is available at the election of taxpayers and introducing an exemption regime for certain foreign dividends should simplify Ireland's tax regime for Irish based business seeking to grow internationally.

  We have also suggested changes that could be made to Ireland's existing capital gains exemption regime for gains on disposals of substantial shareholdings.

Our approach

Our recommendations are detailed and technical in nature because we consider that detailed consideration is required to implement changes to these important aspects of Irelands' corporation tax regime in a manner that provides

greatest certainty for taxpayers and, where possible, simplifies its operation in a number of key respects.

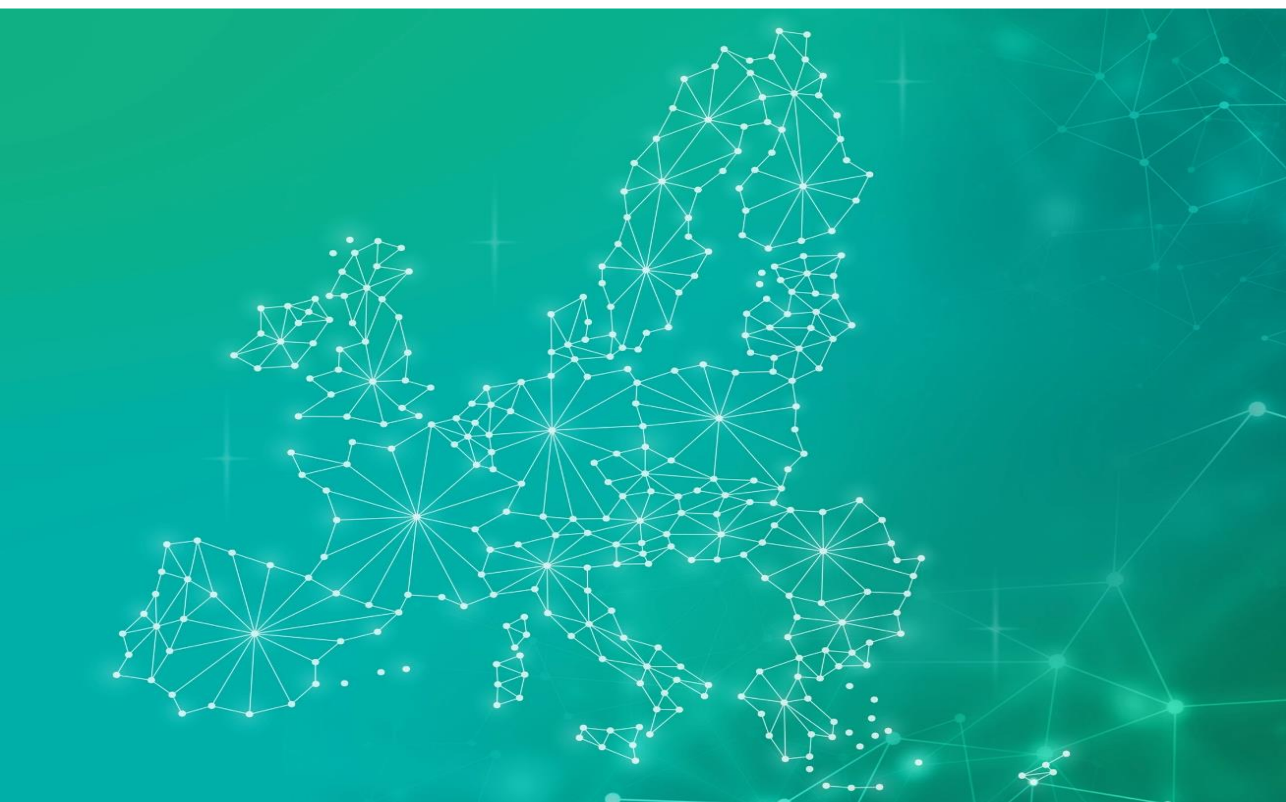
We consider that adoption of the measures set out in this submission could provide an environment where Ireland ultimately adopts a single 12.5% corporation tax rate applying to all profits subject to corporation tax. This simplification in the operation of Ireland's regime is one which we believe Ireland should aspire to achieve within the next few years.

The United Kingdom ('UK') offers a single, reduced rate of 19% on all profits subject to corporation tax for all companies whatever their size or ownership. The striking simplicity and power of the UK tax policy choice on corporation tax can be seen when you compare its regime with an Irish corporation tax regime that has different tax rates for trading income, non-trading income and capital gains and a different effective tax rate for certain profits earned by closely-held companies.

These tax rate differences have, in the past, served to provide protections against the potential base erosion of Ireland's domestic tax base. In circumstances where additional protections are introduced under the adoption of ATAD anti-base erosion measures as well as changes which we have proposed to Ireland's transfer pricing regime, we suggest that protections based on higher corporation tax rates are no longer required.

We recommend that, once these additional protections are in place, Ireland should remove the higher tax rates from its corporation tax regime so that a simplified, and more powerful, corporation tax 12.5% regime remains. This regime can better compete in attracting and retaining investment in an international context.

Our suggestions in relation to the adoption of ATAD measures, changes to Ireland's transfer pricing regime and moving to a more territorial regime seek to achieve, over time, an appropriate balance of different protections so as support this necessary simplification of Ireland's existing corporation tax regime.



Executive summary

The summary below provides a high level overview of KPMG recommendations made in response to the consultation questions. Our response is grouped into three areas which are reflected in three different sections in this submission. They follow the main themes of the consultation being our response and recommendations in relation to: Ireland's adoption of measures under the EU Anti-Tax Avoidance Directive (ATAD); transfer pricing matters; and, moving to a more territorial regime by introducing an exemption regime for certain foreign dividends and adopting an elective branch exemption regime. The final section also includes suggestions in relation to the simplification of Ireland's regime for affording foreign double tax credit relief where an exemption does not apply. Some of the sections refer to supplementary materials that are included in Appendices.

SECTION 1:
Anti-BEPS MEASURES CONTAINED IN ATAD

Question 1: General Anti-Abuse Rule

In order to more perfectly align the Irish General Anti-Abuse Rule ('GAAR') with the minimum standard framework set out under ATAD, we suggest changes should be made to section 811C, Taxes Consolidation Act 1997 (TCA 1997) as follows:

- ✓ Delete subparagraph (II) of subsection (2)(b)(i) which provides that a taxpayer must meet both a tax avoidance test and a business test. This is because ATAD GAAR provides that GAAR does not apply if a taxpayer meets the genuine arrangements test (i.e. even if there is a tax avoidance purpose).
- ✓ Revise the application of the "*business*" exception test at subsection (2)(b)(i)(I) so that the test does not require that activities be carried on with a view to realising a profit.
- ✓ Revise the definition of "*business*" at subsection (1)(a) so that it is not limited to any trade, profession or vocation but includes other business activities.
- ✓ Make expressly clear that the reference to double taxation relief which is set out in subsection (4)(d) includes relief, if applicable, for foreign taxes.

Question 2: Controlled Foreign Company (CFC) rule

The following is an overview of the key features we suggest should be reflected in a CFC rule. We believe that this approach is both aligned with Ireland's international tax policy objectives, avails

of appropriate flexibility under ATAD and meets the ATAD minimum standard of protection.

- ✓ Adopt one of three permitted approaches under ATAD which limits the CFC rule to income which has been artificially diverted to the CFC. Apply the framework set out at subparagraph 2(b) of Article 7, 'the Option B approach'.
- ✓ Under Option B, define "*essential purpose to obtain a tax advantage*" as set out in ATAD to mean a purpose of artificially diverting income to the CFC. Provide a safe harbour that, if the activities of the CFC are in the nature of a trade under Irish tax principles, the taxpayer can assume that arrangements that form part of that trade have not been put in place with the purpose of artificially diverting income.
- ✓ Apply a gateway to exclude from the scope of a CFC rule arrangements that meet the genuine arrangements test. If this gateway is failed, the taxable CFC income is limited to amounts generated through assets and risks which are linked to significant people functions carried out by the Irish controlling company.
- ✓ To provide additional protection from artificial diversion of income, where the income of the CFC is non-trading in character under Irish tax principles, there is an alternative gateway test if the purpose test is failed. This gateway requires the CFC to meet a genuine economic activities test. If this is failed, the non-trading income (not already taxable in Ireland) is in scope of the CFC rule. The genuine economic activities carve out means that this protection operates in a manner which is aligned with EU freedoms.
- ✓ A subsidiary is potentially a CFC where the Irish parent meets a greater than 50% ownership test which is set by reference to percentage of votes, share capital, entitlement to profits on winding up and distributable profits as well as a company included in a consolidated accounting group of the Irish parent.
- ✓ Apply the CFC rule to the tax exempt profits of foreign branches where Ireland applies a foreign branch exemption regime.
- ✓ Preserve Ireland's tax treaty obligations related to capital gains of treaty resident CFCs.
- ✓ Provide for a White List of excluded countries solely as a basis to reduce the taxpayer burden of calculating for each taxable period the effective tax rate of each subsidiary. This would not allow the taxpayer to presume that the CFC had met either the genuine arrangements or genuine economic activities test under the suggested gateway tests.
- ✓ Apply a simplification approach to achieve a proportionate reduction in compliance burden when calculating the effective tax rate of the CFC under Irish tax principles by taking as a starting point the timing of recognition of the income in the accounts of the CFC in its functional currency for the tax accounting period. Apply Irish capital gains tax principles to compute capital gains in the local functional currency to avoid distortions caused by currency movements.
- ✓ Apply permitted exclusions by excluding from scope subsidiaries with accounting profits of no more than EUR 750,000 and non-trading income and non trade related capital gains of no more than EUR 75,000 as well as subsidiaries whose accounting profits amount to no more than 10% of operating costs for the period.
- ✓ Avoid double taxation by providing credit relief for taxes on CFC taxable income for foreign taxes which are equivalent to corporation tax, including EU CFC charges on the same profits. Provide double tax relief if profits assessed to tax under the CFC regime are later received as a taxable dividend or realised as part of a taxable capital gain on disposal of a CFC.
- ✓ Provide transitional relief to the Irish parent for subsidiaries acquired from third parties by not applying the CFC rule to the acquired subsidiary until the second tax accounting period post acquisition.
- ✓ Develop the CFC legislative measures in close consultation with businesses and tax practitioners to ensure they can operate as intended across different business sectors in Ireland. Support implementation with detailed guidance developed in conjunction with business and tax practitioner representatives.
- ✓ Apply with prospective effect to CFC income of companies for tax accounting periods beginning on or after 1 January 2019.

Question 3: Exit taxation

Having reviewed the framework for the exit taxation regime set out in Article 5 and in the recitals to the Directive, our recommendations for revisions to Ireland's existing exit tax regime are as follows.

- ✓ Apply 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. (The capital gains tax rate of 33% currently applies to an exit gain).
- ✓ Apply transfer pricing principles to the exit gain by pricing the market value of the asset upon import and exit using transfer pricing principles set down in the OECD Guidelines on transfer pricing.
- ✓ Measure the exit gain in the functional currency of the company (using an average exchange rate to translate the taxable measure in functional currency into Euros to arrive at the exit tax payable amount).
- ✓ Apply an uplift in tax basis to the market value (established under arm's length principles) of an imported chargeable asset, whether imported from EU Member States or third country jurisdictions.
- ✓ Extend exit tax events to the transfer of an asset to a foreign tax exempt branch (in the event that Ireland moves to adopt a foreign branch exemption regime) and more generally broaden the scope of exit taxation events to align with the four exit taxing events described in Article 5. This includes removing the concept of an excluded company from the existing regime.
- ✓ In order to meet the ATAD minimum standard, potentially remove the ability to postpone the entirety of the exit charge under section 628, leaving only the possibility which is permitted under ATAD of deferring the payment over a 5 year period (which is given under section 628A).
- ✓ Apply domestic reliefs including the substantial shareholding gains exemption available under section 626B, TCA 1997 in determining the amount of the chargeable exit gain.
- ✓ Adopt permitted exceptions for temporary transfers of assets in certain financial services transactions.
- ✓ Adjust the manner of operation of the relief under section 634, TCA 1997 to align with CJEU case law and exit tax principles.

Question 4: Hybrid mismatch measures

We recommend that Ireland adopts the following approach to implementation of hybrid mismatch measures.

- ✓ Implements the framework under ATAD without going beyond that framework i.e. does not apply hybrid mismatch counter measures to payments to jurisdictions with a nil tax rate nor to mismatches arising from transfer pricing adjustments.
- ✓ Implements the main measures with effect from 1 January 2020 and potentially adopts the extended implementation deadline of 1 January 2022 for reverse hybrid measures.
- ✓ Excludes the securitisation regime set out at section 110, TCA 1997 from the general scope of the measures but instead adjusts the anti-hybrid measures already contained in section 110 so that they are aligned with the ATAD regime.
- ✓ Applies the ATAD hybrid mismatch approach to the design of a branch exemption regime i.e. does not provide for a branch exemption under domestic law unless the profits of the foreign branch are subject to tax in the branch jurisdiction.
- ✓ Applies the ATAD hybrid mismatch approach to the design of a dividend exemption regime i.e. does not apply a dividend exemption where the payor has claimed a deduction for the dividend payment.
- ✓ Excludes lease receipts from the scope of the secondary defensive measures as such receipts are already included in taxable income.
- ✓ Avails of the permitted exemptions to exclude certain 'on-market' repo transactions, certain loss absorption regulatory capital instruments in the banking sector, and defined collective investment vehicles from the scope of the measures.
- ✓ Treats 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 recipient from an Irish perspective.
- ✓ Designs measures after close review and analysis of international tax developments,

especially in jurisdictions such as the United States of America (US) (which has seen a major reform of its tax regime including international tax matters).

- ✓ Consults with business and tax practitioners, including review of draft legislative measures prior to enactment, to ensure that the measures are understood across business sectors and achieve their intended effect.
- ✓ Provides detailed implementing guidance to provide certainty for taxpayers on the scope and application of the measures.

SECTION 2:
IRELAND'S TRANSFER PRICING REGIME

Question 5: Key considerations when incorporating the 2017 OECD Transfer Pricing Guidelines

We consider that the 2017 OECD Transfer Pricing Guidelines ('the 2017 Guidelines') are the appropriate reference point for Ireland's transfer pricing rules:

- From a defensive perspective in asserting Ireland's right to tax profits associated with the control of risk and oversight of DEMPE functions by Irish based decision makers.
- In protecting Ireland's domestic tax base by adopting transfer pricing guidance which is consistent with the outline approaches suggested in this submission in relation to adoption of an EU compliant CFC regime and exit taxation measures.
- To reduce the risk of double taxation and uncertainty for taxpayers which could arise where Ireland's framework for transfer pricing is out of line with the framework adopted by its major trading partners.

Considerations for adoption include:

- ✓ *timing of implementation with adequate advance notice of adoption for taxpayers*,

  If a decision is taken in 2018 to adopt the 2017 Guidelines, a mandatory date for adoption should apply no earlier than 2020.

  The operative date should be signalled as soon as possible in 2018.

  In recognition of the position faced by businesses who already operate in an international environment where the 2017 Guidelines are applied, allow for early adoption by taxpayer election for 2018 or 2019 tax accounting periods.

- ✓ *application to intra group financing transactions*,

  Ireland should not seek to change its current approach to transfer pricing of financing arrangements until there is international consensus on how Article 9 (of the OECD Model Tax Convention) applies to capital and debt.

  It is important that Ireland continues to actively engage in the OECD working group on pricing financial transactions and capital in order that its views can be taken into account as the OECD works to develop consensus in this area.

- ✓ *application of the authorised OECD method of attribution of profits to branches*,

  We suggest that Ireland adopts the authorised OECD approach to the attribution of profits to branches both in the case of Irish branches of non-tax treaty resident entities and in the case of foreign branches of Irish residents that are not located in tax treaty jurisdictions.

- ✓ *their application to the pricing of transactions in capital assets within the corporation tax regime, and*
- ✓ *readiness for adoption on the part of business and Revenue.*

Question 6: Arrangements that were agreed before 1 July 2010

It would be appropriate to include within the scope of the transfer pricing regime those arrangements which are still in place that were agreed before 1 July 2010 ('grandfathered arrangements'). This should be done with prospective effect and not require the application of transfer pricing adjustments to past transactions under grandfathered arrangements.

We suggest that this approach is followed, with one exception. This 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 do not change and the loan remains in place between the same counterparties.

Question 7: Extension of transfer pricing rules to SMEs

The existing scope of application of Ireland's transfer pricing regime should be retained to apply to entities within groups that exceed the EU size thresholds for SMEs.

This appears to achieve an appropriate balance between the risk of loss of tax revenues from mispricing of transactions in cross border trade between group members of SMEs with the complexity and administrative burden associated with meeting transfer pricing requirements. This also avoids the potential adverse impact on Revenue's transfer pricing resources of administering compliance for a higher volume of transfer pricing cases if the regime is extended to enterprises of a smaller scale.

If transfer pricing is extended to smaller enterprises, it should not be extended to entities that do not exceed the EU size definition of a small or micro entity[1].

If it decided to extend transfer pricing rules to medium sized enterprises, we suggest that:

- ✓ Safe harbour approaches are introduced which would not require transfer pricing documentation to be prepared where a transaction is within the scope of defined safe harbour transactions and potentially also safe harbour pricing ranges.
- ✓ Medium sized entities can avail of a lighter touch minimum documentation standard than that which applies to larger taxpayers.
- ✓ Optional adoption is made available to those SMEs that seek to put in place Irish transfer pricing arrangements e.g. to align their Irish position with that which applies to group members in other jurisdictions that apply full local transfer pricing requirements.
- ✓ Early announcement and potentially deferred adoption for smaller companies in comparison to larger companies to allow smaller companies greater time to review intra group transactions and to put appropriate transfer pricing documentation in place.

Question 8: Extending domestic transfer pricing rules to non-trading income

The difference in corporation tax rate between the 12.5% rate of tax on trading income and the 25% rate of tax on non-trading income means that the application of transfer pricing to non-trading income could result in an outcome which is not neutral for transactions between two taxpayers within the scope to Irish corporation tax. This is notwithstanding that this is neutral from a transfer pricing perspective as the understated income of a counterparty which is subject to a transfer pricing adjustment is matched by the overstated income of the corresponding party to the transaction.

Developments in an EU test case on the non-application of transfer pricing provisions to

[1] A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million.

transactions between domestic taxpayers suggests that the non-application of transfer pricing to such transactions is not in breach of EU fundamental freedoms.

If the positive December 2017 decision of the Advocate General is upheld by the Court of Justice of the European Union (CJEU), Ireland could reframe its transfer pricing regime and:

- apply transfer pricing to non-trading transactions, but
- not apply transfer pricing to transactions between domestic taxpayers.

By adopting this approach, Ireland's regime could both be more robust in protecting against potential misuse in the context of cross border mismatches arising from differences in transfer pricing whilst remaining compliant with EU freedoms.

At a minimum, if the AG's opinion is upheld by the CJEU, it should support the application of simplified procedures for transactions between domestic taxpayers as compared to the regime applicable to transactions with taxpayers outside the charge to Irish tax.

If it is decided to retain transfer pricing for transactions between domestic taxpayers, legislative change of a procedural nature could be made to avoid the disproportionate impact of the differences in tax rate between trading and non-trading income.

This would include:

- ✓ Measuring the corresponding adjustment in like manner and applying the same rate of tax for the counterparty companies.
- ✓ Providing relief for corresponding adjustments on a current period basis and on a self-assessed basis for taxpayers.

Extending transfer pricing approach to capital transactions

We suggest that it would be appropriate to apply transfer pricing principles to the measurement of:

- ✓ The market value consideration which is applied in measuring the disposal consideration of chargeable assets under the Corporation Tax Acts.

  We suggest that this approach should be adopted in tandem with the application of a 12.5% rate of corporation tax to chargeable gains arising on the disposal of chargeable assets in use for the purposes of a trade.
- ✓ The amount of expenditure eligible for capital allowances on assets acquired from non-resident group members.

These changes should not affect the continuing application of capital gains tax provisions to transactions by individuals where market value is applied to measure the taxable disposal proceeds on chargeable assets and the assets are not being held as part of a trade or business undertaking.

Question 9: Transfer pricing documentation requirements

In order to balance the protections afforded by having robust documentation standards applicable in Ireland to transfer pricing which meet international norms with the documentation compliance burden for taxpayers, we consider that it would be appropriate to:

- ✓ Require transfer pricing documentation to be prepared no later than the due date for the filing of the corporation tax return for the tax accounting period in which the relevant transaction was reflected.
- ✓ Impose the full scope of the transfer pricing documentation requirements which are described in the final report under Action 13 of the BEPS Project on taxpayers who are within the scope of the Country-by-Country (CbyC) reporting requirements.
- ✓ Issue guidance on the expected scope of documentation to be included in the master file and local file balancing information requirements of use to Revenue with the burden associated with documentation preparation. The guidance could allow for appropriately adjusted documentation requirements to apply to smaller multinationals.
- ✓ In keeping with current Irish best practice in relation to transfer pricing documentation, Ireland's formal adoption of transfer pricing documentation requirements should be aligned with OECD guidelines and should not impose additional requirements solely for Irish transfer pricing purposes.
- ✓ In circumstances where an Irish taxpayer has access to transfer pricing documentation which is aligned with the OECD standard and covers the transaction that the Irish entity is party to, Ireland continues its current practice of not

requiring that the company itself must prepare the documentation or that the documentation must be in Ireland, once it can be made available to Revenue.

- ✓ Adopt safe harbour approaches to transfer pricing. A taxpayer is not required to prepare pricing documentation where a transaction falls within scope of a defined safe harbour.

  Safe harbours also benefit Revenue as they reduce the administrative burden of reviewing pricing documentation for agreed safe harbour transactions. A number of possible approaches are set out in our response to Question 7 (as safe harbours can be expected to provide greatest proportionate relief for enterprises of a smaller scale).

- ✓ Should transfer pricing be extended to SMEs, in accordance with OECD guidance, SMEs should only be required to provide information about their material cross-border transactions upon a specific request from Revenue in the course of a tax audit or for transfer pricing risk assessment purposes.

SECTION 3:
ADOPTING A TERRITORIAL REGIME

Question 10: Suggestions for an elective branch exemption and dividend exemption regime

Outline of suggested Irish branch elective exemption regime

We suggest that Ireland could move to adopt a branch exemption regime which would be available at the election of taxpayers along the following lines:

- ✓ Exempt from tax profits arising from a trade conducted through a foreign branch in any jurisdiction outside Ireland. Exclude countries which are included on an EU blacklist of jurisdictions which do not meet acceptable corporate tax governance standards.
- ✓ The exemption is available only where the branch is engaged in the conduct of a trade.
- ✓ Apply Ireland's CFC regime to the foreign branch profits exempt from Irish tax.
- ✓ Exemption is not available where the branch is not recognised as a taxable presence in the branch jurisdiction i.e. the branch exemption would be available only where the profits of the branch can be said to be subject to tax in the foreign jurisdiction.
- ✓ The exemption extends to branch profits whether in the character of income or capital gains arising to the branch.
- ✓ Apply Ireland's exit taxation regime to accruing capital gains on assets transferred from an Irish taxable presence to a foreign tax exempt branch.
- ✓ For maximum flexibility, make available the branch exemption regime at the election of companies, on a branch-by-branch basis.
- ✓ Relief would not be available for foreign taxes on branch profits where the exemption regime applies.
- ✓ Relief would not be available for branch losses against Irish profits where the branch exemption applies. This is with the exception of any 'final' and otherwise unused losses arising on the 'liquidation' or unwind of the foreign branch. In accordance with EU case law precedents, these losses should remain available for use against Irish profits.
- ✓ Transitional measures related to past branch losses would apply in moving to adopt a branch exemption regime and also where a taxpayer makes a future election to apply the exemption regime to a previously loss making branch. These essentially provide that the exemption from Irish tax is available to the extent the branch profits exceed branch losses previously offset against Irish profits.
- ✓ In circumstances where a taxpayer conducts a business through a transparent entity such as a partnership and the business gives rise to a taxable branch presence abroad, the corporate partner should be entitled to the branch exemption on its share of the foreign branch

profits provided that the partner's indirect interest in the branch's profits represents a holding of at least 5%.

Outline of dividend exemption regime

We suggest that a dividend exemption regime should apply as follows:

- ✓ Apply to dividends where the Irish resident company has a direct or indirect interest of at least 5% in the company from which the company is ultimately sourced.
- ✓ To be eligible for exemption, the dividend (which may be tracked through any number of intermediary layers of company) should be paid by a company which is resident for tax purposes in a jurisdiction to which Ireland's substantial shareholding exemption on capital gains applies i.e. tax treaty jurisdictions.
- ✓ A dividend exemption should not be available where the payor has secured a tax deduction for the dividend.
- ✓ For tax exempt dividends, tax relief would not be available for taxes borne on payment of the dividend or for taxes borne on the profits from which the dividend is paid.

Section 3 includes detailed suggestions in relation to the simplification of Ireland's existing double tax credit relief regime for foreign taxes on branch profits, dividends and royalties.

In the case of branches, these include:

- ✓ Providing certainty on the deductibility of foreign tax as an expense of the trade in the case of branch losses.
- ✓ Amending paragraph 9FA, Schedule 24, TCA 1997 so that Ireland's unilateral credit pooling relief for tax credits on branches can operate as intended.
- ✓ Providing for the operation of credit relief on a pooling basis for branches operating in business sectors (such as insurance) with business profit cycles which can apply over periods of 7 to 10 years.

In the case of dividends it is suggested that Ireland should:

- ✓ Permit taxpayers to track and attribute tax credits to dividends solely by reference to a taxpayer election which is not tied into resolutions made under local company law.
- ✓ Change the manner of operation of credit relief under paragraph 9I, Schedule 24, TCA 1997.
- ✓ Simplify the operation of tax credit relief for dividends paid from the profits of indirect subsidiaries by calculating tax credits on a pooled basis for the profits of a holding company and its subsidiaries.

In the case of Ireland's tax credit regime for royalties, we suggest that Ireland adopts the following simplification measures:

- ✓ Rewrites the legislative measures which underpin the operation of the credit relief regime for royalties to make them easier to read and more straightforward to administer in practice.
- ✓ Provides clarity on the scope of royalty payments that are eligible for the relief in the context of payments for services.
- ✓ Clarifies the entitlement of the company to deduct excess and unused creditable foreign taxes on royalty income under general principles.

Ireland could also improve the competitiveness of its regime for credit relief on royalties by enhancing its regime but it is recognised that these changes may have cost implications. These include:

- ✓ calculating the net income measure (which operates to limit the amount of credit relief) by reference to net margins from the royalty profits instead of by reference to the margins of the trade as a whole,
- ✓ offsetting excess unused credits against other income of the trade, and
- ✓ pooling surplus tax credits to carry forward for use in future periods.

We suggest different approaches to introducing enhancements to balance Exchequer costs.

In tandem with adoption of a branch and dividend exemption regime, Ireland should review the operation of its corporation tax exemption for capital gains on disposals of substantial shareholdings to provide greater certainty that corporation tax only applies once within a corporate holding structure. This could include changes to:

- ✓ the substantial shareholding exemption at section 626B, TCA 1997
- ✓ repeal section 591A, TCA 1997 which applies to 'abnormal dividends', and
- ✓ clarify the interpretation and application of the scope of corporate reorganisation and reconstruction reliefs especially where shareholders are otherwise tax exempt on income and gains from the company.

SECTION 1: Anti-BEPS measures contained in ATAD

Introduction

In Section 1, we set out our response to Questions 1 to 4 of the consultation on matters for Ireland to consider upon implementation of anti-avoidance measures contained in ATAD. These include a General Anti-Abuse Rule, a Controlled Foreign Company rule, exit taxation and hybrid mismatch measures.

Ireland will need to adopt a complex set of measures in ATAD which are only framed in general terms in the Directive. This requires careful consideration of how the measures could best fit into Ireland's existing corporation tax system. In recognition of this complexity, our comments and suggestions in response to Questions 1 to 4 are technical and detailed in nature.

We believe that our response illustrates that, notwithstanding the complexity, Ireland can implement ATAD measures in a manner which is consistent with the existing framework of its corporation tax regime.

We believe that this can also be done in a manner that future proofs Ireland's regime when we look ahead to the potential interaction of ATAD measures with future changes to Ireland's transfer pricing regime as well as the possibility of moving to a more territorial regime.

In framing our suggestions for adoption of the ATAD measures, we have assumed that Ireland will adopt changes that we have suggested in our response in Section 2 of this document on transfer pricing matters and will also move to adopt an exemption regime for foreign branch profits and certain foreign dividends (discussed in Section 3).

In order to test if the suggested policy and technical choices in adopting ATAD measures represent a best fit for Ireland's existing system, we have sought to identify to commonalities between the principles underlying ATAD measures and the policy principles which form part of the framework of Ireland's regime.

One of the most important of these principles is that Ireland only seeks to tax profits which are attributable to activities carried on in Ireland except in circumstances where profits have been artificially diverted to entities outside the charge to Irish tax. This has led to the suggested approach for adoption of a CFC rule.

Ireland's corporation tax regime is focused on providing certainty of taxation for taxpayers whilst remaining in line with international best practice and meeting its obligations under EU law.

Given the complexity associated with implementation of ATAD measures and the relatively short timeframe for adoption, we urge that policy makers and Revenue work closely with industry and tax practitioners in implementing the measures. This should include consultations based on draft legislative measures. By testing the operation of draft legislative measures against outcomes across a range of business sectors which operate in Ireland, businesses and Revenue alike can be confident that the measures, when implemented, will fit within Ireland's tax regime in a manner that is understood and provides certainty of outcomes.

We have anticipated that, at a future date, Ireland will also move to adopt a further ATAD measure which is a general interest limitation rule. Where relevant, we have considered how adoption of other ATAD measures could potentially impact the future adoption of an interest limitation rule and have included comments in the relevant part of our response.

Question 1: Matters to consider on implementation of a General Anti-Abuse Rule (GAAR)

Overview of suggested approach to implementation of GAAR

The approach and design of Ireland's General Anti-Avoidance Regime (GAAR) at section 811C, Taxes Consolidation Act 1997 (TCA 1997) is aligned in a number of ways with the GAAR which is set out at Article 6 of ATAD. It requires some changes to align it more perfectly.

Under ATAD, GAAR is focused on counteracting the abuse of corporate income tax measures. Ireland's GAAR covers a range of taxes beyond corporation tax including income tax, capital acquisitions tax, stamp duty, and more.

At recital 11 to the Directive, it is stated that '*Within the Union, GAAR should be applied to arrangements that are not genuine; otherwise the taxpayer should have the right to choose the most tax efficient structure for its commercial affairs*.'

In order to more perfectly align the Irish GAAR with the minimum standard which is set out in the recital to the Directive and the framework for GAAR set out in Article 6, we suggest the following changes should be made to section 811C:

- ✓ Delete subparagraph (II) of subsection (2)(b)(i) which provides that a taxpayer must meet both a tax avoidance test and a business test. This is because ATAD GAAR provides that GAAR does not apply if a taxpayer meets the genuine arrangements test (i.e. even if there is a tax avoidance purpose).
- ✓ Revise the application of the "*business*" exception test at subsection (2)(b)(i)(I) so that the test does not require that activities be carried on with a view to realising a profit,
- ✓ Revise the definition of "*business"* at subsection (1)(a) so that it is not limited to any trade, profession or vocation but includes other business activities.
- ✓ Make expressly clear that the reference to double taxation relief which is set out in subsection (4)(d) includes relief, if applicable, for foreign taxes.

Detailed overview of GAAR

In the table below, we have set out a high level overview of the features of the ATAD GAAR regime which are described both in the recitals to the Directive and in Article 6. We have compared these with the features of the Irish regime which are set out under section 811C, TCA 1997.

Alignment of Irish regime	Features of ATAD GAAR regime
✓	GAAR has a function to fill in gaps which should not affect the applicability of specific anti-abuse rules. This is how Irish GAAR has been applied.
✓	Taxpayer has the right to choose the most tax efficient structure for its commercial affairs. This is set out in recitals to the Directive. This principle is well established and applied under Irish case law.
✓	GAAR applies to transactions with domestic, EU and third country counterparties in a uniform manner. The application of GAAR in a domestic and cross border context does not differ. The Irish provisions apply to the Irish tax consequences of arrangements with Irish and non-Irish counterparties.
✓	Penalties can apply under GAAR.
✓	ATAD GAAR is confined to corporate income tax. Section 811C applies to a broad range of Irish taxes including corporation tax.
?/X	Application of genuine economic arrangement test to all business activities (including potentially financial activities). If the taxpayer satisfies the genuine economic test, GAAR does not apply. The scope of the genuine economic arrangement test is framed as a business exception test under Irish GAAR and requires both that a business related test is satisfied and that the purpose of the transaction was not to give rise to a tax advantage. The scope of business activities is limited only to those activities that are undertaken with a view to realising a profit and which are considered to be in the nature of a trade, profession or vocation for Irish tax purposes. ATAD GAAR applies only where both of the following apply: ■ there is an arrangement or series of arrangements which have been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, and ■ they are not genuine having regard to all relevant facts and circumstances in that they are not put into place for valid commercial reasons which reflect economic reality. This means that under ATAD GAAR will not apply where the taxpayer meets the genuine economic arrangements test.

Alignment of Irish regime	Features of ATAD GAAR regime
	Under section 811C, Irish GAAR may not apply if **both** tests set out under subparagraphs (2)(b)(i)(I) and (II) are met. Subparagraph (I) requires that the transaction "*was undertaken …with a view to the realisation of profits in the course of the business activities of a business carried on by the person*." Business for this purpose is defined at subsection 1(a) to mean "*any trade, profession or vocation*" which includes a subset only of the broader range of potential business activities. The application of the business test appears not to be aligned with the framework for ATAD GAAR in two respects. The first is to require a profit realisation motive and the second is to confine the definition of business to a subset only of business activities. The second test under subparagraph (II) further requires that the transaction "*was not undertaken primarily to give rise to a tax advantage*". ATAD is clear in not requiring a taxpayer to meet an additional tax avoidance purpose test where there are genuine arrangements that are in place for valid commercial reasons which reflect economic reality.
✓	A tax advantage under GAAR is one that defeats the object or purpose of the applicable tax law. A tax advantage under section 811C is very widely defined but an exception is provided (at subsection (2)(b)(ii)) to disapply section 811C where the transaction did not result directly or indirectly in a misuse of the provision or an abuse of the provision having regard to the purposes for which it was provided.
?/✓	Affords reliefs from double tax where relevant. Subsection (4)(d) of section 811C provides for relief from double taxation. All other references in section 811C are to taxes administered by the Irish Revenue. It would be welcome to have clarity that the reference to relief from double taxation could also include double taxation arising by reason of the imposition of foreign and Irish taxes to the same item.
✓	The in scope transaction is ignored and re-characterised for domestic tax purposes. This is the consequence for the relevant Irish taxes where a transactions falls within the scope of section 811C.

As can be seen from the comparative overview of the key features of Irish GAAR and the GAAR framework set out in recitals to ATAD and in Article 6 of the Directive, many aspects of Ireland's regime are aligned with the framework of the regime set down in the Directive. This is with the exception of areas which are identified above and which are discussed further below.

a. ATAD GAAR does not apply to genuine arrangements

The framework for GAAR as set out in the Directive involves the imposition of a two part test to each transaction. This is that there is a motive to avoid tax and, further, that there are not genuine arrangements which are defined by reference to a requirement for sufficient economic reality to be associated with the transaction. Where the genuine arrangements test is satisfied, the Directive provides that GAAR should not apply.

It is clear from the wording in recital 11 to the Directive that this formulation for GAAR is to apply throughout the EU i.e. in a consistent manner EU-wide. Recital 11 states that '*Within the Union, GAAR should be applied to arrangements that are not genuine; otherwise the taxpayer should have the right to choose the most tax efficient structure for its commercial affairs.*'

This formulation of the GAAR test is broadly consistent with case law from decisions of the Court of Justice of the European Union (CJEU)[2] which has established the standard for the application of anti-abuse measures as one which requires "*a wholly artificial arrangement which does not reflect economic reality".*

The genuine arrangements test in the Directive is framed as a business exception test in Irish legislation. It is set out in in two parts in subsection (2)(b)(i)(I) and (II) of section 811C. Unlike the framework for GAAR under the Directive, the second part of the test in Irish law which is set out at subparagraph (II) requires the taxpayer also to meet a motive test of the transaction not being undertaken or arranged primarily to give rise to a tax advantage. Unlike ATAD, it is not sufficient that the taxpayer has met the genuine arrangements (or business exception) test.

We suggest that subparagraph (II) should be deleted in order to meet the Directive's requirements for a GAAR that applies a consistent standard EU-wide and that is also aligned with EU case law precedents.

b. Aligning the ATAD genuine arrangements test with section 811C business exception test

The business exception test that is set out at subparagraph (I) is the formulation adopted in Irish law of the genuine arrangements test set out in the Directive. It provides that the economic reality exception which is described at Article 6(2) is available under section 811C in relation to transactions effected with a view to realising profits in the course of business activities in the nature of a trade, vocation or profession. We suggest that the operation of this exception could be more perfectly aligned with the Directive where the profit making motive is deleted and the definition of business is extended to include other business activities.

This might be done as follows:

- By deleting the words "*with a view to the realisation of profits*" from subparagraph (2)(b)(i)(I) to read as follows "*was undertaken …~~with a view to the realisation of profits~~ in the course of the business activities of a business carried on by the person.*"
- By reframing the definition of *"business*" at subsection (1)(a) to read as follows: "*business activities **which include but are not limited to** a trade, profession or vocation*".

This broadening of scope of the definition of business appears to be better aligned with the test in ATAD but also with the meaning of economic activities that has been considered by the CJEU in recent findings of the court on review of anti-abuse measures in the domestic law of Member States[3].

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[2] The leading case which established this principle is Cadbury Schweppes case, C-196/04. This principle has been endorsed by the CJEU in more recent cases in which it has considered the application of various domestic anti-abuse measures by Member States. See later footnotes for further details.

[3] In the 20 December 2017 decision in the joined cases of Deister Holding (C-504/16) and Juhler Holding (C-613/16), the CJEU reviewed anti-abuse measures in German domestic law which sought to deny relief from dividend withholding tax on dividends paid by German resident companies unless the non-resident parent company met a number of tests (one of which related to the requirement that the company was engaged in defined economic activities). The manner of definition of the economic activities under German law was found not be aligned with the EU principle that anti-abuse measures could apply in the case of a wholly artificial arrangement which does not reflect economic reality. At para 73 (referenced in para 97), the CJEU found "*The fact that the economic activity of a non-resident parent company consists in the management of its subsidiaries' assets or that the income of the company results only from such management cannot per se indicate the existence of a wholly artificial arrangement which does not reflect economic reality*".

c. Clarifying operation of double taxation relief for non-Irish taxes where GAAR applies

Finally, in order that it is clear that Irish GAAR can operate equally in a domestic as well as a cross border scenario[4] (e.g. involving EU or third country counterparties), it would be useful to expressly confirm that the reference to double taxation in subsection (4)(d) of section 811C includes double taxation which might arise by reason of the imposition of both foreign and Irish tax to the same item.

We suggest that this refinement is particularly important in the context of Ireland's requirement to respect freedoms available under the Treaty for the Functioning of the European Union in the implementation of any measures under a directive including GAAR[5]. It is clear from this evolving line of EU case law, that domestic anti-abuse measures (including affording relief from double taxation) should be applied in an equivalent manner to comparable transactions with resident and non-resident counterparties.

Related matters

Subject to the suggested changes outlined above, we consider that the interpretation of Ireland's GAAR can continue to evolve based on precedents that can emerge from judgments handed down by the Irish courts as well as by the CJEU.

We foresee that one area of EU jurisprudence that is likely to evolve in future is the question of the interaction of domestic GAAR provisions and the double tax treaty obligations of Member States. This international aspect of the application of GAAR is relevant to GAAR as it operates in the context of ATAD which focuses on international aspects of corporate income tax regimes. We recommend that Ireland's tax policy makers continue to monitor the development of EU jurisprudence on the application of general anti-abuse measures, both as it relates to the application of GAAR but also as it potentially affects Ireland's tax treaty policy.

Implementation risks

We have summarised in the table below possible implementation risks that could arise when seeking to meet the minimum standard under ATAD for a GAAR that should apply EU-wide on a consistent basis to target abuse of corporate income tax measures.

In the following table, we have described possible consequences arising from the identified implementation risks and how the risks have been addressed by our suggested implementation approach.

[4] Recital 11 to the Directive provides that '*It is furthermore important to ensure that GAARs apply in domestic situations, within the Union and vis-à-vis third countries in a uniform manner, so that their scope and results of application in domestic and cross-border situations do not differ*'.

[5] In the joined cases of Deister Holding (C-504/16) and Juhler Holding (C-613/16) (German cases) and in the Eqiom and Enka case (C-6/16) (a French case), the CJEU found that anti-abuse measures in domestic law in Germany and France respectively were in breach of EU freedoms. The cases dealt with measures which related to the payment of dividends by resident companies to non-resident companies. The burden of proof for the German or French taxpayer (related to the non-application of dividend withholding tax to dividends paid to certain non-residents) was found to be higher for certain non-resident shareholders than for domestic recipients of dividends. This difference in approach in the application of domestic anti-abuse measures under German and French law was found to represent a barrier to the freedom of establishment. It is clear from this evolving line of EU case law that domestic anti-abuse measures should be applied in an equivalent manner to comparable transactions with resident and non-resident counterparties.

Implementation risk	Consequence	Addressing risk
Not perfectly aligned with ATAD regime.	Uncertainty for taxpayers and Revenue alike in the application of domestic GAAR measures if the ATAD GAAR framework and evolving EU case law precedents on the application of GAAR in an EU context are based on measures which diverge from the domestic framework[6].	Deleting the second part of the business exception test in Irish law which requires a taxpayer with genuine arrangements to also satisfy a primary purpose tax advantage motive test which does not apply under ATAD GAAR. Clarifying that the genuine economic arrangements test can apply to business activities other than those undertaken with a profit motive and is not limited to activities in the course of the conduct of a trade, profession or vocation. Clarifying that double tax relief is also available, where applicable, for double taxes arising by reason of double taxation from the application of Irish and foreign taxes to the same item.
Not perfectly aligned with ATAD.	Risk of legal challenge to existing cases which are being litigated through the courts under notices of opinion raised under section 811C (and its pre-cursor, section 811).	Proposing the adjustments outlined above should not affect the scope of existing cases which are in the process of being litigated through the courts under section 811C (or the former version of Irish GAAR under section 811) as they should apply with prospective effect.

[6] "*Measures taken by the Member States for the prevention of fraud and abuse must be appropriate for attaining that objective and must not go beyond what is necessary to attain it"* (para 56, decision dated 20 December 2017 of the CJEU in the joined cases of Deister Holding (C-504/16) and Juhler Holdings (C-613/16) which concerned German anti-abuse measures related to withholding tax on dividends and its application in the context of the EU Parent Subsidiary Directive (90/435/EEC).

Question 2: Factors in determining the preferred approach to implementing a Controlled Foreign Company (CFC) rule in Ireland

Overview of suggested approach to implementation of CFC rule

The following is an overview of the key features we suggest should be reflected in a CFC rule. We believe that this approach is both aligned with Ireland's international tax policy objectives, avails of the appropriate flexibility under ATAD and meets the ATAD minimum standard of protection.

- ✓ Adopt one of the three permitted approaches under ATAD which limits the CFC rule to income which has artificially been diverted to the CFC. Apply the framework set out at subparagraph 2(b) of Article 7, 'the Option B approach'.
- ✓ Under Option B, define "*essential purpose to obtain a tax advantage"* to mean a purpose of artificially diverting income to the CFC. Provide a safe harbour that, if the activities of the CFC are in the nature of a trade under Irish tax principles, the taxpayer can assume that arrangements that form part of that trade have not been put in place with the purpose of artificially diverting income.
- ✓ Apply a gateway to exclude from the scope of a CFC rule arrangements that meet the genuine arrangements test. The taxable CFC income is limited to amounts generated through assets and risks which are linked to significant people functions carried out by the Irish controlling company.
- ✓ To provide additional protection from artificial diversion of income, where the income of the CFC is non-trading in character under Irish tax principles, there is an alternative gateway test if the purpose test is failed. This gateway requires the CFC to meet a genuine economic activities test. If this is failed, the non-trading income (not already taxable in Ireland) is in scope of the CFC rule. The genuine activities carve out means that this protection operates in a manner which is aligned with EU freedoms.
- ✓ A subsidiary is potentially a CFC where the Irish parent meets a greater than 50% ownership test which is set by reference to percentage of votes, share capital, entitlement to profits on winding up and distributable profits as well as a company included in a consolidated accounting group of the Irish parent.
- ✓ Apply the CFC rule to the profits of foreign branches where Ireland applies a foreign branch exemption regime.
- ✓ Ireland's CFC regime should not operate to override the rights of tax treaty jurisdictions to tax capital gains where those rights are allocated to that jurisdiction under a tax treaty.
- ✓ Provide for a White List of excluded countries solely as a basis to reduce the taxpayer burden of calculating for each taxable period the effective tax rate of each subsidiary. This would not allow the taxpayer to presume that the CFC had met either the genuine arrangements or the genuine economic activities test under the suggested gateway tests.

Overview of suggested approach to implementation of CFC rule, continued

- ✓ Apply a simplification approach to achieve a proportionate reduction in compliance burden when calculating the effective tax rate of the CFC under the Irish tax regime by taking as a starting point the timing of recognition of the income in the accounts of the CFC in its functional currency. Apply Irish capital gains tax principles to compute capital gains in the local functional currency to avoid distortions caused by currency movements.
- ✓ Apply permitted exclusions by excluding from scope subsidiaries with accounting profits of no more than EUR 750,000 and non-trading income or capital gains of no more than EUR 75,000 as well as subsidiaries whose accounting profits amount to no more than 10% of operating costs for the period.
- ✓ Avoid double taxation by providing credit relief for taxes on CFC taxable income for foreign taxes which are equivalent to corporation tax. Provide double tax relief if profits assessed to tax under the CFC regime are later received as a taxable dividend or realised as part of a taxable capital gain on disposal of a CFC. Double tax relief should also be available to offset a CFC charge to tax in another EU Member State on the profits of an indirect underlying CFC.
- ✓ Provide transitional relief to the Irish parent for subsidiaries acquired from third parties by not applying the CFC rule to the acquired subsidiary until the second tax accounting period post acquisition.
- ✓ Develop the CFC legislative measures in close consultation with businesses and tax practitioners to ensure they can operate as intended across different business sectors in Ireland. Support implementation with detailed guidance developed in conjunction with business and tax practitioner representatives.
- ✓ Apply with prospective effect to CFC income of companies for tax accounting periods beginning on or after 1 January 2019.

Ireland's tax policy objectives and a CFC regime

We understand that Ireland's adoption of a CFC regime should meet the following tax policy objectives:

- Ireland seeks to tax only profits attributable to activities in Ireland.
- A CFC regime affords appropriate protection in the event that Ireland moves to a more territorial system of taxation and provides an exemption from tax for foreign branch profits and an exemption from tax for dividends from certain foreign subsidiaries.
- Insofar as possible, the CFC regime does not present a barrier to investment or the location of substantive business activities in Ireland. This applies equally to domestic owned Irish business or internationally owned business.
- The regime operates in a manner which retains the relative competitiveness of Ireland's corporation tax regime to attract and retain business investment in Ireland.
- The regime is not overly complex or costly to administer.
- It operates in a manner that affords certainty of outcome for both business and Revenue.

Recital 12 to the Directive provides that "*depending on the policy priorities of that State, 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 have considered these three CFC approaches in the context of the Irish policy objectives outlined above. We consider that the ATAD permitted CFC approach which is most closely aligned with Ireland's policy priorities is a CFC rule which is limited to income which has artificially been diverted to the subsidiary.

In circumstances where Ireland moves to adopt a more territorial regime in relation to the taxation of foreign dividends, we have suggested[7] that Ireland should limit its dividend exemption regime to dividends from subsidiaries that are resident in qualifying jurisdictions which mirror those which are eligible for Ireland's corporation tax exemption on capital gains on disposals of substantial shareholdings. Qualifying jurisdictions are essentially jurisdictions with which Ireland has agreed double taxation treaty arrangements.

In circumstances where a subsidiary is resident neither in the EU or a tax treaty jurisdiction, Ireland potentially faces a risk of deferring taxation of the subsidiary's profits instead of never being entitled to tax those profits.

The Directives also notes (at recital 12) that it is necessary that the CFC rules extend to the profits of permanent establishments (PEs) where those profits are not subject to tax or are tax exempt in the Member State of the taxpayer.

In our response to Question 10 of the consultation on moving to a more territorial regime, we have suggested features of a branch exemption regime that should afford protection, to a significant extent, from the risk of artificial diversion of profits to a tax exempt branch. These include the suggested requirement that a branch exemption should apply only to a branch where the activities of the branch are in the nature of a trade. Whilst the CFC regime must also apply to the profits of branches that are exempt from Irish tax, given the protections which could be built in as inherent features of a branch exemption regime, our analysis below has focused on Ireland's tax regime and policy priorities as they relate to profits in foreign subsidiaries.

Broader context of the Irish corporation tax regime

Ireland's corporation tax regime offers a relatively low rate of corporation tax (12.5%) compared to that in many other countries. This, of itself, reduces the risk of profits being artificially diverted from Ireland to a subsidiary taxable in another country.

To be eligible for the 12.5% rate of corporation tax requires that the profits arise from activities in the nature of a trade[8]. When the activities are not considered to be in the nature of a trade (we have described these as *passive activities* and the related income as *non-trading income),* the profits would be subject to corporation tax at a rate of 25% if taxable in Ireland. Capital gains which are not

[7] See our response to Question 10.

[8] Where the profits arise directly to a company subject to corporation tax, the 12.5% rate applies to profits from carrying on a trade in Ireland. Where the profits arise in the form of foreign dividends, taxpayers can make an election under section 21B, TCA 1997 to tax dividends paid from trading profits of subsidiaries at the 12.5% rate.

eligible for the Irish exemption from corporation tax on gains on substantial shareholdings disposals are taxable at a rate of 33%.

When viewed from the perspective of the Irish applicable tax rate, the profits that appear to be most at risk of artificial diversion from Ireland to a subsidiary are non-trading income or capital gains not eligible for the Irish substantial shareholding exemption.

Profits in these categories might be found in subsidiaries engaged in:

- intra group financing activities,
- holding intangible assets including intellectual property and licensing or otherwise exploiting the assets to receive royalties and other income streams,

where the activities are passive activities i.e. not in the nature of a trade for Irish tax purposes.

- investment or holding company activities earning investment income and capital gains on disposal of investment assets (including shares in subsidiaries not eligible for the Irish substantial shareholding exemption).

Whilst these categories of income and the related underlying arrangements might be considered in the context Ireland's tax system to present the greatest risk of artificial diversion of profits to subsidiaries, Ireland should seek to adhere to the principles which are set out in the recitals to the Directive when adopting a CFC regime.

ATAD provides that it is necessary to seek to set a common minimum level of protection for the [EU] internal market. Ireland should therefore seek to shape its adoption of the ATAD CFC rule to meet this standard of achieving a minimum level of protection.

Whilst so doing, Ireland must also respect the fundamental freedoms set out in the Treaty for the Functioning of the European Union (TFEU)[9]. Case law set down by the Court of Justice of the European Union has established the principle that anti-abuse measures which are included in the direct tax systems of Member States should only apply to "*a wholly artificial arrangement which does not reflect economic reality*"[10].

Recital 12 to the Directive provides that, in the context of [targeting] income categories (e.g. categories such as non-trading income and capital gains which are described above), CFC measures "*should be combined with a substance carve-out aimed to limit, within the Union, the impact of the rules to cases where the CFC does not carry on a substantive economic activity.*" In the context of general provisions which ATAD includes for a CFC regime that includes protections against particular categories of income, Article 7 provides that Member States may decide to refrain from applying the substantive economic activity test to CFCs resident or situated in third countries.

Adopting an equivalent approach to EU residents and to residents of third countries is one which Ireland commonly applies in its tax system. Ireland typically applies measures on an equivalent basis to residents of EU Member States and to residents of jurisdictions in which Ireland has agreed double tax treaty arrangements. Adoption of an equivalent approach for EU residents and residents of third countries in the context of a CFC regime is also considered to be in line with Ireland's policy of ensuring its corporation tax regime does not present a barrier to businesses which operate internationally from an Irish base.

Ireland should adhere to a number of principles set out in ATAD when adopting a CFC regime which seeks to provide protection from the artificial diversion of profits from Ireland.

Ireland should:

- Meet a minimum level of protection when shaping the specific elements of its CFC rules. We believe that the minimum level of protection and the effectiveness of Ireland's adoption of the rules must be assessed by reference to the operation of those rules in the broader context of the Irish corporate tax system. It is acknowledged in the Directive that implementation is left to Member States because the framework set down in the Directive comprises only general provisions.

[9] The requirement to respect the fundamental freedoms is also acknowledged in recital 12 to the Directive.

[10] This principle was established in the leading case of Cadbury Schweppes, C-196/04, and has been endorsed in recent judgments on anti-abuse measures in EU Member States.

- Ensure that if it targets income categories that might be considered to be at greatest risk of anti-avoidance in the form of artificial diversion (which we suggest is non-trading income and certain capital gains), Ireland must respect EU freedoms. These require, broadly, that an anti-abuse measure should not apply to genuine economic activities.
- Ensure that its CFC rule is proportionate in that if it limits its CFC rule to income which has been artificially diverted to the subsidiary, Ireland should precisely target situations where most of the decision making functions which generated the diverted income at the level of the controlled subsidiary are carried out in the Member State of the taxpayer.
- Implement rules that counter avoidance but should not create double taxation.
- Retain the right to adjust a tax liability upwards in accordance with the arm's length principle, where applicable. Ireland should be in a position to continue to enforce taxing rights under its transfer pricing regime.

Protective measures in force in Ireland

Ireland already has a number of protections in place to ensure that it asserts its right to tax profits attributable to activities in Ireland. A CFC regime should only be applied in circumstances where the profits arising in the foreign subsidiary have not been accessible to tax in Ireland after applying other taxing rights.

Having applied the protections available under existing Irish law, the profits of a CFC that are not taxed in Ireland can be broadly summarised as those that:

- Arise to a company that is not resident for corporation tax in Ireland as Ireland has the right to tax profits of an Irish resident company.
- Are not accessible to taxation by means of adjusting upwards the measure of Irish profits under the arm's length principle as applied in line with OECD transfer pricing guidelines.
- Are not attributable to the activities of the dependent agent carrying on a trade in Ireland through a branch or agency.

Having closely considered the manner of application of these taxing rights, we have found that they apply with strongest effect, in practice, to profits that are considered to arise from the carrying on of activities in the nature of a trade under Irish tax principles. We have illustrated this in a range of examples in the table below.

The examples explore the manner in which Ireland can assert its taxing rights to tax the profits of non-Irish incorporated companies which are found to be tax resident in Ireland, under its transfer pricing regime, and where Irish companies act in Ireland as agents for a non-resident.

The examples illustrate a range of scenarios where the decisions and activities of individuals acting for

an Irish resident company relate to the business risks and assets of the CFC. These examples seek to highlight potential gaps in the protections against avoidance in the form of artificial diversion of profits to the CFC that we suggest should influence the manner in which Ireland shapes the specific elements of its CFC regime in a way that best fits Ireland's tax system.

Ireland's taxing rights	Application of taxing rights
Example 1: Residence The strategic business and key policy decisions of the CFC are taken by Irish resident individuals who are members of the Board of Directors of the CFC. Although Board of Directors' meetings are held in the CFC jurisdiction, the Board merely rubber stamps decisions taken by Irish resident directors who make decisions in Ireland in their capacity as directors of the CFC. The activities of the CFC's business are conducted, on a day to day basis, in the CFC jurisdiction. These may not be considered to be in the nature of a trade under Irish tax principles. They could be, for example, intra group financing activities, the holding of intangible assets on which the company receives royalty income, etc.	**Ireland has the right to tax the worldwide profits of resident companies** The company is considered to be resident in Ireland for Irish corporation tax purposes because the central management and control of the company is exercised in Ireland. If the CFC is also resident for corporate income tax purposes in a tax treaty jurisdiction, the tax treaty will provide a mechanism to determine whether the dual residence status of the CFC should be resolved by the application of an effective place of management test or requires agreement on the part of the two competent authorities that the company is a resident of Ireland for treaty purposes. Where the CFC is resident and subject to tax in a non-tax treaty jurisdiction and the company is also resident in Ireland, it is subject to taxation in Ireland on its worldwide profits. Unilateral double tax credit relief may be available in Ireland to avoid double taxation on its profits. Where the activities of the CFC are not in the nature of a trade, the rate of Irish corporation tax applicable to the profits is 25%. In the case of a company which, although resident under domestic law in Ireland and the tax treaty jurisdiction, is a resident of Ireland for treaty purposes, the treaty would typically provide that if the activities in the CFC jurisdiction meet the standard for recognition of a PE in the CFC jurisdiction, the profits attributable to the PE are primarily taxable there. Where the profits are also taxed in Ireland as the residence state, double taxation is avoided under the terms of the treaty through Ireland granting double tax credit relief for tax borne on these profits in the treaty state. Where the activities of the company are such that the significant people functions and the control over the assets and risks of the CFC can be considered to be exercised in Ireland, it is likely that a significant part of the profits of the CFC would be attributable to Ireland and taxed solely in Ireland under the application of arm's length transfer pricing principles which apply under the treaty. Where the profits not attributed to the PE

Ireland's taxing rights	Application of taxing rights
	have been taxed in the PE jurisdiction, a treaty based corresponding adjustment can relieve such profits from double taxation in the CFC jurisdiction.
Example 2: Transfer Pricing The exercise of strategic management and oversight and key business policy decisions are taken in the CFC jurisdiction by the Board of Directors of the CFC. The company is not considered to be resident in Ireland for corporation tax purposes. Notwithstanding the capacity of the Board of Directors of the CFC to make decisions and to act independently, if required, of the policy directions and requests of its Irish shareholder, the directors have limited access to resources in the CFC jurisdiction. The company contracts for the provision of outsourced support services under arrangements with group members in Ireland which are remunerated based on a routine return over costs. The CFC retains and reflects in its financial statements profits from its activities net of payments for these outsourced services. The activities of the CFC could be, for example, intra group financing activities or the holding and exploitation of intangible assets held by it in the form of royalty income. The credentials and competence of the board of directors and of the limited direct employee resources of the CFC are not such that they can be said actually to exercise, on a day-to-day basis, functional control over the key business risks and assets of the CFC. Instead, senior executives of the Irish parent are considered, based on a functional analysis, to exercise control over the risks and assets of the CFC's business.	**Transfer pricing currently applies to transactions entered into in the course of a trade** Under transfer pricing principles, the exercise of the control over the risks of the CFC suggests that the Irish group members should reflect a potentially significant amount of the profits arising from the assets of the CFC. This is where the group member exercises day-to-day, functional control over the key risks and assets of the CFC. The analysis related to control of risks and business assets is set out in the 2010 OECD Guidelines but is more clearly set out under the 2017 OECD guidelines on transfer pricing. Ireland's transfer pricing regime currently limits the scope of Irish transfer pricing adjustments to arrangements arising in the course of a trade which is taxed under Case I[11]. Under current law, the Irish transfer pricing regime may not apply to allow Ireland to assess to tax by means of an upward transfer pricing adjustment on the controlling entity, those CFC profits that are attributable to the control functions exercised by the Irish company where those activities are not considered to arise in the course of a trade carried on in Ireland. In Section 2 of this submission on transfer pricing, we have suggested Ireland should extend the scope of its transfer pricing regime to include those that do not arise in the course of a trade carried on in Ireland. On the assumption that this is done, Ireland could use its transfer pricing regime (in particular the guidance on the meaning of control set out in the 2017 OECD Guidelines) to assess a potentially significant amount of the CFC's profits to tax in Ireland where either the activities of the CFC or those of the related control functions exercised by the Irish company do not arise in the course of the conduct of a trade in Ireland. Under current law, where control over the entirety of the key business risks and assets of the CFC business is exercised as part of a trade in Ireland by the Irish company, the CFC should only be

[11] Trading profits are taxed under Case I where the trade is carried on in Ireland.

Ireland's taxing rights	Application of taxing rights
	entitled to a financing return on its assets. Profits generated by the CFC's assets above that financing return are attributable to the Irish controlling entity.
Example 3: Dependent Agent All of the decisions in relation to the acquisition and disposal of key assets of the CFC e.g. intangible assets which are licenced to group members in return for royalty income, are made by executives in Ireland. Where the business of the CFC relates to holding and exploiting intangible assets, these decisions could include whether to accept the terms of contracts for outsourcing arrangements entered into by the CFC such as brand development activities in the case of an asset such as a brand, R&D activity in the case of other intangible assets, as well as contracts for the conclusion of routine, low value adding support services such as HR, general administration and other services. Where the business of the CFC is intra group lending, these could include decisions on whether or not to advance a loan. The level and extent of decision making by executives of the Irish entity is such that the Irish entity is considered to act as a dependent agent of the CFC.	**A non-resident company is subject to corporation tax in Ireland on its profits attributable to a trade carried on in Ireland through a branch or agency** Where an Irish company is acting as agent of a non-resident company and is conducting a trade or business in Ireland through a fixed place of business in Ireland, the non-resident company is within the scope of corporation tax in Ireland. Where, however, the nature of the activities conducted by the agent do not comprise the conduct of a trade in Ireland, Ireland does not tax such profits unless they can be considered for another reason to be Irish source. It is assumed in this example that the profits are not otherwise from an Irish source e.g. they are foreign source interest income or royalties arising from rights to intangible assets that are not exercisable or enforceable in Ireland. Where the activities of the CFC do not constitute activities in the nature of a trade, it is therefore possible that, notwithstanding that the Irish company may act as an agent of the company, the activities may not create a taxable presence for the CFC in Ireland. Where a pattern of activities has given rise to the possibility of the Irish company acting as an agent of the CFC, those activities may well support a functional analysis that finds that some or all of the key risks of the business of the CFC are controlled in Ireland. Where this is the case, a transfer pricing analysis which is similar to that outlined in the transfer pricing example above may apply. The exercise of control over risks of the CFC may give rise to a transfer pricing adjustment to increase the measure of the Irish taxable profits of the Irish entity exercising the control.

The analysis of the protections afforded under Ireland's current tax regime which is illustrated in the examples above, suggests that the following activities and related profits are those that are most likely to remain potentially outside the scope of existing Irish protections. These are likely to be of greatest policy priority from an Irish perspective to bring within the scope of a CFC regime:

- Income arising from passive activities that do not constitute an activity in the nature of a trade under Irish tax principles, or
- Capital gains arising on the disposal of assets of a type that are considered to be chargeable assets for Irish tax purposes.

Where profits of a CFC are in the nature of capital gains and they arise to a CFC that is resident of a treaty jurisdiction for tax treaty purposes, it can be expected that the treaty would apply[12] to allocate taxing rights on such gains exclusively to the jurisdiction of residence of the CFC.

Ireland's CFC regime should not operate to override the rights of tax treaty jurisdictions to tax capital gains where those rights are allocated to that jurisdiction under a tax treaty.

In the circumstances of CFCs resident outside the EU and outside tax treaty jurisdictions, we suggest[13] that Ireland retains its existing right to tax capital gains on disposal of shares and to tax dividends paid from such subsidiaries. If this scope of taxation was applied to such companies, Ireland therefore potentially faces a risk of deferring its right to tax the profits of those CFCs where it does not have a CFC regime instead of a risk of never being able to tax the profits.

Profits of a CFC from a trade

In the above analysis of the illustrative scenarios, where the CFC's activities are in the nature of a trade, Ireland has taxing rights which it can exercise to tax an appropriate share of the CFC's profits, principally through the application of its transfer pricing regime. Under Ireland's current transfer pricing regime, the amount of the profits from the CFC's assets that is attributable to control functions exercised in Ireland that relate to activities from a trade should be reflected by the Irish controlling company as part of its trading profits taxable in Ireland.

Under OECD transfer pricing principles, the functional analysis and concepts that apply when determining whether and to what extent an entity has exercised control are substantially the same as the concept of significant people functions (SPFs) which applies in the case of attribution of profits to branches. Having applied transfer pricing requirements and taxed on the Irish entity the profits attributed to the exercise of control of the CFC risks by the Irish entity, what is left of the CFC trading profits untaxed in Ireland are those CFC profits not attributable to the SPFs in Ireland.

We have discussed the meaning of control in this submission in our response to Question 5 on transfer pricing matters and illustrated it in transfer pricing examples which are set out in Appendix I.

They illustrate how the transfer pricing guidelines support Ireland's right to tax under its transfer pricing regime an amount of the profits from assets held by a CFC that are attributable to SPFs located in Ireland where the arrangements relate to trading activities taxed under Case I. Recital 14 in the Directive is clear when implementing the anti-avoidance measures under the Directive, Ireland can continue to enforce its right to make upward adjustments to taxable profits under arm's length principles.

Ireland's CFC regime should be implemented so that it does not seek to tax twice profits that are already taxable under the scope of Ireland's transfer pricing regime.

The examples in Appendix 1 also illustrate that if the scope of Ireland's transfer pricing regime cannot be said to extend to the significant people functions exercised by an Irish company in relation to the risks and assets of a CFC (e.g. because the activities do not relate to activities carried on in the course of a trade), the application of transfer pricing principles under a proposed CFC rule which is discussed below could result in an equivalent amount of CFC income taxed in Ireland.

Where Ireland extends the scope of its transfer pricing regime to cross border non-trading transactions, as we suggest in our response to transfer pricing Question 9, this broader scope should result in the taxation in Ireland of profits attributed to the exercise in Ireland of control functions by the Irish entity even where the activities are not in the nature of a trade.

Ireland's existing protections are least effective in counteracting avoidance to artificially divert profits which arise from arrangements related to a CFC engaged in passive activities.

The profits that are left untaxed in the CFC after Ireland has exercised its existing taxing rights under its transfer pricing regime, are broadly speaking:

- Income profits of the CFC of a trading character that have not been attributed to significant people functions in Ireland.
- Potentially all of the income and capital gains of the CFC from passive activities.

[12] This is with limited exceptions such as gains on disposal of Irish immovable property or shares deriving their value from such assets.

[13] See discussion in response to Question 10 on moving to adopt a more territorial tax regime.

If Ireland extends its transfer pricing regime to non-trading activities, the profits that are left untaxed in the CFC after Ireland has exercised its existing taxing rights under its transfer pricing regime are income profits not attributed to significant people functions in Ireland – whether in the nature of a trade or passive activities.

We have set out below detailed comments on the adoption of a CFC rule.

a. Limit CFC income to income which has artificially been diverted to the subsidiary

Where Ireland seeks to adopt a CFC approach which targets the artificial diversion of profits to the CFC, it seems to us that the general provisions for a CFC rule that are set out at paragraph 2(b) of Article 7 (Option B) present the best fit with Ireland's existing tax regime.

Ireland should choose to adopt a CFC framework which reflects the general provisions set out under paragraph 2(b) of Article 7.

The CFC rule under the Option B framework is the approach which is described in recital 12 of the Directive as a CFC rule which "*is limited to income which has artificially been diverted to the subsidiary*". The CFC rule under Option B applies "*where non-genuine arrangements have been put in place for the essential purpose of obtaining a tax advantage*".

In implementing Option B, Ireland should define "the essential purpose of obtaining a tax advantage" to mean a purpose of artificially diverting income to the CFC.

We suggest that, in applying this tax avoidance purpose test, Ireland should implement a safe harbour that if the activities of the CFC are in the nature of a trade under Irish tax principles, the taxpayer can assume that arrangements that form part of that trade have not been put in place with the purpose of artificially diverting income to the CFC.

Under the Option B approach, the income to be taxed in Ireland under a CFC rule is limited to the amounts[14] generated through assets and risks which are linked to significant people functions carried out by the Irish controlling company.

Where pricing under Ireland's transfer pricing regime has appropriately reflected the pricing impact of the exercise of control functions by significant people functions in Ireland, there should be no additional profits of a CFC assessable to tax under a CFC regime which is modelled on Option B. This is because Ireland's transfer pricing regime applies to arrangements related to the conduct of activities in the nature of a trade in Ireland.

There is also a reduced risk of artificial diversion of profits to the CFC (as compared to non-trading profits) because of the application of the 12.5% rate of corporation tax to trading profits.

We recognise however, that transfer pricing concepts associated with significant people functions/ the exercise of control functions are unfamiliar to Irish taxpayers and Revenue alike in the context both of income from non-trading transactions and capital gains arising on the disposal of assets.

The Directive provides at recital 12 that, where a Member State limits its CFC rules to income which has been artificially diverted to the subsidiary, it is critical that they *"precisely target situations where most of the decision-making functions which generate a diverted income at the level of controlled subsidiary are carried out in the Member State of the taxpayer."* Meeting this standard of precise targeting will be difficult until such time as Ireland can develop a transfer pricing approach which is understood in its application to arrangements related to non-trading transactions and to asset disposals that give rise to capital gains.

The Directive also requires that Member States meet a minimum standard of protection. This minimum standard necessitates consideration in an environment where uncertainty exists about the application in practice of the Option B framework to passive activities and to disposals of capital assets.

As outlined above, Irish policy makers may well consider that there is a higher risk of avoidance in the form of the artificial diversion of profits to a CFC in the case of profit categories of non-trading income and capital gains which are taxed at rates of 25% and 33% respectively.

These policy issues present a challenge in shaping its CFC rule choices which is unique to

[14] Paragraph 2 of Article 8.

Ireland. It is a consequence of the design of Ireland's schedular tax system regime which imposes different taxing rules and different corporation tax rates to income from a trade, non-trading income and capital gains.

We have suggested in Section 2 of this response document on transfer pricing policy choices that Ireland should consider extending the regime at a future date to non-trading and to capital transactions. This could, in time, reduce the potential for uncertainty and administrative complexity potentially arising from choosing a CFC regime which relies solely on transfer pricing type protections.

Ireland's schedular tax system essentially distinguishes between trading and non-trading income with capital gains taxed under separate rules. If there is current uncertainty surrounding the application of a transfer pricing approach to tax an appropriate amount of artificially diverted non-trading income and capital gains profits, Ireland's policy preference might be to seek to tax in their entirety profits of these categories which have been artificially diverted.

This category distinction is not captured in the ATAD general provisions for a CFC regime which is set out at Article 7, 2(a) (Option A). It appears to us therefore that an alternative approach of adopting Option A does not fit with the wider framework of Ireland's tax system.

We suggest however, that in applying an Option B approach to limit its CFC rule to taxing artificially diverted profits Ireland could introduce supplementary CFC protections that would effectively target these risk profit categories at higher risk of diversion. For CFC profits in the category of non-trading income and capital gains, where there the tax advantage test is not met such that there is an artificial diversion of profits, we suggest that Ireland provides an alternative gateway test for taxpayers.

The adoption of an alternative gateway test where there is an artificial diversion of profits, should be less complex and lead to less costs and administrative uncertainty for businesses and Revenue alike in a tax system where there is greater uncertainty surrounding the application of transfer pricing principles to non-trading profits and capital gains because of the lack of application to date of Ireland's transfer pricing regime to these profits.

Where a Member State adopts a CFC rule that seeks to tax certain categories of income, the Directive requires at recital 12 that "*to comply with the fundamental freedoms, the income category should be combined with the substance carve-out aimed to limit, within the Union, the impact of the rules to cases where the CFC does not carry on a substantive economic activity*." Article 7 also provides that Member States that adopt a CFC rule by reference to income categories may also extend the substance carve-out to CFCs in third countries.

We suggest that Ireland could reasonably introduce additional CFC protections within the general framework of an Option B anti-avoidance focus on the artificial diversion of profits. However, where its application is, in effect, likely to apply to certain income categories, Ireland must respect the fundamental freedoms. We suggest that Ireland could adopt an additional CFC protection which should afford greater assurance that Ireland can, in practice, meet the minimum standard of protection which is required under ATAD. We believe that this addresses the risk of uncertainty in implementation that arises in the application of a transfer pricing approach to taxpayers unfamiliar with the application of transfer pricing profits to non-trading income and to capital gains.

This additional gateway test could provide that where the tax purpose test related to artificial avoidance of profits is failed, and the activities of the CFC are not in the nature of a trade under Irish tax principles, the profits of the CFC are subject to tax in Ireland under the CFC rule unless the CFC is engaged in genuine economic activities.

This formulation of the test is chosen as one which is already considered by Ireland to be aligned with EU freedoms. It is a test which exists in other anti-avoidance measures under Ireland's tax legislation[15]. It should therefore be considered to be a policy choice which meets the principles set out in the ATAD recitals but which also should mean a consistency of approach between a CFC rule and other anti-avoidance measures in Ireland's tax system. It should therefore be considered to represent a choice which best fits Ireland's tax system.

Should Ireland, in the future, remove the difference in rate that applies between income from a trade taxed at 12.5% and other income taxed at 25% and the rate distinction applying to capital gains, this approach still provides protection under a CFC rule

[15] See for example, section 590, TCA 1997.

that captures the distinction between profits which are active and passive in character (the latter which can still be said to represent a higher risk of artificially being diverted).

Other comments on Option B

By looking to the arm's length principle to measure the amount of CFC profit taxable under the genuine arrangements gateway test, the approach is inherently capable of accommodating future changes to business models adopted by companies for the supply of goods and services. This is in contrast to the general framework approach under paragraph 2(a) of Article 7 (Option A) which requires taxpayers to categorise the legal character of profits arising to subsidiaries and then to assess to tax under a CFC rule income which falls into certain categories. As we have seen in recent years,[16] the legal character of services and the types of flows of goods and services across international supply chains are constantly changing in response to developments in technology, the demands of consumers and innovations in business practice.

Finally, we believe that the approach outlined above is also best suited to a small open economy that seeks international capital investment to support future growth. This approach does not seek to tax profits of a subsidiary of an Irish intermediary parent company within a multinational group if the profits are linked to significant people functions carried out by a controlling company outside Ireland. This is illustrated in examples in Appendix 1.

b. Determining if a subsidiary has paid tax below the threshold tax amount

Article 7 requires the taxpayer to compare the tax paid on the CFC's profits with the corporation tax measured under Irish tax principles to establish if the paid by a subsidiary is below the threshold amount set out at Article 7 and results in the subsidiary being a CFC.

It would be useful to provide minor simplifications to ease the administrative burden of this computational exercise.

This could include allowing taxpayers to recognise the income for Irish tax purposes in the tax accounting period based on the timing of recognition of the income in the accounts of the CFC where it has adopted appropriate accounting standards. We suggest that the measurement of the profits under Irish tax principles could also be done in the functional currency of the subsidiary as this avoids potential distortions in the measure of the amount of tax borne on the profits because of fluctuations in currency value which could arise if this was done in Euros, for example, or by reference to the functional currency of the Irish parent.

Where the profit of the CFC is in the character of a capital gain, Irish tax principles applicable to capital gains tax should apply to measure the gain. We suggest that the gain and related effective tax rate should be measured in the functional currency of the foreign company so as to avoid any distortive effects of foreign currency movements between the functional currency of the company and the Euro.

In the case of a foreign jurisdiction which adopts a fiscal tax grouping, consideration would need to be given to the practicalities of allocating tax paid by the local entity that is the head of the fiscal unity to each entity within the fiscal unity in addition to separately measuring the profits of each entity that forms part of the local fiscal consolidation.

We suggest that, in the case of jurisdictions that apply a tax consolidation or fiscal unity concept for their local taxpayers, the effective tax test for CFC purposes for each entity or branch located in that jurisdiction be calculated for members of the local tax consolidation by calculating the threshold tax rate for the tax consolidation or fiscal unity as a whole.

For example, the Netherlands adopts a fiscal grouping approach under which transactions between group members are ignored for tax purposes. The parent of the fiscal unity is the single taxpayer for the fiscal unity and pays corporate income tax by reference to the combined taxable profits of the members of the fiscal unity. It is suggested that the effective tax paid test for each entity that is a member of the Dutch fiscal unity would be based on an effective tax rate percentage that is calculated by reference to the amount of Dutch corporate income tax paid by the fiscal unity expressed as a percentage of the taxable profits as measured under Irish tax principles of the fiscal unity as a whole. A similar approach might be adopted for countries that, like Ireland, provide a tax grouping mechanism for sharing losses.

[16] A trend which we believe is accelerating.

c. Adoption of a White List

We suggest that a White List is adopted for the purposes only of allowing taxpayers to make a presumption that the CFC has met an effective tax rate.

The use of a White List would not be intended to allow the taxpayer to assume that the genuine economic arrangements or genuine economic activities gateway tests are met. Reliance on the White List to positively assert that the CFC is not subject to a lower effective tax rate would only be available where these tests were met.

A White List might include CFCs that are resident in EU Member states and, at a minimum, those tax treaty jurisdictions which have a corporate income tax regime and do not apply a territorial regime. It is suggested that a White List might be adopted under regulations which could allow for flexibility to update and refine the list for new tax treaty jurisdictions or to remove jurisdictions if concerns arise in relation to the applicable effective tax rate.

Adoption of a White List approach as a basis for determining if a subsidiary has met the effective tax rate test would provide a welcome reduction in administrative burden that could otherwise require Irish taxpayers to compute, year on year, an effective tax rate measured under Irish tax principles for each subsidiary. To impose this computational burden does not appear to be proportionate where it can be expected that the majority of subsidiaries of Irish parented groups will not be subject to CFC because they have met the gateway tests that apply under the proposed regime.

Recital 12 to ATAD notes that '*It should be acceptable that, in transposing the CFC rules into their national aw, 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 rate level.*"

It is also suggested that to be excluded from the scope of the regime by reason of being resident in a White List jurisdiction, a company must be resident for tax purposes in that jurisdiction and be subject to tax there.

d. Permitted exclusions for CFCs with small profits and those engaged in lower value adding activities

We suggest that, in implementing the regime, Ireland avails of permitted exclusions set out at paragraph 4 of Article 7. These are CFCs which should be considered to present a low risk of artificial diversion of profits.

This permits Member States to exclude smaller companies or companies with lower operating margins from the scope of CFC provisions.

Although not entirely clear-cut, the better reading of ATAD would suggest that a Member State could exclude from the scope of a CFC rule both entities and permanent establishments:

- with accounting profits of no more than EUR 750,000, and non-trading income of no more than EUR 75,000[17], as well as
- a CFC of which accounting profits amount to no more than 10% of its operating costs for the tax period.

e. Transitional relief

We suggest that transitional relief might be afforded to groups who acquire CFC's from a third party during a tax accounting period.

The proposal is that the acquiring group would not be required to assess the acquired subsidiaries under the CFC regime until a future tax accounting period post acquisition e.g. no earlier than the second accounting period following their acquisition.

For example, an Irish parent with a 31 December financial accounting year end acquires a number of indirectly held foreign subsidiaries as part of an international acquisition from a third party in October 2019. It is suggested that the Irish parent would not be taxed under the CFC rule in respect of profits of these subsidiaries until the tax accounting period beginning on 1 January 2021. This is approximately 14 months post acquisition.

This is suggested to give the acquiring group time to assess and understand the detailed activities etc. undertaken by the newly acquired subsidiaries before being required to apply the CFC regime.

It also affords the acquiring group the opportunity during the tax accounting period of acquisition to restructure, if necessary, the manner of operation, assets, etc. of those subsidiaries so that the parent can meet the gateway tests if there is a concern related to the purpose test and artificial diversion of profits to those subsidiaries.

[17] This could also include non-trade related capital gains.

f. Double tax relief

As the CFC rule potentially applies to undistributed profits of a CFC, ATAD provides that double tax credit relief should be available for undistributed profits of a CFC which are assessed to tax under the CFC regime and are subsequently distributed.

If the dividend from previously taxed profits of the CFC is taxable in Ireland,[18] relief should be afforded from double taxation by excluding the dividend from a double charge to tax.

ATAD also provides that profits assessed to tax under the CFC regime should not be taxed twice e.g. where the profits are subject to tax as part of a capital gain arising on the sale or disposal of a CFC. Where corporation tax on chargeable gains potentially applies to a CFC and profits of that CFC have been subject to tax under the CFC rule, the taxable gain should be reduced by the amount of the previously taxed profits and the Irish tax base cost for the acquirer should be correspondingly increased.

Relief should also be available to offset a CFC charge to tax in another EU Member State on the profits of an indirect underlying subsidiary e.g. where an EU resident subsidiary of an Irish parent is, in turn, a parent of a CFC. This is so as to avoid a double charge to tax within the EU on multiple levels of CFC charges for a multi-tier holding structure within the EU.

g. Interaction with a move to adopt a territorial regime

In a later section of this response (see Question 10), we discuss the possibility of Ireland moving to adopt a more territorial basis of taxing foreign branch profits and foreign dividends.

Where Ireland moves to adopt a branch exemption regime, we suggest in our response to Question 10, that Ireland could build in conditions for application of a foreign branch profits exemption that provides protection from the risk of artificial diversion of profits e.g. that the branch exemption would only be available to branch profits where the branch is engaged in the conduct of a trade.

The CFC rule should also apply to profits of a foreign branch which are exempt from Irish tax.

The adoption of a CFC regime would also provide additional protections to Ireland to assert its taxing rights in relation to profits of subsidiaries of Irish companies in a case where Ireland moves to adopt (as suggested) a dividend exemption regime for certain foreign dividends.

The provisions related to the adoption of a dividend exemption would need to provide for tax free repatriation to Ireland for that amount of the profits of the subsidiary have already been taxed under the CFC rule.

Related matters

Throughout this discussion, we have referred to the interaction of the CFC regime with other protections under Ireland's regime, principally in relation to transfer pricing matters. In our response to Questions 5-9 on transfer pricing matters, we have made a number of suggestions related to Ireland's transfer pricing regime which will be relevant to understanding how Ireland's CFC regime might operate in the future within the broader framework of Ireland's corporation tax regime.

In response to Question 10 on Ireland moving to adopt a more territorial regime, we have made suggestions as to the conditions that might apply to an exemption regime for the profits of foreign branches and certain foreign dividends. These have been suggested with a view to achieving a balance of protections from base erosion for Ireland as a result of the combination of the conditions to apply the exemption regime and the CFC framework outlined above.

Implementation risks

We have summarised in the table below possible implementation risks that could arise when seeking to meet the minimum standard under ATAD for a CFC regime.

In the table, we have described possible consequences arising from the identified implementation risks and how the risks have been addressed by our suggested implementation approach.

[18] In our response to Question 10, we have this might be the case even if Ireland moves to adopt a broader dividend exemption regime, if the subsidiary is not resident in a tax treaty jurisdiction.

Implementation risk	Consequence	Addressing risk
Not aligned with wider framework of Ireland's 12.5% corporation tax regime.	Complexity and costs of application. Potential uncertainty of application which potentially creates a barrier to investment in Ireland. Reduces the relative competitiveness of Ireland's overall corporation tax regime in international terms.	Design of gateway tests and a safe harbour for the non-application of the CFC rule which are tailored to reduce the risk of artificial diversion of profits for those profits considered to present the highest risk of diversion but also applies concepts and tests which are understood and currently apply elsewhere in Ireland's tax system. Application of a distinction in treatment between trading profits and non-trading profits/capital gains. Transfer pricing principles can be applied but also a gateway which is based on a genuine economic activities test which is aligned with EU freedoms in the case of CFC profits in the character of non-trading income or capital gains. Provides simplification measures to calculate the measure of taxable profits under Irish tax principles for a CFC.
Clashes with CFC regime of investor countries leading to a double charge to tax under multiple CFC regimes.	Restricts investment. Reduces the relative competitiveness of Ireland's corporation tax regime to attract and retain investment – whether from domestic or international owned businesses.	Select approach which focuses on the artificial diversion of profits to a CFC (Option B framework). Less likely to be restrictive when compared to the typical classification approach adopted by investor countries. Applies transfer pricing concepts aligned with DEMPE approach in Actions 8-10 of the OECD BEPS Project. Balances protection for profits at higher risk of diversion with not seeking to tax profits not attributable to activities in Ireland. Flexible to accommodate future changes in business models for conducting business internationally.

Implementation risk	Consequence	Addressing risk
Complex computations to determine if each subsidiary is a CFC.	Undue administrative burden on taxpayers where the CFC meets the substance gateway tests.	Use of White List. To include EU Member States and tax treaty jurisdictions. To provide presumption that a taxpayer can rely upon solely in relation to the effective tax rate of a CFC. Provides simplification measures to calculate the measure of taxable profits under Irish tax principles for a CFC.
Use of novel concepts such as significant people functions as a basis to measure CFC taxable profits.	Uncertainty and potential for double taxation.	Provide an alternative gateway of genuine economic activities which taxpayers can meet in the case of CFCs with income categories of non-trading income and capital gains. Continue to review the application of these concepts in tandem with future developments in Ireland’s transfer pricing regime, in particular where the regime is extended to non-trading transactions and capital transactions. Develop Revenue guidance working with business and practitioners on the meaning of significant people functions and the application of this concept in the context of a CFC rule which seeks to assess the activities of the CFC and the controlling company in relation to the business risks and assets held by the CFC.

Question 3: Matters to consider on transposing the exit tax regime in ATAD

Overview of suggested approach to transposing the ATAD exit taxation regime

Having reviewed the framework for the exit taxation regime under ATAD as set out in Article 5 and in the recitals to the Directive, our recommendations for revisions to Ireland's existing exit tax regime are as follows:

- ✓ Apply 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. (The capital gains tax rate of 33% currently applies to an exit gain).
- ✓ Apply transfer pricing principles to the exit gain by pricing the market value of the asset upon import and exit using transfer pricing principles set down in the OECD Guidelines on transfer pricing.
- ✓ Measure the exit gain in the functional currency of the company (using an average exchange rate to translate the taxable measure in functional currency into Euros to arrive at the exit tax payable amount).
- ✓ Apply an uplift in tax basis to the market value (established under arm's length principles) of an imported chargeable asset whether imported from EU Member States or third country jurisdictions.
- ✓ Extend exit tax events to the transfer of an asset to a foreign tax exempt branch (in the event that Ireland moves to adopt a foreign branch exemption regime) and more generally broaden the scope of exit taxation events to align with the four exit taxing events described in Article 5. This includes removing the concept of an excluded company.
- ✓ In order to meet the ATAD minimum standard, potentially remove the ability to postpone the exit charge under section 628, leaving only the possibility, which is permitted under ATAD, of deferring the payment over a 5 year period (which is given under section 628A).
- ✓ Apply domestic reliefs including the substantial shareholding gains exemption available under section 626B, TCA 1997 in determining the amount of the chargeable exit gain.
- ✓ Adopt permitted exceptions for temporary transfers of assets in certain financial services transactions.
- ✓ Adjust the manner of operation of the relief under section 634, TCA 1997 to align with CJEU case law and exit tax principles.

Detailed overview of suggested implementation choices on transposition of ATAD exit taxation regime

In the overview above, we have outlined our suggestions for the main changes to Ireland's exit tax regime which we believe could more perfectly align the regime with the requirements of the measures set out in Article 5 of the Directive together with the recitals to the Directive.

The rate of exit tax

There does not appear to be any particular tax policy reason for the divergence which has occurred in recent years between the corporation tax rate and the rate of tax applied to chargeable gains under the corporation tax code.

Where, as is the case in respect of exit taxation, a gain arises on an asset held for the purposes of the trade of the existing company, we suggest that it would be more aligned with Ireland's corporation tax regime to tax the gain at a rate of 12.5%.

Foreign currency gains and exit tax

In accordance with the approach generally adopted to the measurement of profits and gains arising in a trading context, ***we suggest that the measure of the exit gain should be done based on the tax functional currency of the company (or of the Irish branch of the company, as the case may be).***This should reduce the risk of foreign currency translating gains giving rise to unexpected increases or decreases in the amount of the taxable exit gain as compared to the commercial gain that would be recognised where an increase in the market value of the asset is recorded in the functional currency of the company.

Where the exit gain amount is measured in functional currency, we suggest that an average translation rate applicable to the tax accounting period in which the gain arises is applied in translating the exit tax payable into Euros which amount is then subject to the exit tax payment arrangements.

Market value

Ireland's exit tax regime already measures the exit gain by reference to a deemed disposal of an asset at its market value on the exit date. This is aligned with EU case law findings which have emerged from review by the CJEU of various features of Member States' exit tax regimes.

In order to minimise a risk of double taxation arising on a misalignment of the measure of a taxable amount where an asset is imported from another jurisdiction e.g. an EU Member State, we suggest that the Irish approach to measurement of the market value of the asset should be more closely aligned to that set out in the Directive. The Directive provides at paragraph 6 of Article 5 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 to us to closely accord with an asset disposal price based on the arm's length principle set out in the OECD's transfer pricing guidelines.

At present, an exit gain under Ireland's regime applies the market valuation principles that apply under the capital gains tax provisions. In many instances, these may be closely aligned with the arm's length price applied under transfer pricing principles. However, it appears to us that the capital gains tax market value provisions do not provide to the same extent for the specific facts and circumstances of a contractual relationship to be taken into account in arriving at the market value of the asset. To do so (as required under the arm's length pricing guidelines) would seem to us to be more perfectly aligned with the approach to determining market value which is required under the Directive.

The adoption of a transfer pricing approach to the measurement of market value is also more likely to afford symmetry of treatment in the measurement of market value in the case of exit events occurring between Member States. The Directive requires at Article 5, paragraph 5, that where the transfer of the asset (or change in tax residence status of the exiting company) is to another EU Member State, the 'importing' Member State shall accept the value established by the exiting Member State as the starting value for tax purposes.

The adoption of a transfer pricing approach to the measurement of market value would appear to us to give rise to less risk of mismatches, double taxation and taxpayer disputes arising which would require resources both on the part of taxing authorities and businesses to resolve.

Treatment of imported chargeable assets

Ireland's corporation tax regime seeks to tax the profits of non-resident companies which are attributable to the conduct of a trade through a branch or agency in Ireland. In like manner to the step up in market value basis which ATAD requires for assets imported from an EU Member State, we suggest that in computing future gains arising to

companies on the disposal of chargeable assets, the tax basis for assets acquired upon an import event should also be the market value (for transfer pricing purposes) of the asset at the date of import.

An import event would mirror taxable exit events and include, for example, a non-resident company becoming tax resident in Ireland such that the asset becomes a chargeable asset for Irish tax purposes for the first time or there is a transfer of a chargeable asset to the Irish branch of a non-resident company from a presence not taxed in Ireland.

We suggest that this step up in basis arising upon an import event might not be given where an asset is imported from a jurisdiction which does not meet EU standards for good tax governance (i.e. the jurisdiction is included on an EU blacklist of non-cooperative jurisdictions).

As this approach should apply to import events applying to assets of non-resident taxpayers in comparable circumstances, this approach should protect Ireland from any assertion of discriminatory treatment which may be said to be in contravention of EU principles related to freedom of capital (and freedom of establishment). If the asset is imported from a company that is a subsidiary of an Irish parent, Ireland will also benefit from additional protections afforded by a Controlled Foreign Company regime in the event that profits from capital gains arising in the subsidiary to the date of import might not otherwise be taxed in Ireland.

Other changes to Ireland's current exit tax regime

Ireland's regime currently includes the concept of an excluded company which does not trigger an exit gain.

The concept of an excluded company can no longer apply in an ATAD compliant regime.

This means, in effect, that exit tax would apply irrespective of the ownership of the affected company.

Ireland's regime is currently confined to exit taxation events which are triggered by a company ceasing to be resident for tax purposes in Ireland. The scope of exit taxing events will need to be broadened to include transfers to branches/head office (as the case may be) where the asset ceases be within the charge to Irish tax. Section 620A, TCA 1997 provides for deemed disposals of assets by companies in a range of scenarios which result in a chargeable asset ceasing to be chargeable to tax in Ireland by reason of the asset becoming situated outside Ireland. Some of these charging events overlap with the scope of exit taxation events that are provided for in ATAD.

We suggest that the provisions of section 620A are reviewed and amended in tandem with

review and amendment of sections 627 to 629A which contain the core provisions relating to Ireland's current exit tax.

ATAD provides for relief from exit taxes in the case of temporary transfers of assets. ***Ireland should also 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.

Ireland's current exit tax regime provides for a broader scope to defer payment of the tax than that which is afforded under ATAD. To align Ireland's regime more perfectly with ATAD, ***Ireland should consider whether it should remove the ability to postpone the exit charge which is currently afforded under section 628***, leaving only the possibility of deferring the payment over a 5 year period (which is given under section 628A).

Based on our analysis of EU case law[19] it is not entirely clear that a Member State should not provide a mechanism to defer taxation of the exit tax until the asset is disposed of (at least to a taxable presence in another EU Member State) in circumstances where such a deferral would be available if an asset was transferred between two taxable presences within the same Member State (as would be the case under Ireland's tax regime). It could be argued that this difference in treatment is discriminatory and is not proportionate and may therefore be in breach of EU freedoms.

Interaction of exit tax with other provisions

We suggest that the taxable measure of the exit gain should also take account of domestic reliefs e.g. the exemption from corporation tax which is available under section 626B, TCA 1997, which would be available in the event of an actual disposal of shares or securities by a company that meet the conditions for the substantial shareholding exemption[20]. This would involve the deletion of subsection (3)(e) in section 626B.

A recent CJEU decision in the Finnish A Oy case (C-292/16) suggests that the manner in which Ireland affords relief under section 634, TCA 1997 from double taxation where a foreign branch of an Irish company is transferred to an EU Member State is not aligned with EU principles. Finland, like Ireland, immediately recognises a taxable capital gain arising on the transfer of a branch of a resident company to an EU resident company under the terms of the EU Merger Directive. The Merger Directive provides for a mechanism for relief from such tax in the case of countries which adopt a worldwide taxation regime. This is to provide credit relief from the tax otherwise arising on the disposal gain for an amount of tax that would otherwise have been charged in the other Member State upon the transfer in the absence of the Merger Directive.

Notwithstanding that the Finnish relief (and the Irish relief provided under section 634, TCA 1997) appear to be in line with the relief mechanism described in the Merger Directive, the CJEU found that the legislative relief was contrary to the freedom of establishment. This is because it did not afford a possibility of deferral of taxation which would have been available if the permanent establishment had been transferred within Finland.

Based on our analysis of this case, it would appear that Ireland should also revise its legislative relief under section 634. We suggest that the approach set out in the exit tax regime (which provides for a deferral of tax) could be applied in an equivalent manner in framing a revised relief under section 634.

Related matters

Our suggestion above in relation to the adoption or application of a transfer pricing arm's length principle to the measure of the exit gain is aligned with other suggestions discussed later in this response document related to the application of Ireland's transfer pricing regime to pricing

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[19] Including the recent judgment in the A Oy case, C-292/16.

[20] The National Grid case C-371/10 is leading case on the interaction of domestic tax measures such as exit taxes with EU freedoms, in particular, the freedom of establishment. The case addressed the tax consequences for a Dutch company of transferring its place of management to the UK. At para 37 of that case, the CJEU found that "*From the point of view of legislation of a Member State aiming to tax capital gains generated in its territory, the situation of a company incorporated under the law of that Member State which transfers its place of management to another Member State is similar to that of a company also incorporated under the law of the former Member State which keeps its place of management in that Member State, as regards the taxation of capital gains relating to assets which were generated in the former Member State before the transfer of the place of management.*"

This general principle strongly supports the application of the exemption in section 626B to a deemed disposal arising on an exit taxation event in circumstances where a company not subject to an exit taxation event would have been entitled to an exemption from corporation tax on capital gains under that section on a disposal of the shares.

transactions in capital assets (see response to Question 8). It is also aligned with our suggested approach to adoption of a Controlled Foreign Company (CFC) regime which limits the CFC rule to profits, including capital gains, which have been artificially diverted to the CFC (see response to Question 2).

Implementation risks

We have summarised in the table below possible implementation risks that could arise when seeking to amend Ireland's exit tax regime to align the framework of the regime with the framework for exit taxation which is set out at Article 5 of ATAD. In the table, we have described possible consequences arising from the identified implementation risks and how the risks have been addressed by our suggested implementation approach.

Implementation risk	Consequence	Addressing risk
Exit tax rate is not aligned with general corporation tax rate.	Risk of deterring investment or retention of investment in Ireland by domestic business where tax rate (currently 33%) for exit tax gain is disproportionate to the tax rate applicable to profits arising from continuing operations.	An unattractive or disproportionate exit tax rate can deter initial investment and lead to investment location choices outside Ireland.
Exit tax rate applying at capital gains tax rate.	Uncertainty caused by surprise of the application of a rate other than the headline 12.5% corporation tax rate.	Uncertainty can lead to, at best, deferral of investment and, at worst, decisions not to locate new investment.
Different treatment for asset imported from EU and third country jurisdictions.	Risk of misaligning the exit tax regime with the scope of taxation of Ireland's tax regime related to capital gains which is to tax only those gains of non-residents arising from specified assets or from disposals of capital assets held and used for the purposes of a trade carried on in Ireland. Risk of being in breach of wider freedoms of establishment and freedoms of capital together with being in breach of non-discrimination provisions in tax treaties.	Provide for a step up in basis for imported chargeable assets whether imported from EU or third country jurisdictions.
Failure to apply domestic reliefs to the taxable measure of exit tax gain.	Risk of breaching EU law as established by case law precedents.	Ensure existing reliefs including substantial shareholding exemption, if applicable to an actual disposal event, are available in computing an exit gain.
Failure to amend double tax relief mechanism afforded under section 634, TCA 1997.	Risk of contravening EU law following judgment in A Oy case.	Align to meet principles set down in A Oy case judgment.

Question 4: Considerations related to the implementation of hybrid mismatch measures

Overview of suggested approach

We recommend that Ireland adopts the following approach to implementation of hybrid mismatch measures.

- ✓ Implements the framework under ATAD without going beyond that framework i.e. does not apply hybrid mismatch counter measures to payments to jurisdictions with a nil tax rate nor to mismatches arising from transfer pricing adjustments.
- ✓ Implements the main measures with effect from 1 January 2020 and potentially adopts the extended implementation deadline of 1 January 2022 for reverse hybrid measures.
- ✓ Excludes the securitisation regime set out at section 110, TCA 1997 from the general scope of the measures but instead adjusts the anti-hybrid measures already contained in section 110 so that they are aligned with the ATAD regime.
- ✓ Applies the ATAD hybrid mismatch approach to the design of a branch exemption regime i.e. does not provide for a branch exemption under domestic law unless the profits of the foreign branch are subject to tax in the branch jurisdiction.
- ✓ Applies the ATAD hybrid mismatch approach to the design of a dividend exemption regime i.e. does not apply a dividend exemption where the payor has claimed a deduction for the dividend payment.
- ✓ Excludes lease receipts from the scope of the secondary defensive measures as such receipts are already included in taxable income.
- ✓ Avails of the permitted exemptions to exclude certain ‘on-market’ repo transactions, certain loss absorption regulatory capital instruments in the banking sector, and defined collective investment vehicles from the scope of the measures.
- ✓ Treats 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 recipient from an Irish perspective.
- ✓ Is designed after close review and analysis of international tax developments, especially in jurisdictions such as the US which has seen a major reform of its tax regime including international tax matters.
- ✓ Consults with business and tax practitioners, including review of draft legislative measures prior to enactment, to ensure that the measures are understood across business sectors and achieve their intended effect.
- ✓ Provides detailed implementing guidance to provide certainty for taxpayers on the scope and application of the measures.

Detailed overview of suggested implementation consideration

The ATAD hybrid mismatch measures address mismatch situations that result from double deductions, from conflicts in the characterisation of financial instruments, payments and entities or from the allocation of payments.

There are four categories of hybrid mismatch dealt with under ATAD.

Those which result from:

- ***payments under financial instruments,***
- ***the consequences of differences in the allocation of payments made to a hybrid entity or a permanent establishment,***
- ***payments made by a hybrid entity to its owner or deemed payments between a head office and permanent establishment or between two or more permanent establishments, or***
- ***double deduction outcomes from payments made by a hybrid entity or permanent establishment.***

Hybrid mismatches do not include differences that arise from values ascribed to a payment including foreign currency exchange differences or transfer pricing differences.

We recommend that Ireland implements hybrid mismatch measures which apply the framework under ATAD without going beyond that framework i.e. does not apply hybrid mismatch counter measures to payments to jurisdictions with a nil tax rate nor to mismatches arising from transfer pricing adjustments.

We suggest that Ireland implements the measures from 1 January 2020 (and considers deferral of adoption of reverse hybrid measures to 1 January 2022 which are likely to have most effect in the funds sector).

The hybrid mismatch measures under ATAD are anticipated to be complex to implement in practice – particularly when trying to foresee all of the potential impact of the measures on existing intra group arrangements. Close liaison with tax practitioner and industry groups is recommended in the drafting and review of the legislative measures to ensure that they achieve the intended outcome and do not result in unintended outcomes, including double taxation for taxpayers. In addition, detailed implementing guidance should be developed to provide certainty for taxpayers on the scope and application of the measures.

Context for Irish measures

The provisions in section 130, TCA 1997 treat many classes of payments which could otherwise be deductible interest or financing expense as a non-deductible distribution for Irish tax purposes. We recommend that the section 130 provisions are retained[21] until such time as Ireland may choose to review its tax regime for deductions of finance expense. This is because, taken together with the limited overrides available by election[22] under TCA 1997, they serve to inherently protect against a deduction/non-inclusion outcome arising on cross border payments by companies within the charge to Irish corporation tax on financial instruments.

The provisions of section 23A(2), TCA 1997 treat an Irish incorporated company as no longer being Irish resident for tax purposes in certain circumstances. We recommend that this subsection is retained so as to continue to reduce the risk of a hybrid mismatch outcome arising due to the dual resident status of an Irish incorporated company.

To date, Ireland's worldwide taxation regime of taxing resident companies on the profits of foreign branches and taxing foreign dividends has meant limited scope for Irish entities to be counterparties to a hybrid entity mismatch outcome. In applying the hybrid mismatch rules to a circumstance where Ireland continues to tax the profits of a foreign branch or dividends from foreign subsidiaries, it will be necessary to consider whether the existing double tax credit regime which provides for pooling of credits should be adjusted so as not to effectively exclude income from the scope of Irish tax by affording credit relief against Irish tax on income which is received under a hybrid mismatch.

Similar consideration needs to be given to denying the application of the exemption from corporation

[21] In the section below on related matters, we note that Ireland at some future date is expected to introduce an interest limitation rule which aligns with the rule set out in ATAD. In advance of that, we suggest that Ireland should consider a fundamental review of the manner in which relief for financing expense is afforded under Ireland's corporation tax regime. Part of this review is likely to involve a review of the measures in section 130 and whether they are required to provide targeted protection from base erosion in a regime which has a general interest limitation rule in place.

[22] Elections to override section 130 treatment are available under sections 452, 452A and 845A, TCA 1997 which generally only apply either where the payment is subject to tax upon the recipient or will be subject to Irish withholding tax upon payment.

tax on chargeable gains under section 626B, TCA 1997 in the case of otherwise tax exempt gains arising on the disposal of shares (or securities) in the event of a hybrid mismatch outcome which has not been counteracted in the counterparty jurisdiction.

If Ireland moves to adopt a dividend exemption or a branch exemption regime, the design of the regime can factor in anti-hybrid mismatch features from the outset i.e. a branch exemption for foreign profits should not be available unless the branch profits are subject to tax in the branch jurisdiction.

Similarly, a dividend exemption should not be available under an Irish dividend exemption regime where the payor has secured a tax deduction for the dividend.

These features of a branch exemption or dividend exemption regime have been explored in greater detail in this submission in our response to Question 10 in the consultation.

Securitisation activities

The securitisation regime set out in section 110, TCA 1997 provides for an override of section 130 distribution treatment in the context of certain debt issued by a securitisation vehicle. The OECD's report under Action 2 of the BEPS Project identified that vehicles such as securitisation vehicles inherently need to retain a tax deduction outcome in order to meet their objective of proving an efficient and tax neutral means of collectively raising debt. The section 110 measures already include anti-avoidance provisions which limit the scope of the broad based override of section 130.

We recommend that section 110 is excluded from the scope of general anti-hybrid mismatch measures in Irish law but that, instead, the provisions in section 110 are amended so that they align more perfectly with the design of the anti-hybrid mismatch measures in ATAD. In this way, the section 110 provisions can continue to be read on a standalone basis whilst including self-contained hybrid mismatch measures which are aligned with the ATAD regime and provide greater certainty of coutcome in the market for debt raising activities.

Leasing activities

Certain financial services activities can give rise to mismatches in treatment between jurisdictions. It is suggested that leasing activities should be excluded from the scope of this where the lease receipts are subject to tax in Ireland. This should be the case either where lease receipts are taxable under the provisions of section 80A, TCA 1997 i.e. the taxation treatment follows the accounting recognition of income, or the lessor is taxed on the gross rental receipts[23].

ATAD requires that the hybrid mismatch financial instrument provisions should apply where the instrument is taxed under the rules for taxing debt, whether in the payee or payer jurisdiction. Notwithstanding that Ireland does not tax leasing payments under the rules for taxing debt, Ireland's implementation of hybrid mismatch measures should recognise that other counterparty jurisdictions to a lease may tax the leasing payment under their rules applicable to debt and should therefore include the financing element of lease payments made by companies within the scope of the hybrid mismatch measures.

Guidance would be useful to illustrate how such measures might work in the case of lease rental payments which are not otherwise bi-furcated in Ireland but which might be treated in part as related to debt financing and, in part, as the provision of a service for tax purposes in the counterparty jurisdiction.

Financial services sector exclusions under ATAD

ATAD provides that certain financial instruments may be excluded from the scope of the mismatch measures. We recommend that these exclusions are adopted.

This should protect the existing well understood tax treatment of, for example, stock repo transactions[24] which occur in the marketplace and provide necessary liquidity in financial instruments for

[23] The treatment of leasing income as included in taxable income even where the lessor is taxed on a financing return and the lessee claims a deduction for operating lease rentals is illustrated at example 1.25 in the OECD October 2015 report under Action 2 of the BEPS Project. Recital 28 of ATAD provides that in implementing the hybrid mismatch measures under ATAD, Member States should use the applicable explanations and examples in the OECD BEPS report on Action 2 as a source of illustration or interpretation to the extent that they are consistent with the provisions of the Directive and with EU law. The OECD report acknowledges in discussion at paras 64 and 65 that it can be difficult in practice to conclude if an agreement should be treated as a services agreement in the nature of a lease or a financial instrument.

[24] Article 2(9)(a) permits certain on-market hybrid transfers such as stock repo transactions involving payments by financial traders to be excluded from in scope hybrid payments under the measures related to financial instruments.

counterparties to such transactions together with the exclusion for loss-absorbing regulatory capital instruments issued by banks[25].

More generally, we recommend that Ireland's tax policy makers consult closely with the financial services sector when implementing hybrid mismatch measures so as to ensure that the measures can operate as intended and that permitted exclusions from the scope of the measures can also be implemented in a manner that is understood by industry participants.

This is particularly the case for the funds industry. Many international funds structures use intermediary holding vehicles such as partnerships to collect together classes of investor with common investment requirements. Partnerships are potentially a type of reverse hybrid entity in Ireland i.e. where the investor or investee jurisdiction treats the partnership not as a transparent entity as Ireland does but as an opaque entity which is taxed in a similar manner to a company.

The Directive provides for an exclusion from the scope of the reverse hybrid measures[26] for certain regulated collective investment vehicles. We recommend that, in implementing the hybrid mismatch measures, Ireland's policy makers work closely with fund industry participants to ensure that Ireland's adoption of the measures can both allow Ireland to meet its obligations under ATAD while continuing to compete internationally as a centre of excellence for fund administration activities.

Hybrid entity mismatches

Irish tax law taxes entities formed under foreign law in accordance with the foreign legal characteristics of the entities. This has meant that, in practice, there is little scope for a mismatch treatment of entities between Ireland and other EU Member States in the case of entities formed under the law of other EU Member States. This is with the limited exception of certain partnership structures which may, upon the election of the taxpayer, be taxed as corporations in certain Member States. Due to the complexities associated with taxing partnerships under Irish tax law together with existing anti-avoidance measures which apply to limit deductions for partnership losses, these generally have not been used by Irish taxpayers to achieve double deduction outcomes.

As a result of the ability for taxpayers in the US to "check the box" and treat entities which might be corporations in law as transparent branches or partnerships for US corporate income tax purposes, the most common occurance of hybrid

[25] Article 9, paragraph 4, permits the exclusion of certain interest payments on banking sector regulatory capital instruments from the scope of the hybrid mismatch measures until 31 December 2022.

[26] See Article 9a, paragraph 2.

entities between Ireland and other jurisdictions are those between Ireland and the US.

US tax reform includes hybrid mismatch measures which are expected to be included in detailed enacting regulations during 2018. These measures are expected to counteract hybrid mismatch outcomes arising from interest and royalties (whether arising because of mismatches in financial instruments or hybrid entities). The effects of US hybrid mismatch measures are also expected to deny a tax exempt outcome to dividends deducted in the payor jurisdiction, to restrict the use of losses arising to dual resident entities as well as denying branch mismatch outcomes.

The adoption of US anti-hybrid measures should mean that, where Ireland introduces complementary hybrid mismatch measures, the opportunity for mismatches arising between Ireland and the US in respect of hybrid instruments and entities should be significantly reduced.

Ireland should closely review the adoption of the US anti-hybrid measures so that it can ensure that its drafting of ATAD aligned anti-hybrid measures can counteract mismatches without resulting in double taxation outcomes.

In addition to carefully reviewing the possible interaction of Irish hybrid mismatch measures with US hybrid mismatch measures, the fundamental changes to the US taxation of foreign profits which has been implemented by the new tax reform laws should be carefully considered as Ireland drafts its measures - particularly as it considers the conditions necessary to satisfy the "included in income" test which lies at the heart of identifying a hybrid mismatch outcome.

As a result of the expected broadening in scope of US current taxation of profits arising to overseas subsidiaries of US multinationals not just to profits taxable under its CFC regime but to profits taxed currently under the Global Intangible Low-Taxed Income (GILTI) regime, there can be expected to a greater incidence of current US taxation at the level of the US parent of the profits of foreign entities.

Care would need to be taken that such income (even if taxed on the part of an entity which is not considered to be the recipient of the income under an Irish tax analysis) can be treated as included in income for the purposes of determining if a hybrid mismatch outcome arises. Where it is not so treated, and there is a denial of a deduction in Ireland under a hybrid mismatch measure, there is a risk of double taxation of income arising.

Related matters

It is expected that Ireland in the future will need to consider the adoption of a general interest limitation rule in line with the rule set out in Article 4 of ATAD. In order that the adoption of a general interest limitation rule should not result in denying a deduction for genuine business expense, we recommend that, in advance of its adoption, Ireland should conduct a fundamental review of its regime for relief for financing expense. This may require a re-assessment of the effectiveness of its hybrid mismatch measures if some of the existing targeted rules which deny a deduction for interest expense (such as section 130 mentioned above) are replaced with a general interest limitation rule.

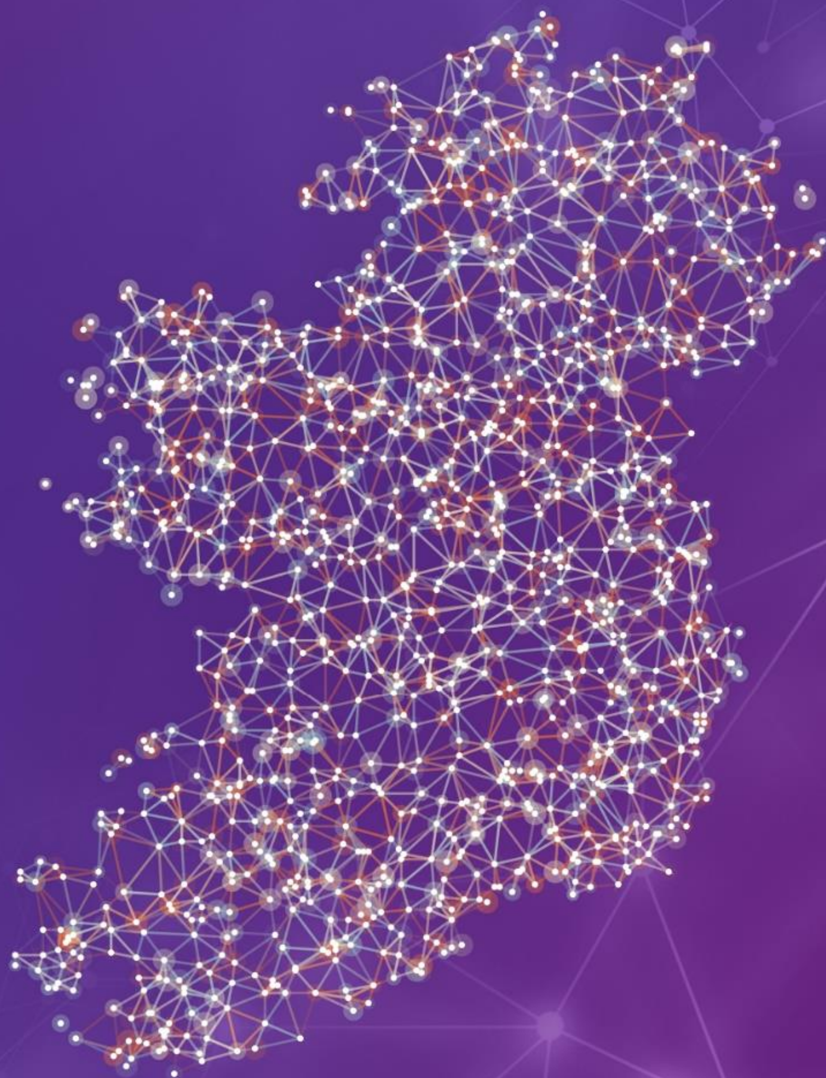
Implementation risks

We have summarised in the table below possible implementation risks that could arise when seeking to meet the minimum standard under ATAD for hybrid mismatch measures.

In the table, we have described possible consequences arising from the identified implementation risks and how the risks have been addressed by our suggested implementation approach.

Implementation risk	Consequence	Addressing risk
Hybrid mismatch measures extended beyond ATAD framework.	Uncertainty and risk of double taxation.	Confine adopted measures to the ATAD framework and not go beyond.
Definition of *included in income* does not recognise all income taxed in another jurisdiction.	Uncertainty and risk of double taxation.	Ensure that current inclusion of taxable income (even if taxed on another legal entity) is taken into account in determining if income is included in tax in another jurisdiction. Close review and monitoring of adoption of hybrid mismatch measures in the US in addition to reviewing the expanded scope of the current inclusion of the earnings of foreign subsidiaries in US taxable profits. This is a jurisdiction which affords opportunities for cross border mismatches to arise due to the flexibilities afforded under US tax law for taxpayers to choose the characterisation of domestic and foreign entities for tax purposes.
Broad based application to financial services regulatory capital.	Risk of limiting sources for capital with loss-absorption regulatory capital characteristics for banks.	Avail of ATAD exclusions for defined regulatory capital which are available up to 31 December 2022.
Broad based application to debt raising activities.	Potentially affect securitisation activities.	Adjust targeted anti-avoidance measures already contained in section 110 to align with ATAD requirements, thereby allowing the section 110 measures to be read on a ‘standalone’ basis and provide the greatest certainty of application of the measures to market based debt raising transactions.

SECTION 2: Ireland's transfer pricing regime



Introduction

In Section 2, we have set out our response to Questions 5 to 9 of the consultation on transfer pricing matters.

In our response, we take into account the enhanced protections against base erosion that Ireland will have following the adoption of ATAD measures.

We have suggested changes to the shape of Ireland's transfer pricing regime which we believe complement ATAD measures but which are also aligned with Ireland's obligations to adhere to EU freedoms.

Our response suggests that Ireland should not immediately move to mandatorily adopt a transfer pricing regime that reflects all of the changes outlined in our response but should move to adopt it over time.

This is necessary in order that businesses and Revenue can absorb and fully understand the impact of the changes and ready themselves for adoption.

We believe that transfer pricing is becoming a more central part of Ireland's corporation tax regime as it relates to the taxation of profits from international business.

The suggestions we have put forward to change Ireland's transfer pricing regime (both in a domestic and international context) should serve to:

- strengthen Ireland's position in asserting its right to tax profits associated with the control of business risks exercised by Irish based decision makers,
- protect Ireland's domestic tax base by adopting transfer pricing which is consistent with the design principle of ATAD measures which provide protections against base erosion, and
- reduce the risk of double taxation and uncertainty for taxpayers which could arise if Ireland's framework for transfer pricing is out of line with the framework adopted by its major trading partners.

We suggest that the type of changes we have proposed provides an opportunity for Revenue and business to work together to develop safe harbours for the application of transfer pricing to commonly occurring business transactions.

The development and adoption of safe harbours should provide greater certainty for the application of transfer pricing to low risk transactions as well as simplifying day-to-day administrative compliance with transfer pricing requirements for both businesses and Revenue.

We foresee that increased Revenue resources will be needed in the transfer pricing area in order to:

- administer compliance with Ireland's transfer pricing regime,
- act as competent authorities in disputes to assert Ireland's taxing rights in relation to profits from international activities, and
- continue Ireland's active engagement in OECD working groups that are developing future transfer pricing guidance.

Question 5: Key considerations when incorporating the 2017 OECD Transfer Pricing Guidelines

We consider that the 2017 OECD Transfer Pricing Guidelines ('the 2017 Guidelines') are the appropriate reference point for Ireland's transfer pricing rules[27].

What do the 2017 Guidelines say?

The changes to the OECD Guidelines issued as part of Actions 8-10 of the OECD BEPS Project emphasise that profits should follow risk. Where the important risks for a business are controlled will have a significant impact on where potential profits should be recognised. Allocation of significant profit potential (both upside and downside) depends on the assumption of economically significant and specific risks.

The 2017 Guidelines build on insights and guidance in the 2010 Guidelines. Although they do not contain fundamental changes in approach, the 2017 Guidelines contain an expanded range of examples which deepen the range of insights available on identifying risks and the control of risk. They might also be said to distil and refine the approach in the 2010 Guidelines to determining who might be said to control risks thereby making it easier to identify and apply the relevant guidance in this area.

Risk and control of risk

The 2017 Guidelines provide that the assumption of risk is firstly evidenced by the intra group contract. Additional evidence is available from the actual conduct of the parties. The assumption of risk requires the control of risk, involving capability and actual performance of decision-making to take on and respond to risk together with financial capacity[28] to bear the risk.

Control of risk involves:

- the capability to make decisions to take on, lay off or decline a risk bearing opportunity, together with actual performance of that decision making function, and
- the capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with actual performance of the decision making function.

Decision makers should possess competence and experience in the area of the particular risk for which the decision is being made and possess an understanding of the impact of their decision on the business.

It is not necessary for a party to perform the day to day mitigation of risks in order to have control over those risks – such day to day mitigation may be outsourced provided the party outsourcing the risk mitigation activities has the capability to i) determine the objectives associated with the outsourced activities, ii) control the appointment of the agent providing the risk mitigation functions, iii) assess whether the objectives are being adequately met, and iv) decide whether to adapt or terminate the contract with the agent.

With regard to intangible assets (also described as IP) and their ownership, development and exploitation, it is not necessary that the entity assuming and controlling the risk also carries out the DEMPE functions (the development, enhancement, maintenance, protection and exploitation) relating to the intangible asset. The specific DEMPE functions that are relevant will depend on the nature of the intangible asset. The outsourcing of DEMPE functions is common practice and, where it occurs, it is possible for the IP owner to retain the risk associated with the IP provided it continues to exercise control over the outsourced activities.

Where DEMPE functions are carried out by parties other than the IP owner, appropriate compensation should be paid. The absence of DEMPE functions, and in particular the important functions that make a significant contribution to the value of the intangible asset carried out by the party contractually assuming risk, will reduce the profits of that party and may increase the difficulty in evidencing the control of risk by that party.

Where the party contractually assuming risk, as supported by actual conduct, meets the control requirement and has the financial capability to bear

[27] The OECD 2010 Guidelines are currently the reference point for Irish transfer pricing provisions.

[28] 2017 OECD Guidelines, 1.65

the risk, the allocation of risk to that party is not affected even where another party also exercises control of the risk through, for instance, the performance of DEMPE functions.

Experience of application of the 2017 Guidelines

Irish companies engaging in business transactions with foreign group counterparties are finding, in practice, that counterparty jurisdictions are already applying the 2017 Guidelines as their reference point for raising transfer pricing queries and assessments.

In addition, in its role as competent authority for transfer pricing disputes arising under Ireland's double tax treaties, Irish Revenue is managing disputes with other taxing authorities who are applying the principles of the 2017 Guidelines.

Ireland as a small open economy and the 2017 Guidelines

Intangible assets represent some of the most valuable classes of assets held and exploited by Irish based businesses. The 2017 Guidelines contain a number of changes and expansion in scope of guidance related to the transfer pricing of intangible assets when compared to the 2010 Guidelines.

The guidance in relation to the control of risk and the exercise of oversight and management of DEMPE functions relevant to intangible assets provides a strong foundation from which Ireland can apply transfer pricing provisions:

- ***From a defensive perspective in asserting Ireland's right to tax profits associated with the control of risk and oversight of DEMPE functions by Irish based decision makers.***

  A small number of Irish based decision makers can and do, in practice, exert control over business operations in other markets which may be larger in scale than the Irish operations (as a result of the relative size and scale of Ireland's economy in comparison to other economies in which the business operates). The expanded discussion in the 2017 Guidelines of the meaning of control of risk in the context of intangible assets is particularly useful to taxpayers and taxing authorities in a smaller economy. This is because an allocation of profit influenced by the relative scale of businesses in two jurisdictions would not adequately capture the profits attributable to the activities of decisions makers located in a smaller jurisdiction in controlling the main risks of the business.

- ***In protecting Ireland's domestic tax base by adopting transfer pricing guidance which is consistent with the outline approaches suggested in Section 1 of this submission in relation to adoption of an EU compliant CFC regime and exit taxation measures.***

  In line with ATAD permitted CFC approaches, we have suggested that Ireland should adopt a CFC regime which seeks to limit the CFC rule to profits that have been artificially diverted to the CFC. In the context of adopting an ATAD compliant exit tax regime, we have suggested that Ireland applies transfer pricing provisions to measure the market value of capital assets imported to and exported from the scope of charge to tax in Ireland.

  Our recommendations on how Ireland's might best fit the general provisions set out in the Directive with its tax system are based on the understanding that Ireland's policy approach is to seek to tax only those profits which belong to Ireland. The 2017 Guidelines provide an internationally recognised framework for determining the amount of those profits in the context of transactions between members of multinational groups.

  The OECD Guidelines are also recognised by the European Commission as an internationally recognised framework for applying the arm's length principle in pricing transactions between members of a multinational group. Their adoption also potentially reduces the risk of future EU State aid challenges in relation to Ireland's corporation tax regime.

- ***To reduce the risk of double taxation and uncertainty for taxpayers which could arise where Ireland's framework for transfer pricing is out of line with the framework adopted by its major trading partners.***

  The 2017 Guidelines have emerged from an intensive period of debate amongst countries participating in the OECD BEPS Project. Although there was not always consensus on all points in the process of updating the 2017 Guidelines, they address those areas where there is greatest convergence of views. Where they are applied by two jurisdictions in pricing the same intercompany transaction, the adoption of a common approach presents less risk of a double taxation outcome and less risk of disputes arising which can cause uncertainty for taxpayers and taxing authorities.

Detailed considerations for adoption of the 2017 Guidelines

a. Timing of adoption

Timing is one of the most important considerations to bear in mind when adopting the 2017 Guidelines. In accordance with the current legislative framework for Irish transfer pricing, a Ministerial Order is required to change the reference guidelines used for Irish transfer pricing from the 2010 Guidelines to the 2017 Guidelines.

Businesses with cross border transactions face a number of challenges in meeting transfer pricing requirements. These include:

- differences in approach adopted by taxing authorities in other jurisdictions in applying updated OECD guidelines,
- uncertainties caused by marketplace changes arising from developments such as Brexit, and
- changes in tax law in counterparty jurisdictions, the most dramatic of which has been recent tax reform measures enacted in the United States ('US').

External factors such as Brexit and US tax reform are likely in 2018 and 2019 to result in Irish based businesses that engage in transactions with UK and US group members adjusting their supply chains for delivery of goods and services in these markets. Changes to business supply chains will require adjusting and re-pricing intra group transactions in those supply chains. As described above, many Irish based businesses operating in international markets are already operating in an environment where the 2017 OECD Guidelines apply.

It is understood that the feedback from this consultation will be reviewed and taken into account as part of a decision by Irish policy makers on timing of adoption of the 2017 Guidelines. This is likely to mean that policy makers may only be in a position to make a decision on timing of adoption in the second half of 2018. Recognising that taxpayers may need some time to review and consider whether their current pricing meets the 2017 Guidelines as well as to adjust their business operations to external market developments and the impact of US tax reform measures[29], we suggest that ***if a decision is taken in 2018 to***

[29] Both for US parented multinationals with operations in Ireland and Irish based operations supplying goods and services to group members based in the US.

adopt the guidelines that a mandatory date for adoption should apply no earlier than 2020.

In order to afford businesses the greatest opportunity to ready themselves for adoption of the 2017 Guidelines in Ireland, we suggest that announcement of the operative date should be signalled as soon as possible in 2018.

This is to allow companies the opportunity to align their Irish transfer pricing approach with the 2017 Guidelines as they put in place revised intra group trading relationships to address market changes. If Ireland was to introduce mandatory adoption in 2018 or 2019, there is the risk that businesses still in the process of business restructuring face updating their transfer pricing approach for both existing arrangements and post restructuring arrangements within a short timeframe. Such changes are likely to occur during 2018 and 2019 as businesses respond to these developments.

In recognition of the position faced by:

- businesses who already operate in an international environment where the 2017 Guidelines are applied by counterparty jurisdictions, and
- groups who complete significant restructuring of business supply chains in 2018 and 2019,

we suggest that provision is made for taxpayers to elect for early adoption of the 2017 Guidelines instead of the 2010 Guidelines for 2018 or 2019 accounting periods.

Should taxpayers elect for early adoption in an environment where they are already applying the 2017 Guidelines, they can get the benefit of applying the 2017 Guidelines to achieve greater group-wide consistency of approach. In addition, repricing of new business arrangements can also be done from an Irish perspective on a basis which is aligned with the transfer pricing regime going forward.

We recommend that the timing of the ongoing compliance obligation to prepare and retain transfer pricing documentation is set so that companies can comply where documentation is in place no later than the due date for filing the corporation tax return for the tax accounting period in which the relevant transaction is reflected.

Further comments on transfer pricing documentation requirements are included in our response to Question 9.

b. Application to intra group financing arrangements

The 2017 Guidelines contain very little guidance in relation to pricing of intra group financial transactions including intra group loans, guarantee arrangements, etc. Work on the development of guidance in this area is still ongoing under the framework of the OECD BEPS Project.

Ireland's approach (which has been adopted by many other countries) seeks to apply an arm's length price to a loan based on the contractual terms of the loan e.g. taking into account factors such as the period for which the loan is advanced, the currency of denomination of the loan, whether it is secured, whether the right to repayment is subordinated to those arising under loans advanced by other lenders, etc.

Under Ireland's approach, the pricing of the loan does not require an assessment of the capital adequacy of the borrower (or to ask if a third party lender would have advanced a loan or made an equity investment in the case of a third party)[30]. The Irish approach takes into account the repayment capacity of the lender in assessing the risks associated with the loan and its pricing impact on the arm's length return on the loan.

We suggest that Ireland should not seek to change its current approach to transfer pricing of financing arrangements until there is international consensus on how Article 9[31] (of the OECD Model Tax Convention) applies to capital and debt.

It is important that Ireland continues to actively engage in the OECD working group on pricing financial transactions and capital in order that its views can be taken into account as the OECD works to develop consensus in this area.

c. Attribution of profits to branches

At present, Ireland's approach to the attribution of profits to branches is to follow the basis which is set out in the relevant tax treaty[32]. In the case of

[30] Developing guidance on approaches to capital allocation is an area where there is least international consensus at present.

[31] Article 9 deals with pricing transactions including loans between associated parties.

[32] Irish domestic transfer pricing provisions do not apply to price transactions between a head office and a branch or between branches of a company.

the Irish branches of non-tax treaty residents, Ireland seeks to tax only those profits that are attributable to the branch.

We suggest that Ireland adopts the authorised OECD approach to the attribution of profits to branches both in the case of Irish branches of non-tax treaty resident entities and in the case of foreign branches of Irish residents that are not located in tax treaty jurisdictions.

We believe that this approach should reduce the risk of challenge to the overall framework of Ireland's transfer pricing regime. Where the significant people functions related to the branch's activities are located in Ireland, the adoption of this approach affords a similar advantage to Ireland in asserting its taxing rights in relation to branch profits as that outlined above in relation to pricing cross border transactions between group members.

Applying OECD Guidelines in allocating profits to branches provides Ireland with a recognised framework for determining the amount of Irish profits attributable to the branch whether Ireland retains its worldwide taxation regime or moves to adopt a more territorial basis of taxation by adopting a foreign branch exemption regime (available at the election of the taxpayer).

The OECD working group on transfer pricing under Action 7 of the BEPS Project continues to debate the basis for attribution of profits to branches. It is not expected that this effort will change the core principles of the authorised OECD approach.

It is important that Ireland continues to actively engage in the OECD working group on branch profit allocation in order that its views can be taken into account in developing future guidance in this area.

d. Pricing transactions related to capital assets in use for the purposes of the trade

We suggest that the arm's length transfer pricing principles (as set out in OECD Guidelines) should be used to determine the price for the disposal and acquisition of capital assets by companies.

It is suggested that a transfer pricing approach is adopted to determine the market value of such capital assets instead of the current variety of rules that apply to determine a market valuation of an asset. This would mean applying transfer pricing principles to establish the market value consideration instead of the rules that currently apply for corporation tax purposes which are imported from the Capital Gains Tax Acts and apply market value consideration as the taxable measure of disposal proceeds when computing a capital gain arising on disposal of a chargeable assets by a company to a connected party.

We do not propose that the adoption of the OECD Guidelines as a basis for potentially adjusting the taxable measure of chargeable asset disposal proceeds should impose a taxing event which would not otherwise arise e.g. this is not intended to impose a taxable capital gains event for an asset disposal which arises in the course of the transfer of an asset to another member of a capital gains tax group. The no gain/no loss treatment which currently applies to a range of asset transfers should continue to apply.

We suggest that a transfer pricing approach is also adopted to determine open market value when pricing capital expenditure on assets which is eligible for capital allowances under Ireland's capital allowances regime.

These suggestions are discussed in greater detail in our response to Question 8 of the consultation on transfer pricing and non-trading transactions. In our response, we explore how adoption of a transfer pricing approach to price the market value of a capital asset across a range of provisions in the corporation tax code which apply market value tests to transactions involving capital assets might allow improved consistency of approach across Ireland's tax regime.

Adopting a transfer pricing approach to pricing the market value of capital asset transfers is also suggested in the context of adopting an exit taxation regime and in the context of pricing profits attributable to Ireland in respect of assets held by a CFC. We have discussed in detail suggested design features of an ATAD compliant exit tax and CFC rule in Section 1 of this document.

e. Readiness for adoption

The comments above have focused, in the main, on the experience of business in relation to the international adoption of the 2017 Guidelines. It can also be foreseen that additional Revenue resources will be needed in the area of transfer pricing when considering the demands on transfer pricing resources that will raise as a result of:

- administering compliance with Ireland's domestic transfer pricing regime,
- acting as competent authority on disputes under tax treaties, and

- continuing Ireland's active engagement at the OECD in working groups that are developing future guidance.

Implementation risks

We have summarised in the table below possible implementation risks that could arise in changing the reference guidelines for Irish transfer pricing to the 2017 Guidelines.

In the table, we have described possible consequences arising from the identified implementation risks and how the risks have been addressed by our suggested implementation approach.

Implementation risk	Consequence	Actions mitigating risk
Not ready for adoption. **The fundamental principles in the 2017 Guidelines apply under the 2010 Guidelines. However, expanded guidance, especially in the area of pricing intangible assets means that taxpayers and tax authorities alike will need to familiarise themselves with the detail of the guidelines to be confident that their transfer pricing position is aligned with the 2017 Guidelines.**	Potential for double taxation where inconsistent application by taxpayers and inconsistent interpretation by taxing authorities in the application of new guidelines.	Deepen transfer pricing resources in Revenue to provide a basis to (i) apply 2017 Guidelines consistently across taxpayers (ii) defend Ireland's position in relation to cross border transfer pricing disputes, and (iii) participate actively in the international debate on the ongoing evolution of transfer pricing guidance including pricing of financing transactions and the attribution of profits to branches. Early announcement allowing a period before a mandatory adoption date to give taxpayers time to ready themselves by adjusting transfer pricing, where necessary, to align with the 2017 Guidelines.
Ireland's transfer pricing regime is not aligned with international norms.	Uncertainty of basis for pricing which can act as a barrier to investment. Double taxation where counterparty jurisdiction applies the 2017 Guidelines. Increased risk of EU State aid challenge.	Application of transfer pricing principles and the clearer exposition of the meaning of control of business risks in the 2017 Guidelines is consistent with the proposed approach to Ireland's adoption of an ATAD compliant CFC rule as well as pricing the market value of asset transfers under an exit tax regime. It is also consistent the wider BEPS agenda of aligning profit attribution with economic substance. Option for early adoption by taxpayers of the 2017 Guidelines (e.g. allowing taxpayers already operating internationally in jurisdictions applying the 2017 Guidelines to also apply them in Ireland).
Ireland at a disadvantage in protecting its tax base.	Loss of corporation tax revenues.	Adoption of 2017 Guidelines as a basis to support Ireland's right to tax profits attributable to the actions of Irish based decision makers.

Questions 6 - 9: Additional considerations regarding Ireland's domestic transfer pricing rules

Question 6: Arrangements that were agreed before 1 July 2010

We suggest that, in tandem with updating the reference guidelines for transfer pricing purposes to the 2017 Guidelines, it would be appropriate to include within the scope of the transfer pricing regime those arrangements which are still in place that were agreed before 1 July 2010 ('grandfathered arrangements'). This should be done with prospective effect and not require the application of transfer pricing adjustments to past transactions under grandfathered arrangements.

We suggest that this approach is followed, with one exception. This 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 do not change and the loan remains in place between the same counterparties.

Many taxpayers that continue to rely on this exception for grandfathered arrangements do so in relation to longstanding arrangements which are in place between Irish members of a group. This means that, in practice, they do not apply transfer pricing to arrangements in place between Irish group members e.g. in the case of interest free loans and other informal financing arrangements or to management support and other services provided by an Irish parent to its Irish subsidiaries.

Where Ireland adopts the approach suggested in response to Question 8 below which is not to apply transfer pricing to intra Ireland transactions, the removal of the exception for grandfathered arrangements should have a less significant impact on many taxpayers that rely upon it. This is because, for cross border transactions, it can be expected that, in many cases, taxpayers already apply transfer pricing to transactions in accordance with transfer pricing requirements that apply in the counterparty jurisdiction.

We recommend that there is early announcement in advance of the effective date of a removal of provisions affecting grandfathered arrangements. This is to allow taxpayers time to review the scope of transactions potentially affected by such changes and to put in place appropriate transfer pricing arrangements.

We do not consider that the timing of adoption of all of the changes to Ireland's domestic transfer pricing regime which might emerge from review of responses to Questions 6 to 9 of the consultation should necessarily be aligned with the mandatory timing of adoption of the 2017 Guidelines (discussed in relation to Question 5 above).

A change to adopt the 2017Guidelines as reference guidelines can be done by means of Ministerial Order. Giving effect to changes that might emerge from issues addressed in response to Questions 6 to 9 will require legislative amendments. Such amendments should only be adopted after detailed consultations with taxpayers and practitioners to ensure that they are understood and they have their intended effect.

Advance notice of adoption of new measures should be done to allow taxpayers to ready themselves to comply with new requirements from the chosen effective date.

Question 7: Extension of transfer pricing rules to SMEs

Due to the relatively small size of the Irish economy and its strongly performing export sector, a greater proportion of Ireland's SMEs are engaged in cross border transactions than is the case for SMEs operating in larger economies within the EU.

On the one hand, this might be considered to give rise to a greater risk for Ireland that a loss of tax revenues could arise from SMEs mispricing transactions related to cross border flows of goods and services. On the other hand, the risk of under reporting profits, in practice, is mitigated by Ireland's low rate of tax in comparison to the rates of corporate income tax applicable in the main economies in which Ireland's SMEs engage in cross border trade.

One of the greatest risk of loss of tax revenues from mispricing transactions in the case of privately owned SMEs arises in the case of the provision of goods and services at undervalue by a company to its shareholders (or their relatives). Ireland's taxing provisions include wide ranging measures to impose tax on individuals in relation to benefits arising to them from the transfer of assets or the provision of goods and services at undervalue by companies owned by them. In addition, measures apply to deny a tax deduction to the company for such payments or transfers of assets at undervalue. Ireland also has extensive anti-avoidance provisions which counteract the transfer to and holding of assets by closely-held foreign companies owned by Irish residents and the loss of tax revenues associated with the income and capital gains arising from the assets held by those companies.

Studies have shown that doing business in export markets places a burden of complexity on the business which can disproportionally affect businesses that are smaller in scale. The complexities of operating in export markets and the competitive challenges those markets present for SMEs should also be borne in mind when assessing the balance of the risk of loss of tax revenues due to a lack of transfer pricing with the additional burden of tax compliance that would arise for SMEs if the scope of transfer pricing was extended to smaller companies. SMEs operating in exports markets are seeking to expand in those markets at a time of considerable change and related complexity in some of Ireland's biggest export markets.

The exclusion from the scope of transfer pricing for SMEs in the current Irish transfer pricing provisions is defined by reference to EU size thresholds which is applied taking together the wider group of associated entities to which the company belongs . The European Commission recognises that Member States can provide tax reliefs in the form of reduced or simplified tax administrative obligations for SMEs in recognition of the disproportionate burden that complex tax provisions can place on smaller entities competing in the same market as larger entities.

The area of greatest additional compliance burden which could affect SMEs if transfer pricing is extended to them is that associated with transfer pricing related to transactions with other Irish taxpayers. If transfer pricing is more generally confined to transactions with persons outside the charge to Irish tax, this should reduce the scope of the additional compliance burden faced by many SMEs. This is because some countries (notably not including the UK) impose transfer pricing requirements on smaller taxpayers such that many smaller Irish counterparties to transactions with taxpayers in those jurisdictions already face local transfer pricing requirements.

We have considered the balance of the risk of loss of tax revenues from mispricing cross border trade between group members of SMEs with the complexity and administrative burden associated with meeting transfer pricing requirements. We have also considered the potential adverse impact on Revenue resources of administering an increased volume of taxpayer cases if the scope of transfer pricing requirements is extended to SMEs.

Based on the balance of these considerations, we suggest that the existing scope of application of Ireland's transfer pricing regime should be retained i.e. confined to entities within groups that exceed the EU size thresholds for SMEs.

If it decided to extend transfer pricing rules to medium sized enterprises i.e. those that exceed the EU size thresholds for small entities, we suggest that:

- At a minimum, the transfer pricing rules should not be extended to entities that do not exceed the EU size definition of a small or micro entity[33].
- Safe harbour provisions are introduced which taxpayers may seek to rely upon as a means of simplifying compliance with transfer pricing rules. Where a transaction falls within the scope of a transfer pricing safe harbour, the taxpayer can rely on the safe harbour and not prepare documentation to support the transfer price.

  Different types of safe harbour approaches could be considered. Although it is suggested that safe harbours should apply across all taxpayers, the anticipated effect of a reduced documentation burden could be expected to have the greatest proportionate impact of reducing the compliance burden for companies of a smaller scale.

[33] A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million.

- One type of safe harbour approach would be to not require transfer pricing obligations to apply to defined types of activities which might be expected to yield a routine return and thereby represent activities which might be said to be low risk from the perspective of Revenue in administering compliance with transfer pricing obligations.

  Guidance is available from the OECD, the European Union's Joint Transfer Pricing Forum and the Platform for Collaboration on Tax (a joint initiative of the IMF, OECD, UN and World Bank) on the adoption of safe harbour provisions and simplified transfer pricing bases for a range of intra group transactions such as, for example, routine low value adding services. These resources could be used as a basis for developing safe harbours that can be expected to be aligned with international transfer pricing norms.

- Another type of safe harbour approach that could be explored would be for Ireland's competent authority to seek to agree safe harbours on a bilateral basis[34] with competent authorities in jurisdictions, such as the UK, where business based in Ireland can expect to have high volumes of cross border transactions.

  This might involve agreeing that, for example, defined activities which reflect pricing with returns within an agreed range e.g. a return of at least x% above cost, would be considered by both jurisdictions to be low risk from a transfer pricing perspective. Taxpayers applying transfer pricing which falls within these defined safe harbour activities and pricing ranges would not be expected to prepare additional transfer pricing documentation to support the transfer price in either jurisdiction.

  Such an approach could be considered in relation to pricing of intra group loans e.g. providing that intra group loan arrangements that apply interest rates within a defined range should be treated as low risk from a transfer pricing perspective and not require taxpayer pricing related documentation.

- A safe harbour approach might apply in relation to the timing of provision of documentation to Revenue. For example, a company that is part of a group that does not exceed the SME size thresholds would not be expected to provide transfer pricing documentation unless requested to do so upon audit by Revenue.

  OECD guidance at paragraph 33 of the October 2015 report under Action 13 of the BEPS Plan on transfer pricing documentation acknowledges that jurisdictions can and should reasonably adopt lighter touch documentation standards for smaller enterprises.

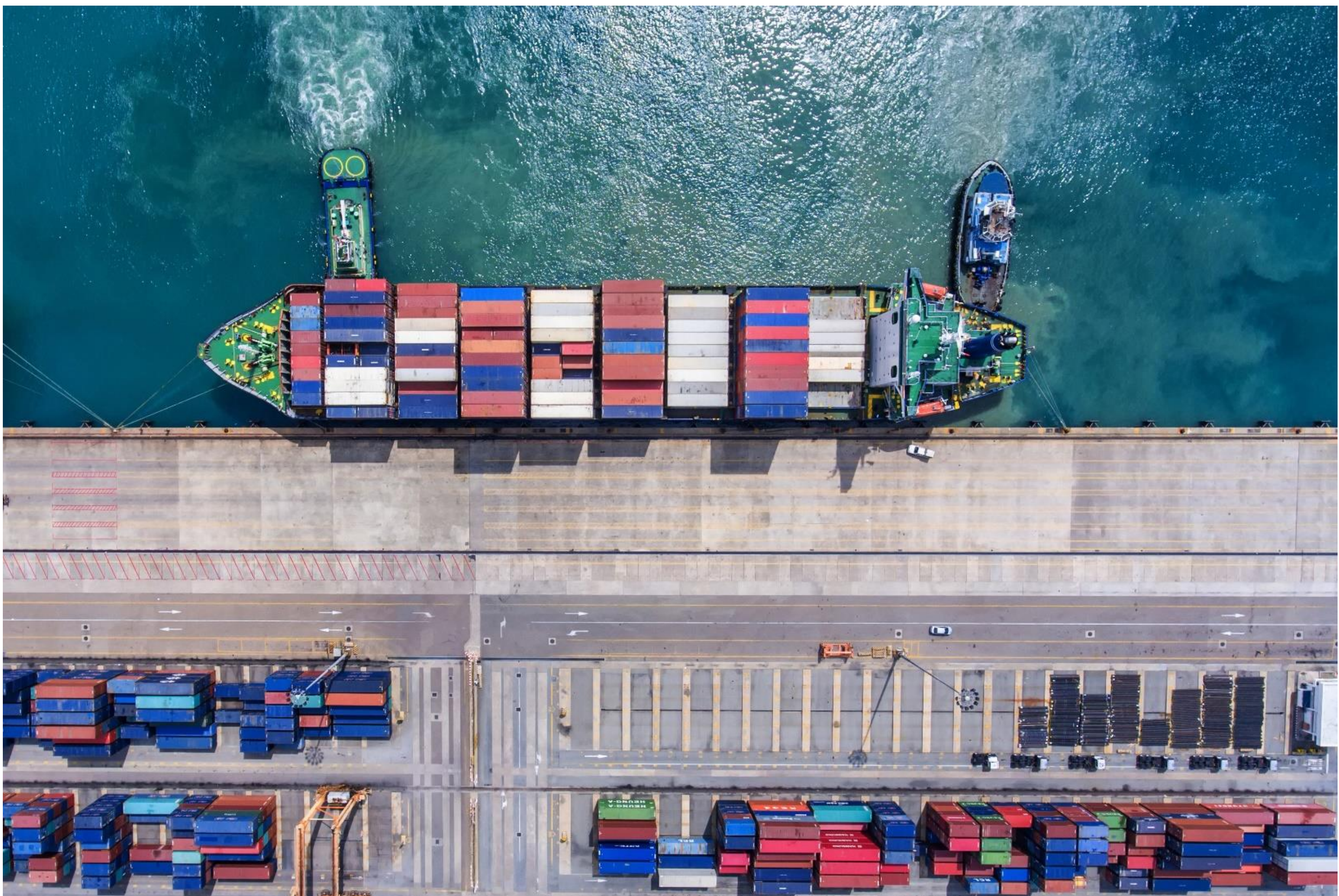
- Consideration might be given to allowing optional adoption by SMEs. This might be of interest to SMEs that are already faced with transfer pricing requirements in jurisdictions that apply full local transfer pricing requirements to smaller groups. Consideration of whether optional adoption is feasible would require an assessment of the extent of Revenue resources that might be required to administer the regime for SMEs that optionally adopt the regime.

- Early announcement and potentially deferred adoption for smaller companies in comparison to larger companies to allow smaller companies greater time to review intra group transactions and to put appropriate transfer pricing documentation in place. This recognises the reality that such taxpayers will have fewer internal resources available to meet transfer pricing obligations.

Question 8: Extending domestic transfer pricing rules to non-trading income

The purpose of transfer pricing provisions is to provide protection that sufficient profits (measured on arm's length principles) are recognised on business transactions between associated persons. If a service is under-priced and the provider and recipient companies are within the scope of tax in the same jurisdiction, there is typically no net transfer pricing exposure or understatement of taxable profits arising in that

[34] The 2017 OECD Guidelines, Chapter 4 on safe harbours recommends the agreement of bilateral safe harbours as a means of providing greatest certainty that reliance on safe harbour approaches will not result in double taxation for enterprises. Supporting guidance at Annex I includes sample wording for a bilateral memorandum of understanding.



jurisdiction because the understated profits of the service provider are matched by the overstated profits of the recipient.

In Ireland, this expected neutral outcome (or zero sum game) may not be achieved if, for example, the income is taxable at the 25% rate of corporation tax but the matching expense is only deductible at the 12.5% rate of corporation tax.

Concerns have been raised by the European Commission (which have been acknowledged by Seamus Coffey in his Review of Ireland's Corporation Tax Code) that the non-application of domestic transfer pricing rules to non-trading transactions creates risks associated with using Ireland as a location for intra group financing activities and the outcome is a cross border mismatch which results in a tax deduction with no income inclusion in Ireland. This could arise, for example, where a loan is advanced by an Irish lender on interest free terms and there is no income inclusion under Ireland's existing transfer pricing regime and the jurisdiction of the loan borrower affords a notional interest deduction based on an arm's length interest rate on the loan.

Another international aspect for consideration in the design of Ireland's transfer pricing regime is that the adoption of transfer pricing rules must also respect Ireland's obligation to respect the freedoms afforded under the Treaty for the Functioning of the European Union. If Ireland's implementation of transfer pricing provisions as they apply to cross border transactions were considered to be disproportionate and overly restrictive when compared to those applicable to domestic transactions, Ireland could be seen to be in breach of EU freedoms[35].

There is a test case at present before the CJEU in relation to the German transfer pricing regime as it relates to the provision of intra group guarantees

[35] The freedom most likely to be relevant to transactions between members of a group is freedom establishment.

and financing facilities within Germany[36]. The German transfer pricing regime does not seek to impose an arm's length guarantee payment or arm's length return on interest on transactions arising within the German domestic framework. Nor does Germany's transfer pricing regime generally apply to transactions between domestic taxpayers. This is because it is recognised that there is no net exposure or loss of tax from a German perspective because imposition of additional income upon the lender would be offset by a deduction for an expense in the borrower entity within Germany.

The opinion of the Advocate General (AG) has found that the non-application of the German transfer pricing regime to domestic transactions remains compliant with EU freedoms.

Should this December 2017 finding of the AG be upheld by the CJEU, we suggest that it would be legitimate for Ireland to not apply transfer pricing adjustments to transactions between domestic taxpayers.

The AG's opinion suggests that, even if Ireland continues to apply transfer pricing to domestic transactions, Ireland should not be in breach of EU freedoms where it applies simplified transfer pricing requirements to domestic transactions as compared to cross border transactions with taxpayers who are not within the scope of Irish tax.

These developments in EU thinking in relation to transfer pricing suggests that if Ireland were to reframe its transfer pricing regime and:

- ***apply transfer pricing to non-trading transactions, but***
- ***not apply transfer pricing to transactions between domestic taxpayers,***

Ireland's regime could both be more robust in protecting against misuse in the context of cross border mismatches arising from differences in transfer pricing whilst remaining compliant with EU freedoms.

The scope of the potential for domestic transfer pricing adjustments arising on intra group arrangements is higher in Ireland than in other European countries simply because they adopt a different approach to tax grouping arrangements for direct tax purposes. The broad scope for the recognition of transfer pricing adjustments on intra group transactions in Ireland is simply a consequence of the design of Ireland's tax grouping regime which sees each member of a tax group assessed to corporation tax on a standalone basis with transactions between group members generally taxed in like manner to transactions with third parties. Separate provisions apply under the group relief regime to give relief for losses surrendered between members of a tax group and to give relief from withholding tax on intra group payments.

In some countries (for example, the Netherlands) transactions occurring between members of a tax grouping are entirely ignored for tax purposes. Within the Netherlands, this achieves the same neutrality of outcome to that which we are proposing would apply in an Irish context i.e. there is no adjustment for transfer purposes for intra Ireland transactions. At a minimum, this should apply in Ireland to domestic transactions between members of a tax group.

If it is decided to retain the scope of existing transfer pricing to apply to domestic transactions between corporate taxpayers (including between members of a tax group), legislative changes could be made to procedural requirements under Ireland's transfer pricing regime so as to avoid a disproportionate impact of the imposition of transfer pricing adjustments on non-trading transactions.

These would include:

- **Measuring corresponding adjustments in like manner and applying the same rate of tax in making transfer pricing adjustments for the counterparty companies.**

  Take, for example, the advance of a loan on interest bearing terms between two Irish resident members of a group, the lender being a holding company and the borrower a company engaged in the conduct of a trade. For the borrower company which has used the borrowing for the purposes of its trade, the consequence of disallowing an expense in excess of an arm's length amount is to disallow an expense otherwise deductible at a rate of 12.5%. It is suggested that the corresponding tax adjustment for the same tax accounting period of the counterparty holding company to adjust its taxable outcome as lender should be assessed to tax in an equal amount at a rate of

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

12.5% and measured in accordance with Case I principles.

- ***Providing relief for corresponding adjustments on a current period basis as well as on a self-assessed basis for taxpayers.***

  If, for example, a taxpayer identifies that intra group transactions were not reflected on an arm's length basis at period end, a transfer pricing adjustment as well as a corresponding adjustment could be made in the tax returns of the counterparties to the transactions. Such adjustments would give effect to both the disallowed deduction or additional income assessed under the transfer pricing provisions on the original company, as well as the corresponding adjustment in the tax return of the counterparty company.

  Under current transfer pricing provisions, a domestic corresponding adjustment is only available in the next tax accounting period and not on a contemporaneous basis.

Extending transfer pricing approach to capital transactions

We have considered below issues related to the application of a transfer pricing approach to pricing transactions in capital assets.

We suggest that it would be appropriate to apply transfer pricing principles to the measurement of:

- ***The market value consideration arising on the disposal of a chargeable asset for the purpose of the corporation tax code.***

  We suggest that this approach should be adopted in tandem with the application of a 12.5% rate of corporation tax to chargeable gains arising on the disposal of assets in use for the purposes of a trade.

  We do not propose that the adoption of OECD Guidelines as a basis for potentially adjusting the taxable measure of chargeable asset disposal proceeds to a market value amount should impose a taxing event which would not otherwise arise e.g. this is not intended to impose a taxable capital gains event for an asset disposal which arises in the course of the transfer of an asset to another member of a capital gains tax group. The no gain/no loss treatment which currently applies to a range of asset transfer should continue to apply.

  In Section 1, we reviewed the basis for imposing market value deemed disposal proceeds for assets upon the happening of exit taxation events. On review of the market value definition which is set down under the exit tax provisions in ATAD, we found that the definition of market value very closely corresponds to the concept of an arm's length price as it would apply under OECD Guidelines to price the sales consideration for the sale of an asset between independent parties, being a willing buyer and a willing seller. In that section, we suggested that Ireland adopts an arm's length price as the basis for determining the market value of chargeable assets imported from outside Ireland and used for the purposes of a trade carried on in Ireland as well as for deemed disposals of assets arising upon exit taxation events.

  Adoption of this consistent basis of measurement of market value consideration should also mean that there is less likelihood of a mismatch arising in the valuation approach applied to disposals of chargeable assets used for the purposes of a trade in Ireland between Irish companies and companies not within the scope of Irish tax which are resident in jurisdictions that also apply OECD based transfer pricing principles.

- ***The amount of expenditure eligible for capital allowances on assets acquired from non-resident group members[37].***

  At present, even where market value provisions apply to determine the consideration related to the disposal or acquisition of an asset, taxpayers are not mandatorily required to prepare and retain documentation to support the market value. In practice, documentary support for the market valuation applied may be requested by Revenue authorities when reviewing tax returns in the course of a tax audit, etc. but it is not mandatory to prepare such documentation.

  We suggest that, in tandem with the introduction of an arm's length pricing approach for such

[37] Such requirements apply under the provisions of section 291A in relation to eligible expenditure incurred on acquiring specified intangible assets as described in that section, section 289 in determining the open market price to determine balancing allowances or balancing charges that arise on disposal of plant and machinery assets as well as section 312, TCA 1997 which applies an open market sales price in computing the tax effects of capital allowances provisions on certain transactions between companies under common control.

transactions, related transfer pricing documentation requirements would apply. This should provide taxpayers and Irish taxing authorities with information to sustain and defend the arm's length price of assets acquired by Irish companies from group members outside Ireland. It should also support Ireland in taxing its share of capital gains arising on the disposal of such assets to companies outside the charge to Irish corporation tax.

By confining the changes in this manner, we believe that it should not affect the continuing application of capital gains tax provisions to transactions by individuals where market value is applied to measure the taxable disposal proceeds on chargeable assets. In this way, individuals who are not otherwise within the scope of Ireland's transfer pricing regime can continue to rely upon a well understood basis for applying market value where deemed market value consideration applies in measuring capital gains on asset disposals, etc.

Question 9: Transfer pricing documentation requirements

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*."

In order to balance the protections afforded by having robust documentation standards applicable in Ireland to transfer pricing which meet international norms with the burden on taxpayers of complying with documentation requirements, we consider that it would be appropriate to:

- Require transfer pricing documentation to be prepared no later than the due date for the filing of the corporation tax return for the tax accounting period in which the relevant transaction was reflected.
- Impose the full scope of the transfer pricing documentation requirements which are described in the October 2015 OECD report under Action 13 of the BEPS Project on taxpayers who are within the scope of the Country-by-Country (CbyC) reporting requirements. This is to prepare a master file and local file as well as complete the annual CbyC report. These are Irish parented multinationals with annual revenues in excess of €750million.
- In accordance with OECD guidance at sections D.3 to D.5 of the Action 13 report under the OECD BEPS Project, we suggest that Ireland issues guidance on the expected scope of documentation in the master file and local file to assist taxpayers in setting appropriate standards for transfer pricing documentation which balances information requirements of use to Revenue with the burden of compliance associated with documentation preparation. These could provide for appropriately adjusted documentation requirements for smaller multinationals.
- In keeping with current Irish best practice in relation to transfer pricing documentation, we suggest that Ireland's formal adoption of transfer pricing documentation requirements is aligned with the OECD guidelines and does not impose additional requirements solely for Irish transfer pricing purposes.
- In circumstances where an Irish taxpayer has access to transfer pricing documentation which is aligned with the OECD standard and covers the transaction that the Irish company is party to, we suggest that Ireland continues its current practice of not requiring that the company itself must prepare the documentation or that the documentation must be in Ireland once it can be made available to Revenue. This should mean that a group operating internationally could prepare a single supporting transfer pricing analysis for jurisdictions which apply the same OECD transfer pricing standards and avoid duplication of effort.
- In our response to Question 7 on transfer pricing and SMEs, we have recommended that a number of safe harbour approaches might be adopted in relation to transfer pricing. Where a transaction falls within a defined safe harbour practice, the taxpayer would not be required to prepare documentation to support the transfer price.

  Although adoption of safe harbour approaches could be expected, in practice, to have the greatest proportionate benefit in reducing the compliance burden associated with transfer pricing documentation for smaller entities, the introduction of safe harbour approaches for transfer pricing purposes would also be very welcome for larger taxpayers. Safe harbour approaches also reduce the administrative burden on Revenue of reviewing of transfer pricing documentation.

A number of safe harbour approaches and their related impact on reducing the compliance of transfer pricing documentation are discussed in our response to Question 7.

- If it is decided to extend the scope of transfer pricing requirements to companies which exceed the EU size thresholds for small companies, we suggest that such smaller taxpayers may only have to prepare and produce transfer pricing documentation upon request by Revenue e.g. in the context of a transfer pricing audit[38].

Implementation risks

We have summarised in the table below possible implementation risks that could arise in changing Ireland's transfer pricing regime as set out our response to Questions 6-9 above.

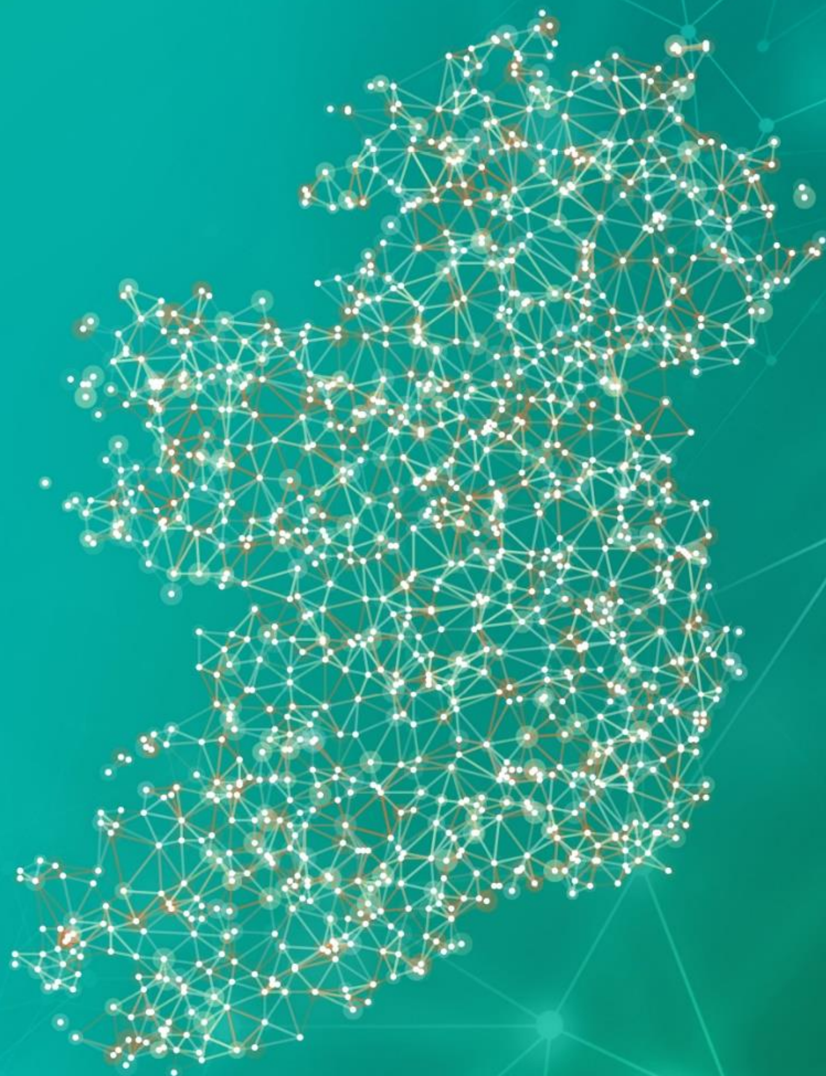
In the table, we have described possible consequences arising from the identified implementation risks and how the risks have been addressed by our suggested implementation approach.

Risk	Consequence	Actions mitigating risk
Not ready for adoption. **The changes outlined above could represent changes in both the range of transactions subject to transfer pricing as well as the standard of supporting documentation. Taxpayers and Revenue authorities would need to understand and be familiar with revised requirements.**	Uncertainty due to inconsistency of adoption across taxpayers and Revenue teams administering compliance with transfer pricing.	Deepen transfer pricing resources in Revenue to provide a basis to support audit teams in general tax audits e.g. where transfer pricing principles are applied to non-trading transactions and to price asset market value requirements which apply throughout the corporation tax code. Early announcement allowing a period before adoption to give taxpayers time to ready themselves by adjusting transfer pricing and preparing documentation, where necessary, to align with revised scope e.g. in relation to previously grandfathered arrangements and capital transactions. Not extending transfer pricing requirements beyond entities in groups which do not exceed the EU size thresholds for SMEs.
Ireland's transfer pricing regime is not aligned with international norms.	Uncertainty of basis for pricing which can act as a barrier to investment. Double taxation where counterparty jurisdiction applies international norms. Increased risk of EU State aid challenge. Duplication of documentation effort if Ireland's	Suggested adoption of approach to exclude domestic transfer pricing transactions from the scope of requirements in a manner which is aligned with developing CJEU jurisprudence. Consistency of valuation basis adopted where market value tests are applied to transactions in capital assets under the corporation tax code as well as under the exit taxation regime, and the measure of profits under a CFC rule

[38] This approach to documentation requirements for smaller taxpayers should be considered to be aligned with OECD guidance at para 33 of the OECD report under Action 13 of the BEPS Project.

Risk	Consequence	Actions mitigating risk
	documentation standard differs from OECD standard.	which are attributable to Ireland in the case of capital assets held by a CFC. Suggested alignment with OECD documentation standards without imposing additional Irish requirements. Not requiring documentation to be prepared by the company or held in Ireland once available to Revenue.

SECTION 3: Adopting a territorial regime



Introduction

In Section 3, we review the domestic and international tax context in which Ireland is considering adopting a more territorial corporation tax regime. This is explored in relation to the introduction of an exemption from corporation tax on foreign branch profits and for certain foreign dividends.

In the preface to this submission, we highlighted that Ireland should use the review of its corporation tax code as an opportunity to simplify the code where it could reasonably do so.

Making available a branch exemption and a foreign dividend exemption are two areas where simplicity could be achieved in the application of Ireland's tax regime to these classes of international profits without the risk to the Exchequer of the loss of tax revenues.

The greatest benefit received from moving to adopt a territorial regime for the taxation of foreign branch profits and foreign dividends is one of greater simplicity in the application of the corporation tax regime. Reduced complexity for business in the operation of the regime should reduce the barriers to conducting business internationally from an Irish base which arise where a regime is complex to administer.

Businesses and Revenue alike can benefit from reduced administrative complexity and greater certainty arising on the amount of Irish tax payable on these profits.

Even though these proposals provide for an exemption from tax, we believe the benefits of simplicity can be achieved in a context which will see Ireland benefit from additional protections to avoid the erosion of its tax base:

- In the form of design features inherent in the suggested branch exemption regime which seek to reduce the risk of base erosion through applying the exemption to branches engaged in a trade,
- By applying design features that draw on anti-avoidance protections set out in EU Directives and on the experience of other Member States which have included protective measures in their longstanding branch exemption regimes,
- In the form of an exit tax regime that will tax gains on assets transferring to tax exempt branches,
- From a CFC regime which will apply to exempt branches and to profits of subsidiaries eligible for a dividend exemption, and
- From limiting the scope of the dividend exemption to dividends from companies resident in tax treaty jurisdictions which is aligned with Ireland's capital gains exemption on disposal of substantial shareholdings.

Simplification and greater certainty in application of the regime is also required in Ireland's regime for granting credit relief for foreign taxes on royalties earned by companies as part of their Irish trade.

We have included suggestions which seek to simplify the operation of the regime and achieve greater certainty of outcomes without changing the framework of the regime.

We have also suggested enhancements to the operation of the regime in a manner which we believe can achieve a balance between improving the regime in the context of the relative competitive position of Ireland's corporation tax regime and the potential cost to the Exchequer of enhanced credit relief.

Finally, we have reviewed the operation of a branch exemption and dividend exemption regime in the context of Ireland's existing corporation tax exemption for capital gains on disposals of significant shareholdings.

We suggest that there is value in reviewing the operation of this capital gains exemption in tandem with the move to adopt an exemption regime for branch profits and certain foreign dividends.

We have identified a number of technical areas in relation to the application of the corporation tax exemption for capital gains that should be reviewed and amended so as to provide greater certainty that the framework of Ireland's corporation tax regime provides for a single level of tax within the corporate holding structure.

Question 10: The effects of moving to a territorial corporation tax base

Current taxation of foreign branches and foreign dividends

An Irish resident company is subject to corporation tax on its worldwide profits including the profits of foreign branches. The company claims credit relief for foreign corporate income tax on the trading profits of its foreign branches against Irish corporation tax on those profits. Differences in the timing and measure of taxable profits between Ireland and the foreign branch jurisdiction can give rise to considerable complexities in claiming the credit relief. This is not withstanding that, in practice, where the foreign corporate income tax on the foreign branches' profits exceeds a rate of 12.5%, the result is no net additional corporation tax liability in Ireland on the foreign branches' profits.

Ireland exempts from corporation tax dividends from Irish resident companies. Foreign dividends are subject to corporation tax at either the 12.5% or 25% rate of tax depending on certain conditions and taxpayer elections. Credit relief against Irish corporation tax on the dividends is available both for foreign withholding taxes deducted on payment of the dividend as well as corporate income taxes paid on the profits from which the dividend is paid. Through a combination of double tax credit relief which is afforded under Ireland's double tax treaties as well as unilateral relief provisions, Irish companies rarely pay corporation tax on receipt of foreign dividends. This is on the basis that the rate of foreign tax credit relief on the dividends at least equals the rate of Irish attributable tax.

However, there is considerable administrative complexity in both tracing the source of foreign dividends received in Ireland (especially through tiers of companies in a holding chain) and evidencing the availability of credit relief in order to secure the nil tax payment outcome.

In summary, the operation of Ireland's credit relief system for foreign corporate income taxes borne on the profits of foreign branches and dividends means that there is little, if any, Irish corporation tax collected on foreign branch profits or on dividends repatriated from foreign subsidiaries.

It is not expected therefore that moving to adopt a territorial regime for foreign branch profits or foreign dividends is likely to affect Irish Exchequer tax receipts on these profits.

The benefits of moving to a territorial regime for foreign branch profits and foreign dividends

The greatest benefit we see 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 these profits.

As noted above, despite the strong likelihood of nil additional Irish tax becoming payable on foreign branch profits or on the repatriation of dividends due to Ireland's comparatively low 12.5% rate of tax[39], there is considerable complexity associated with administering and calculating the credit relief entitlement. This complexity acts as a barrier to the use of Ireland as a hub or central location either for the conduct of business through foreign subsidiaries or through foreign branches.

We foresee that, in future, the conduct of cross border business is more likely than in the past to lead to taxable branch presences in new markets.

This is due to combination of factors. These include Irish based exporters expanding the range of new markets for their exports as well as a response by jurisdictions and by businesses to new business models and to a greater volume of activity being conducted in the digital economy.

Trading in a country through a taxable branch presence is often the result of meeting commercial requirements to establish a presence in the local market. It is also a solution which businesses are adopting to ensure that their transactions with local customers are not subject to other alternative taxes imposed by a country on businesses which do not have a local taxable presence.

[39] Credit relief is capped at Irish tax which is generally applicable at a rate of 12.5% on the Irish measure of the foreign profit.

In addition, over time, the threshold for creating a taxable permanent establishment under double tax treaties is expected to evolve. There is expected to be a greater number of taxable branch presences recognised in tax treaty jurisdictions than might have been the case in the past.

A jurisdiction that operates a more straightforward and simple foreign branch exemption regime is likely to present its taxpayers with less barriers to the conduct of business in new markets through branches than a regime which imposes a more complex worldwide taxation regime with credit relief.

A number of business sectors already operate through branches (in preference to subsidiaries) in order to take advantage of regulatory optimisations, such as the ability to 'passport' a recognised regulatory status from one EU Member State while conducting business in another Member State. These practices are most commonly found in the financial services sector e.g. in sectors such as fund management, insurance and banking.

Businesses operating in these sectors find that significant differences can arise in the timing and measure of taxable income (or the deduction of regulatory reserves) when comparing one country's corporate income tax regime to another[40]. These differences do not pose any specific issues for taxpayers based in countries that offer a branch exemption regime. However, for businesses based in Ireland, they can cause considerable uncertainty as to whether sufficient credit relief will be available for foreign taxes at a time when the related income and/ or expense is recognised for Irish tax purposes.

This additional complexity means that Irish based businesses operating in these sectors are competing on unequal terms with businesses headquartered in EU Member States that operate a branch exemption regime.

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[40] Sometimes this arises because branch accounts are required in the branch jurisdiction to be prepared using local GAAP which may differ from the FRS 102/IFRS accounting standards usually adopted by Irish companies. There are also usually timing differences as to when tax is paid on branch profits and losses are relieved.

The adoption of a branch exemption regime in addition to an exemption regime for foreign dividends would also equalise more closely the Irish tax position in relation to profits arising from the conduct of foreign business through a branch instead of through a subsidiary. At present, branch profits are currently taxed whereas taxpayers may benefit from a significant deferral of taxation on the profits arising in a foreign subsidiary. Equalising the tax position of business conducted through branches with that of subsidiaries is more the norm throughout the EU. It reduces the potential for discrimination to arise in the case of taxpayers that choose, for non-tax reasons, to conduct business through branches instead of subsidiaries.

Detailed outline of suggested Irish branch elective exemption regime

We suggest that Ireland could move to adopt a branch exemption regime which would be available at the election of taxpayers along the following lines:

- An exemption from corporation should be available to profits arising from a trade conducted through a foreign branch in any jurisdiction outside Ireland. A possible exception might be to exclude countries which are included on an EU blacklist of jurisdictions which do not meet acceptable corporate tax governance standards.
- The branch exemption would not be available to a branch whose activities do not constitute the conduct of a trade. In this way, profits from a branch carrying on passive, investment character, activities remain fully subject to corporation tax in Ireland (subject to such credit relief as may be available for foreign taxes on the related income and gains).
- Ireland's CFC regime (which is discussed earlier in this submission) would also apply to the profits of foreign branches which are subject to an exemption regime. In this way, Ireland retains taxing rights on foreign branch profits that are attributable to significant people functions located in Ireland.
- The branch exemption would not be available where the branch is not recognised as a taxable presence in the branch jurisdiction i.e. the branch exemption would be available only where the profits of the branch can be said to be subject to tax in the foreign jurisdiction. This threshold for the application of a branch exemption regime is consistent with hybrid mismatch measures that apply under ATAD in respect of branches.
- The branch exemption would extend to profits whether in the character of income or capital gains arising to the branch e.g. would include capital gains arising on the disposal of assets held by the branch or upon a sale or cessation of the branch business. This would eliminate a difference between the existing treatment of a branch and a subsidiary in equivalent circumstances.
- Ireland's exit taxation regime (discussed in Section 1 of this submission) should provide protection that accruing but unrealised capital gains on assets transferred from an Irish head office to a foreign tax exempt branch remain taxable in Ireland to the extent those gains have accrued and are reflected in the market value of the asset at the point of its transfer to the foreign branch.
- The branch exemption should continue to apply to the profits immediately after the branch ceases to exist e.g. to apply to profits arising on sale of the branch business or on the unwind or cessation of the branch's business.
- For maximum flexibility, it is suggested that the branch exemption regime would be available on a branch-by-branch basis at the election of companies. This could mean that, even post adoption of the regime, existing and new branches could remain taxed in Ireland on a worldwide basis should the company choose not to make an election for a branch exemption.
- Relief would not be available for foreign taxes on branch profits where the exemption regime applies. This is with the exception of any 'final' and otherwise unused losses arising on the 'liquidation' or unwind of the foreign branch. In accordance with EU case law precedents[41] such losses should remain available for use against Irish profits.
- Transitional measures related to past branch losses would apply in moving to adopt a branch exemption regime and also where a taxpayer makes a future election to apply the exemption

[41] This is in line with the principles for cross border relief for losses in the case of Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes) C-446/03.

regime to a previously loss making branch. These are outlined in greater detail below.

- In circumstances where a taxpayer conducts a business through a transparent entity such as a partnership and the business gives rise to a taxable branch presence abroad, it is suggested that the corporate partner should also be entitled to the branch exemption on its share of the foreign branch profits provided that the partner's indirect interest in the branch's profits represents a holding of at least 5%[42].

Branch losses

As a transitional measure in moving to the adoption of a branch exemption regime (with similar principles applying to new branches in the event that a taxpayer elects to apply the exemption regime), it is suggested that in circumstances where branch losses have been used to obtain Irish tax relief, a branch exemption would not be available until such time as the taxable amount of branch profits equals the amount of Irish taxable profits which have been reduced using branch losses.

As a practical matter in establishing an initial transition period upon first adoption of the branch exemption regime, it is suggested that a four year transition period[43] might be required whereby companies would compute the aggregate branch losses used against Irish taxable profits in the preceding four year period. An exemption would not be available for branch profits until such time as the taxable profits have exceeded the branch losses arising in this period.

Similar measures should also apply in the event that an elective branch exemption regime is adopted for new branches established after the regime is in place i.e. a taxpayer that wishes to make an election for a branch exemption can only avail of the exemption where losses associated with the branch have been equalled by taxable branch profits. This would mean for new branches established once the regime is in place, taxpayers could only make the exemption election in respect of branch profits that exceed past losses used against Irish profits.

These provisions also envisage inherently that the rules would be applied on a branch-by-branch basis, rather than treating all foreign branches as a single branch for Irish tax purposes. This aligns more closely with the treatment of subsidiaries as different taxable entities. It also allows for the targeted application of a CFC rule to a single branch, the clearer separation of non-trading activities and the proper allocation of losses under the transition rules.

Comparative overview of the suggested branch exemption regime

We believe that the combination of design features for a branch exemption regime outlined above achieve both the desired simplicity for business whilst also protecting the Irish tax base e.g. in the case where branch losses arise. Base erosion protections afforded by means of the suggested design of the regime would also be supported by protections afforded under a CFC regime as well as a revised exit taxation regime in accordance with ATAD.

In Appendix 2, we have summarised in tabular form the branch exemption regime that applies in a number of EU Member States including the UK, France, the Netherlands and Germany. The comparative summary highlights that the framework adopted for the branch exemption regime differs from country to country. Once the branch exemption applies, it applies to all income and capital gains related to the foreign branch. Loss relief is not available for branch losses of an exempt branch with the exception of 'final' branch losses which remain available for use in accordance with EU freedoms.

All of the Member States apply (as suggested for the Irish regime above) various conditions for the branch exemption which serve to protect their tax base from erosion due to the branch exemption. These measures include:

- Setting minimum branch 'substance' conditions before the exemption applies.
- In the UK, for example, the branch must be engaged in a trade for a branch exemption election to be available. As in Ireland, in the UK the distinction between trading and non-trading activities is well understood. In the case of the Netherlands, for branches in jurisdictions where the Netherlands does not have a tax treaty, the branch must not be regarded as a low taxed

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[42] This percentage interest is suggested to align with that suggested for the foreign dividend exemption.

[43] This is aligned with the current four year statutory deadline for adjustments to prior periods for corporation tax purposes. Where past losses exceed a ceiling amount (in the UK this is £50million), the taxpayer may be required to trace back past loss usage beyond the four year transitional period.

branch engaged in passive activities. In the case of foreign branches in Dutch tax treaty jurisdictions, the branch is required to meet the threshold for recognition as a permanent establishment under the relevant tax treaty. In France, substance criteria set down under French law must be satisfied before the branch exemption can apply.

- Member States including the UK, France and Germany already apply their CFC regimes to the profits of tax exempt foreign branches. The Netherlands is expected to adopt an ATAD compliant CFC regime which should also apply to foreign tax exempt branches.
- France, Germany and the Netherlands also apply 'exit tax' measures to include in taxable profits deemed gains on asset transfers to foreign branches. The UK does not apply an exit tax at the point of the asset transfer to the branch but a gain on the eventual disposal of the asset is taxable with the branch exemption only applying to the gain attributed to the period that it was in the branch.

Detailed outline of dividend exemption regime

We suggest that a dividend exemption regime should apply as follows:

- Apply to dividends where the Irish resident company has a direct or indirect interest of at least 5% in the company from which the company is ultimately sourced.
- It should be available for dividends paid from companies resident in qualifying jurisdictions which mirror those to which the substantial shareholding exemption under Section 626B, TCA 1997 applies. These are essentially jurisdictions with which Ireland has agreed the terms of a double tax treaty.
- To be eligible for exemption, the dividend (which may be tracked through any number of intermediary layers of company) should be paid by a company which is resident for tax purposes in a qualifying jurisdiction i.e. in a jurisdiction with which Ireland has agreed a double tax treaty.
- A dividend exemption should not be available where the payor has secured a tax deduction for the dividend. This is aligned with the approach to hybrid mismatches which Ireland is obliged to adopt under ATAD. It is also aligned with anti-hybrid mismatch measures introduced in the EU Parent/Subsidiary Directive[44].
- Tax relief would not be available for taxes borne on payment of the dividend or on taxes borne on the profits from which the dividend is paid.

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

In Section 1 of this submission, we suggest that Ireland's CFC regime should follow an approach which is to limit the CFC rule to income which has been artificially diverted to the CFC. This is the approach which is set out under Article 7(2)(b) ('Option B').

Under ATAD, the CFC regime should apply to subsidiaries which are more than 50% owned by an Irish resident company (or which form part of a common corporate accounting consolidation of the Irish parent). It should also extend to profits of tax exempt foreign branches.

We have suggested two gateway tests that we believe should mean that the CFC regime affords Ireland taxing rights related to the profits of a CFC, including non-trading profits and capital gains, which are at greatest risk of artificial diversion to a subsidiary. We have also suggested a safe harbour where the profits of the CFC arise from the conduct of activities in the nature of a trade under Irish tax principles.

We believe that the suggested design features of a CFC regime focussed on the artificial diversion of income to a low taxed subsidiary CFC can afford appropriate protections from base erosion if Ireland adopts a dividend exemption regime for dividends paid from companies resident in tax treaty jurisdictions while remaining aligned with EU freedoms and compliant with Ireland's obligations under its tax treaties.

The suggested features for a branch exemption regime outlined above are aligned with the features suggested for a CFC regime. For example, we suggest that a foreign branch exemption would

[44] EU Council Directive 2011/96/EU, as amended subsequently including measures to deal with hybrid mismatch measures under Council Directive (EU) 2015/121.

only be available where the branch is engaged in activities in the nature of a trade. Where the branch is engaged in passive activities, the branch income remains fully taxable in Ireland. We have suggested further that the two gateway tests in the CFC regime should apply on equivalent terms to the profits of foreign branches where they are subject to the branch exemption regime.

In our response in Section 2 to Questions 5 to 9 on transfer pricing matters, we suggest that Ireland should adopt the authorised OECD approach for the attribution of profits to branches including the attribution of profits to branches not based in tax treaty jurisdictions. The combination of protections afforded under the conditions to apply a branch exemption regime and the manner of application of the OECD approach to the allocation of profits to branches means that, even where the conditions for a branch exemption apply, Ireland has further protections to assert taxing rights over branch profits that are attributable to the activities of significant people functions located in Ireland.

We have also considered the interaction of profits taxed under the CFC regime that are subsequently repatriated to Ireland. Should some of the profits of a foreign branch or of a foreign subsidiary be subject to current taxation under the CFC regime, the profits could be repatriated on a tax free basis whether from the branch or from a subsidiary (if it is based in a qualifying jurisdiction).

Where the subsidiary is not based in a jurisdiction which is eligible for the exemption from corporation tax on dividends, it would be necessary to ensure that an amount of the CFC's profits already taxed in Ireland under the CFC regime are not subject to tax again when repatriated to Ireland as dividends.

The exit taxation regime should also ensure that capital gains arising on assets are taxed in Ireland to the extent that they accrue during a time that the assets are held by a taxable presence in Ireland. This is because an exit taxing event should arise when a chargeable asset is transferred from an Irish company or branch to a foreign branch, the profits of which are exempt from Irish tax.

Simplification of Schedule 24 if Ireland does not move to a territorial corporation tax base

Should Ireland not move to adopt a territorial tax base for foreign branch profits and foreign dividends, the following clarifications and simplifications are suggested to improve the operation of the credit relief regime related to different types of foreign profit.

These simplifications are also required to address the continuing application of credit relief rules in the case of branch profits and foreign dividends that remain within the scope of corporation tax even if Ireland applies an exemption regime.

In addition, simplification is required to address the considerable complexity that arises in the application of credit relief rules to foreign taxes borne on royalty income arising to companies in the course of trading activities in Ireland.

In most cases, the complexity of the current provisions arises because the provisions have evolved in a piecemeal and ad hoc fashion over time. This has resulted in needless complexity in the application of provisions which is likely to be best addressed by starting with a 'clean slate' and rewriting them afresh.

Amendments to relief for corporate income taxes on foreign branch profits

We suggest that Ireland could amend the operation of double tax relief for taxes on foreign branch profits as follows:

- Confirm by legislative amendment that a corporate income tax paid on branch profits which is in excess of the Irish capacity to absorb credit relief e.g. because of losses in the Irish company as a whole, is available as an expense deduction (under section 81, TCA 1997) in like manner to any other business expense incurred in conducting the trade.
- Amend the calculation of the unrelieved foreign tax in paragraph 9FA, Schedule 24, TCA 1997 ('para 9FA') to ensure that credit relief is available for foreign taxes on branch profits on a pooled basis in a manner which is understood to be aligned with the policy intent. The intention of para 9FA is to allow the carry forward of unused foreign tax credits on the profits of branches. It is intended to achieve foreign tax credit pooling for branches. However, following the amendment of paragraph 7(3)(c), Schedule 24, TCA 1997 by Finance Act 2013, the provisions of para 9FA do not achieve this in a situation where foreign tax is paid on the profits of a foreign branch but there are tax adjusted losses for Irish tax purposes.
- As outlined above, timing differences can arise between the Irish and branch jurisdiction measure of the taxable profit of the branch. Differences can also arise in the timing of payment of tax on branch profits as well as on the timing of relief for branch losses.

- Revenue's guidance[45] on the taxation of branch profits deals with scenarios where foreign branch taxes are paid before Irish tax on those profits but it does not deal with the position that applies when branch taxes are paid after Irish taxes are paid. Para 9FA does not achieve this symmetry of treatment in all situations.
- Para 9FA provides for the pooling and carry forward of excess foreign tax credits. Based on the formula in para 9FA(2)(a), the excess foreign tax credits available for pooling and carry forward in the period are calculated by reference to the expense deduction allowed for the foreign tax in question under paragraph 7(3)(c), Schedule 24. The Finance (No. 2) Act 2013 amendments to paragraph 7(3)(c) sought to clarify that the expense deduction available is limited to the Irish measure of the foreign income. However, their operation in the context of the provisions of para 9FA means that where no expense deduction is available in that period it follows that there is no excess foreign tax available for pooling or carried forward credit relief.
- 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 is available for the foreign tax and no tax credit is available for pooling relief and carry forward to a future period for relief. This can lead to double taxation and is at odds with the stated intention of para 9FA which is to treat 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 which take effect in the UK from April 2017. An Irish company in an overall loss position can have a UK branch which is paying tax in the UK because of the restrictions placed on the use in the UK of carried forward losses.

  Under the current provisions of para 9FA, the UK corporation tax paid is not available for credit relief in Ireland in the year in which UK tax is payable. However, Irish loss relief rules permit full offset against branch profits for carried forward losses. As a result, there is no Irish taxable profit in the period and no Irish tax on the branch profits. Due to manner of interaction of para 9FA and paragraph 7 of Schedule 24, the UK tax paid is not available for carry forward under the foreign tax credit pooling rules. This leads to double taxation. An illustration of this double taxation outcome is set out in the worked example in the table below.

Example: Illustration of para 9FA and para 7, Schedule 24, branch credit relief

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

UK tax computation	2017
Profit for year	100.0
Losses forward (restricted to 50% of profit)	(50.0)
UK taxable profit	50.0
UK tax @ 19%	9.5
Loss carried forward	50.0

[45] Revenue manual guidance, Chapter 35.02.06 on Foreign Branch Double Taxation Relief.

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		100.0
Loss forward		(50.0)
UK taxable profit/loss		50.0
UK tax at 19%		9.5

Irish tax computation

Profit for year	100.0
Less tax loss forward	(Nil)
Taxable profit	100.0
Irish tax @12.5%	12.5
Double Tax Relief (UK tax)	(9.5)
Irish corporation tax payable	3.0

Summary position		2017	2018	Total
Profit (after losses forward)		Nil	100.0	100.0
UK tax		9.5	9.5	**19.0**
Irish tax		0.0	3.0	3.0
Total tax		10.0	12.5	**22.0**
Effective tax rate borne	**22%**			
Expected tax rate	**19%**			

Proposed Solution

- This outcome could be rectified by amending the formula in para 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 3, we have marked up the text of para 9FA with suggested amendments to achieve this. If the suggested changes were introduced, the reworking of the above example would result in the effective tax rate being equal to the expected tax rate outcome.

- The changes introduced in Section 28 Finance (No. 2) Act 2013 apply 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 3 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.
- Particularly in the case of businesses which are cyclical in nature and which experience volatility in the levels of profits and losses over a number of years e.g. insurance businesses where once off claim events can influence the pattern of profits and losses, we suggest operating branch credit relief by pooling together the profits and losses of branches arising over a rolling period linked to the typical business profit cycle.

  For some classes of insurance risks this can be a period of 7 to 10 years. Adoption of a pooling approach which is aligned with the typical length of a business cycle should serve to smooth out and reduce some of the timing differences that can arise in the recognition of income and expense from these classes of business which can make it very difficult to track and attribute foreign taxes to the related Irish profits.

Simplifying double tax relief for foreign dividend income

In the case of the operation of credit relief for foreign dividends, the following simplifications are suggested:

- Permit taxpayers to track and attribute tax credits related to dividends solely by reference to a taxpayer election which is not required to be mirrored in dividend resolutions based by the paying company.

  One of the greatest difficulties arising in the practical administration of the current credit relief system is aligning dividend declaration resolutions under foreign law with Irish foreign tax credit tracing requirements which may not always be straightforward (or indeed possible) to achieve under local law. The tracking of the dividend source and related tax credits should simply be a matter of a taxpayer election with no requirement to link the source of the dividend for Irish tax purposes to declarations of dividends under foreign law. In many cases, there is no requirement under foreign law to identify the source of the profit from which the dividend is paid i.e. it is simply required that there are adequate profits available for distribution.
- Updating the manner of operation of paragraph 9I, Schedule 24 ('para 9I')to reflect evolving case law insights from the UK courts[46] on the interpretation of the decision handed down in the FII case[47]. The findings in this case required Ireland to introduce the provisions in para 9I in order to conform the Irish corporation tax treatment of dividends from Irish resident and non-resident sources.
- Simplifying the operation of double tax credit relief for cases within scope of the relief under para 9I by providing that the credit relief which applies by reference to the rate of tax in the country where the dividend profits have been subject to tax would apply first, before the application of double tax credit relief which would otherwise apply.

  In this way, a company who is entitled otherwise to credit relief under applicable relief provisions would not have to first apply standard credit relief rules to establish the tax relief otherwise due and then 'top up' the credit relief by making a claim to additional relief under para 9I. The relief under para 9I is capped at the level of Irish tax attributable to the dividend. This change in manner of operation of the relief should not, in practice, change the measure of overall relief given.

  In cases where sufficient credit relief is available under para 9I to offset in full the measure of Irish attributable tax, the taxpayer could simply claim first the relief under para 9I without the requirement to first calculate the relief otherwise available. This would represent a significant

[46] Test Claimants in FII Group Litigation v HMRC [2016] EWCA Civ 1180 reviews the UK application of the CJEU decision in this case to foreign dividends received when the UK's taxation of dividends was similar to Ireland's current regime. The case has passed to the Supreme Court. A linked case, Six Continents Overseas Holdings Limited & CIR [2016] EWHC 2426 (Ch), has passed the Court of Appeal stage.

[47] Test Claimants in FII Group Litigation v Commissioners of the Inland Revenue, C-446/04.

simplification in the operation of the relief. Where the dividend has been sourced to the profits of an underlying company, no future tax credit relief would be available for foreign taxes attributable to those profits.

- Simplifying the current requirement to trace profits moving through intermediary layers of companies over many years by allowing taxpayers to operate and apply a pooled basis of double tax credit relief for a holding company and its subsidiaries. In this way, taxpayers need not maintain records over many years tracking the past history of dividends and the financial years to which they relate but would simply calculate the effective tax rate on the profits of the pooled companies with each successive dividend from that pool having the same effective foreign tax credit rate.

Simplifying double tax credit relief for royalty income

We do not suggest that Ireland should move to adopt a territorial regime and exempt from tax foreign royalty receipts.

In like manner to the taxation of foreign branch profits and foreign dividends, the operation of credit relief on foreign royalties is a combination of tax credit relief and expense deduction relief which are provided under double tax treaties and well as under unilateral relief provisions that are set out at Schedule 24, TCA 1997. The measures have evolved piecemeal over a number of years with the result that the provisions are extremely complex to understand and to apply in practice.

The outcome of the Irish credit relief and expense relief measures is that additional Irish tax is not payable on the royalty income where the amount of foreign taxes borne on royalty income which is received in the course of the trade of the Irish taxpayer is not greater than the Irish tax on the Irish measure of the net taxable royalty income (estimated by reference to the net taxable income of the trade taken as a whole).

In order to expand their export led business operations, Irish based companies which operate in the services sector (particularly where services e.g. software services, derive from the exploitation of underlying intellectual property) are encountering tax regimes in counterparty countries which impose withholding taxes at source on payments which they consider to be in the character of royalties. Although Ireland's network of double tax treaties works to reduce the scope and rate of source country withholding taxes which can be applied by counterparties resident in tax treaty jurisdictions, not all tax treaties provide for a zero rate of withholding tax on royalties and not all new counterparty jurisdictions where the company is seeking to do business will have a tax treaty with Ireland to remove the cost to the company of the local withholding tax.

For companies which have losses or smaller levels of profits and therefore do not have the capacity to offset foreign tax as a credit against Irish corporation tax, it is important that they have certainty that relief in the form of an expense deduction in measuring profits of the trade is available for foreign taxes. This is because such taxes form part of the cost to the company of doing business in that foreign market.

At present, there is uncertainty surrounding the interpretation of Irish measures relating to the deductibility as an expense of the business of foreign creditable withholding tax which is in excess of the profit capacity of the company to absorb credit relief for the tax.

As companies expand into new markets and as business models develop which change the form in which companies exploit intangible assets and deliver services to their customers, they encounter different interpretations in different jurisdictions on the scope of operation of withholding taxes to payments for services. This typically arises because those jurisdictions consider that the payment for the service provided by the Irish company includes 'embedded royalties' which relate to the local customer's right to use the intangible asset that underpins the service e.g. software applications, production know how, management know how, etc.

At present, it can require complex analysis under Ireland's credit relief measures for royalties to understand whether the payment which has borne the foreign tax is eligible for credit relief under Ireland's regime.

Greater clarity on the scope of application of the unilateral relief measures to payments which Ireland regards as payments for services but which the source country regards as including 'royalties' would provide greater certainty of access to the relief regime, especially for taxpayers seeking to expand into new export markets and encountering this complexity in new markets for the first time.

The limitation of the relief to the Irish measure of net taxable income on a trade-wide basis means, in practice, that expenditure which is incurred by companies which invest heavily in developing new products reduces the Irish

measure of the net profits on the royalty income and thereby reduces the capacity of the company to obtain credit relief for foreign taxes borne on the income.

Ireland's credit relief regime for royalties could be made more effective in affording relief for foreign taxes borne on royalty income by introducing a regime which would allow the company to:

- ***calculate the net income measure (which operates to limit the amount of credit relief) by reference to net margins from the royalty profits instead of by reference to the margins of the trade as a whole***,
- ***offset excess unused credits against other income of the trade, and***
- ***pool surplus tax credits to carry forward for use in future periods*** (in a similar manner to the operation of the current pooling relief for foreign dividends and branch profits).

Adoption of enhanced relief could improve the relative competitiveness of Ireland's regime in attracting and retaining businesses which seek to expand into international markets from an Irish base.

It is recognised, however, that granting enhanced relief by a combination of features outlined above could have a significant cost implication for the Irish Exchequer in the case of larger taxpayers which can incur significant unrelieved foreign withholding taxes under the present regime.

We believe that the first of the proposed approaches above to improve the operation of the relief should reduce the barrier to expansion into new markets that the current operation of the relief presents to businesses investing heavily in R&D activities and those investing in business development related to expansion into new markets.

If the cost to the Exchequer of providing enhanced relief by means of a combination of the approaches outlined above is not feasible in the shorter term, we suggest that consideration is given first to costing the impact of the first of the improved approaches outlined above. This is to calculate the net income measure (which operates to limit the amount of credit relief) by reference to net margins from the royalty profits instead of by reference to the margins of the trade as a whole.

Another possible approach to phasing in enhanced credit relief which combines all the above features in a manner which should control the related potential costs to the Exchequer might be to confine this combination of enhanced features of the relief to SME companies. For smaller taxpayers, the lack of credit relief presents the greatest proportionate cost barrier to breaking into new markets. This may represent an acceptable balance between the potentially significant impact of the enhanced relief for the smaller company and the cost to the Exchequer.

We suggest that the following could be done to simplify and make the credit relief regime operate more effectively. The below changes are not expected to have a significant cost impact for the Exchequer but instead should reduce barriers to the provision of services internationally which apply due to the complexity in the application of the credit relief regime:

- ***Rewrite the legislative measures which underpin the operation of the credit relief regime for royalties to make them easier to read and more straightforward to administer in practice.***
- ***Provide greater clarity on the scope of royalty payments that are eligible for the relief in the context of payments for services.***
- ***Clarify the entitlement of the company to deduct excess and unused creditable foreign taxes on royalty income under general principles.***

  This is important in providing certainty to loss making companies or those with smaller profit margins that this cost of doing business in a foreign market is tax deductible. This is a variation on the point set out above in relation to the deduction as an expense of corporate income taxes borne on foreign branch profits.

Related matters

In tandem with consideration of an elective branch exemption regime and a dividend exemption regime, we suggest that Ireland should review the operation of its substantial shareholding exemption which is set out at section 626B, TCA 1997. This is to ensure that there is internal coherence within Ireland's corporation tax regime as it relates to the taxation of capital gains or dividends from substantial shareholdings.

It is also suggested to eliminate double taxation outcomes which can arise within the corporate structure by providing for a clearer legislative exemption for double taxation on the sale of shares held as a capital investment by a company. The availability of a CFC regime should provide

sufficient protection that Ireland can assert appropriate taxing rights over the profits of foreign subsidiaries.

The background to the suggested amendments is outlined below. The purpose of the amendments is to provide certainty for entrepreneurs, and investors more generally, that only a single level of tax should apply within the corporate structure.

This outcome would simplify and strengthen Ireland's 12.5% corporation tax offering so that trading profits of a corporate group are subject to corporation tax at a rate of 12.5% only once within the corporate structure. Further tax may then apply when corporate profits are paid to the individual shareholder as dividends or realised as a capital gain on the sale of shares.

This is likely to require technical changes to a number of taxing provisions so that they operate to achieve this outcome and their application does not, in practice, cause double taxation of profits within the corporate structure. These include:

- ***amending the substantial shareholding exemption from tax on corporate capital gains at section 626B, TCA 1997,***
- ***repealing section 591A, TCA 1997 which applies to "abnormal dividends," and***
- ***clarifying the interpretation and application of the scope of corporate reorganisation and reconstruction reliefs, especially where the shareholders of the corporate entities are other companies or investors that are otherwise tax exempt on income and gains from the company.***

Background to suggested technical changes

Most corporate holding structures include more than one layer of company. As a business expands, the company may set up subsidiaries to carry on activities in foreign markets or to carry on new lines of business. These new companies are often held not directly by the individual owners but under a corporate holding structure which may have one or more layers of intermediate holding companies. This means that individual shareholders hold their shares in a company which, in turn, may have one or more layers of company held underneath it within the corporate holding structure.

Ireland's tax regime then imposes a second level of tax on profits when they leave the corporate structure by taxing dividends received by the individual shareholder from the top holding company and taxing capital gains on sale by the individual of the shares in the company at the top of the corporate holding structure.

When shares in a company are disposed of, the price obtained will reflect the fact that the value of the company has already been diminished by tax (e.g. 12.5% corporation tax) collected on its profits and by tax that will be collected on future profits. To tax a gain on selling the shares themselves is therefore to levy a double tax. It is for this reason that many countries, including Ireland, have capital gains tax exemptions for companies disposing of shares in other companies and that dividends between companies are often exempt. This operates to apply a single level of tax on profits within the corporate structure with a second level of tax paid by the individual shareholder when they receive dividends or realise capital gains on disposal of the shares.

Ireland partially recognises this position through the exemption for gains on disposal of substantial shareholdings at section 626B, TCA 1997. However, this exemption does not always apply and double taxation can occur. Our analysis of why double taxation occurs suggests that there are a number of reasons either as a result of the operation of the detailed conditions for the exemption relief in section 626B or as a result of the interaction of, and application of, other sections in the Corporation Tax Acts.

Where the exemption from tax arising in the case of capital gains on disposal of shares in companies does not apply in cases of a corporate holding structure with multiple layers of companies, double taxation (or even multiple taxation) can occur. There is no evident policy reason for triggering a second layer of corporation tax within the corporate structure and this outcome is uncompetitive in international terms. It undermines the certainty to both Irish and international investors in Irish companies that only a single layer of tax will apply within the corporate structure.

One of the features of international regimes that support a tax environment for attracting equity investment into local entities is that there is certainty of tax treatment in the application of a capital gains regime (including no local double taxation for investors who are otherwise exempt from tax in Ireland). Certainty that double taxation outcomes would not occur within the corporate structure is best achieved by providing a legislative exemption for double taxation on the sale of shares held as a capital investment by a company.

To achieve this certainty of outcome, we suggest that Ireland should conduct a detailed technical review of the operation of Ireland substantial

shareholding exemption as well as a number of other provisions which interact with these provisions[48]. This is so as to ensure that potentially conflicting provisions in the Taxes Acts do not operate to undermine the certainty of application of a single level of taxation of profits within the corporate structure.

The possibility of such double taxation has been substantially increased by the introduction of provisions on 'abnormal dividends' (i.e. section 591A, TCA 1997). This section potentially removes the exemption from tax on dividends received from Irish resident companies in a wide variety of situations and appears to have been designed to ensure that double taxation does occur. In particular, where a foreign dividend exemption regime applies and Ireland has protections under a CFC regime, the repeal of section 591A merits review.

In common with many other capital gains tax provisions, section 591A, TCA 1997 includes a "bona fide" test. Such tests either dis-apply a penal provision when the test is met or dis-apply a relieving provision where the test is failed. Typically, the test is whether or not the transaction is carried out for bona fide commercial reasons and not as part of a scheme of which one of the main purposes is the avoidance of tax. The practical difficulty with applying such tests in the context of paying a dividend to a corporate shareholder is that the application of the test in the facts and circumstances of the taxpayer is vague and subjective. It creates great uncertainty for businesses entering transactions and for Revenue teams in administering the provisions. The result is uncertainty surrounding the potential application of a double charge to tax on profits distributed within the corporate structure.

In looking both at the manner in which the UK[49] has sought to eliminate equivalent double taxation outcomes arising for investors under its substantial shareholding exemption regime and based on findings from our review of the approaches of other international regimes to affording certainty for investors, we suggest that in order to avoid double taxation, the preferred approach within the framework of Ireland's existing regime would be that there would be a legislative exemption for double taxation on the sale of shares.

To achieve this is likely to require a liberalisation of section 626B,TCA 1997 so that an exemption from gains should apply in circumstances where an exemption would have applied if the shareholder e.g. another company had held the interest in shares directly instead of indirectly through shares in the Irish company making the disposal. It would also require the repeal of section 591A, TCA 1997.

Lack of clarity around reorganisations

The introduction of section 615(4A), TCA 1997 by Finance Act 2015 has given rise to a degree of uncertainty as to whether businesses can be de-merged in a tax free manner in Ireland.

The fundamental point is that where businesses are merely being reorganised, no tax ought to arise. Companies will pay tax on their profits and the reorganisations of shares and businesses where there is no change in ultimate economic ownership. Reorganisations with no change in ultimate ownership ought to be tax free. Where there are ultimately changes in economic ownership, the appropriate rates of tax will be paid. In the case of Irish tax resident individuals that will be capital gains tax - currently at a rate of 33% unless the gain is eligible for a relief such as Entrepreneur Relief. In the case of exempt investors such as corporate investors eligible for the corporation tax exemption from capital gains under section 626B, TCA 1997, international investors or pension funds, the gain will be exempt from tax.

It is not clear therefore, for example, what the bona fide tests in the various reorganisation reliefs are designed to achieve in a purely corporate context i.e. if one accepts that there ought not to be double taxation at the corporate level then why are bona fide tests required at the corporate level? In general, Ireland's system of reorganisation reliefs is consistent with systems throughout the world and consistent with EU law which in EU Directive 90/434/EC makes it clear that reorganisations

[48] The UK has recently conducted such a review of its substantial shareholding exemption (SSE), in part to ensure the continuing competitiveness of the UK regime to support equity investment in UK companies. The outcome of that review has led to changes to the UK SSE provisions in recent UK Finance Acts. Our detailed review of the findings from the UK analysis suggests that not all of the features that gave rise to a risk of double taxation in the UK (and which the UK has sought to remove by improving the design of its SSE) are present in the Irish equivalent regime under section 626B. Nonetheless, the Irish regime gives rise to similar risks of double taxation which presents a barrier to investment. When reviewing the adoption of a foreign branch exemption regime and a foreign dividend exemption regime, it would seem to be timely to review, in tandem, the operation and continuing competitiveness of section 626B and related provisions.

[49] See earlier footnote on UK review of its SSE.

including mergers and divisions ought to be tax free.

To create certainty in this area, we suggest consideration is given to a technical legislative change that should support achieving certainty of tax policy outcome that double taxation of profits does not arise within a corporate structure. This could be done by providing that the bona fide tests in reorganisation relief provisions are amended to make it clear that they only apply to individual shareholders. A similar amendment should be made to the stamp duty reorganisation relief provisions. This is to provide greater clarity that the result of a disposal occurring in a reorganisation transaction should not be taxation for classes of otherwise tax exempt investors such as non-Irish resident investors, companies entitled to the SSE exemption under section 626B, TCA 1997 and tax exempt funds or pension funds.

Implementation risks

We have summarised in the table below possible implementation risks that could arise in the course of adoption of a territorial base of taxation for foreign branch profits and foreign dividends as well as changes to tax credit relief for royalties and the tax exemption on gains on disposal of substantial shareholdings.

In the table, we have described possible consequences arising from the identified implementation risks and how the risks have been addressed by our suggested implementation approach.

Risk	Consequence	Actions mitigating risk
Not perfectly aligned with ATAD and freedoms under TFEU.	Uncertainty for business and Revenue alike in the application of domestic measures if they are not aligned with evolving EU case law precedents on the implementation of Directives such as ATAD and the application of the Treaty for the Functioning of the European Union.	Aligning the design of a branch exemption regime and a foreign dividend exemption regime with hybrid mismatch measures, the CFC rule and the exit taxation regime in ATAD. More generally, seeking to equalise the Irish tax treatment for businesses operating internationally through subsidiaries or through branches.
Not sufficiently flexible to accommodate emerging business models, including developments in the taxation of the digital economy.	Risk of reducing the comparative attractiveness of Ireland as a central hub or headquarter location for conduct of international business in the EU and more generally outside the EU.	Suggested design features of a branch exemption regime – available at the election of companies, thereby allowing the company to choose the taxation basis that is the best fit for its business.
Not aligned with regimes available to companies based in other EU Member States.	Risk of reducing the comparative attractiveness of Ireland as a central hub or headquarter location for conduct of international business in the EU and more generally outside the EU.	Suggested design features of a branch exemption regime – available at the election of companies, thereby allowing the company to choose the taxation basis that is the best fit for its business.

Risk	Consequence	Actions mitigating risk
Credit relief regime for royalties is not aligned with the objective of businesses based in Ireland to grow by expanding through providing services into new markets.	Risk of reducing the comparative attractiveness of Ireland as a base to conduct of international business in new markets – often outside the EU.	Suggested improvements to Ireland's credit regime for royalties both to simplify and provide certainty on the operation of the current regime and to introduce design features to reduce the risk of the regime operating in a manner which presents a barrier to expansion into new markets.
Operation of Ireland's substantial shareholding exemption creates risk of double taxation within the corporate structure.	Reduces the relative attractiveness of the regime in attracting and retaining capital investment.	Suggested improvements to the operation of section 626B, TCA 1997 and related legislative provisions to provide greater certainty that there is only a single level of Irish tax within the corporate structure.

Appendices

Appendix 1: Illustrative examples, application of transfer pricing principles and CFC rule under Option B

The examples below provide high level insights into the application of transfer pricing principles where control functions related to the business risks and assets of a CFC are performed by an Irish company.

In Section 1 of this response document, we explore the possibility of Ireland adopting a CFC regime under ATAD which would limit the CFC rule to income which has artificially been diverted to the CFC. This approach is set out in general provisions under Article 7(2)(b) of the Directive. It is known as Option B and is one of two sets of general provisions for a CFC regime framework which are set out in Article 7.

Under the Option B approach, where an entity or permanent establishment is treated as a CFC, the Member State of the taxpayer shall include in the tax base "*the non-distributed income of the entity or permanent establishment arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage".*

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

The Directive goes on to state in Article 8 that "*the income to be included in the tax base of the taxpayer shall be limited to amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company. The attribution of controlled foreign company income shall be calculated in accordance with the arm's length principle".*

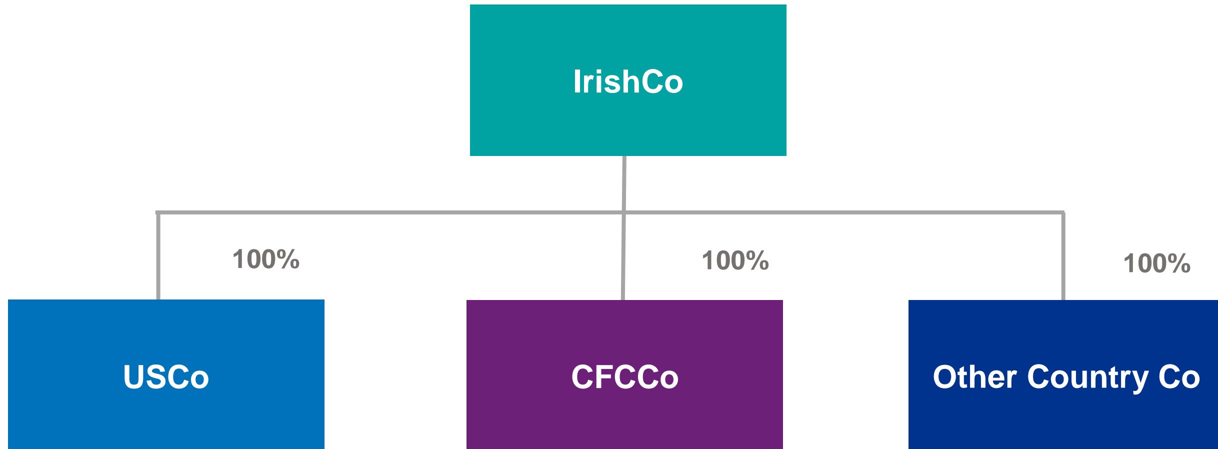
The Directive does not define significant people functions ('SPFs'). The concept of SPFs is covered in the OECD 2010 Report on the Attribution of Profits to Permanent Establishments. While there is no strict definition of SPFs, they can broadly be defined as the conduct of fundamental business functions that lead to the assumption of risk, ownerships of assets, or ongoing management of those risks and assets.

Although the references to SPFs in the 2010 Report apply in the context of the attribution of profits to branches, the same concepts essentially apply and are discussed in the 2010 and 2017 OECD Guidelines on transfer pricing in relation to the assumption and control of risks by one company ('the controlling party') over the assets of another party ('the asset owner').

The significant people functions that can be said to be relevant to the assumption of risks are those which require active decision-making with regard to the acceptance and/or management (subsequent to the transfer) of those risks.

In the examples below, we have used two illustrative scenarios which describe arrangements within an Irish parented group related to the business and assets of a low taxed subsidiary. Functions are performed by an Irish group member in relation to the business and assets of a CFC. The examples explore how transfer pricing rules can be applied using the concept of SPFs and the exercise of control functions in order to identify an amount of profits generated through the assets and risks of the CFC business which are linked to the SPFs or controlling functions performed by the Irish parent.

The following simplified corporate group structure is relevant to both examples:



Example 1: Luxembourg financing subsidiary

Assume that CFCCo is based in Luxembourg and resident in Luxembourg for corporate income tax purposes ('LuxCo'). In this example, LuxCo is performing routine intra group financing activities e.g. the advance and administration of loans to group entities in foreign territories.

LuxCo earns interest income and benefits from a deemed interest deduction under Luxembourg domestic corporate income tax rules in measuring its taxable financing profits. LuxCo is taxed on a low margin (leading to a low effective corporate income tax rate). It is considered to be a CFC from an Irish tax perspective. The Irish parent must consider whether income should be included as taxable income of IrishCo under the CFC rule.

It is assumed that the purpose test which Ireland applies under the CFC rule is one which relates to a motive of artificially diverting income to the CFC and that this purpose test is failed. IrishCo must include taxable income under the CFC rule if *non-genuine arrangements* are in place.

Assume further that the important functions relating to the assumption of risk associated with taking on and advancing loans to group entities are performed by employees of IrishCo. The IrishCo employees have the necessary capability and experience required to assess the level of risk and impact on the business of taking on and advancing the loans, whether and how to respond to those risks and taking any actions to mitigate those risks.

Based on this analysis of the arrangements related to the business and assets of LuxCo, they are considered to be non-genuine arrangements in the context of the CFC provisions.

On the basis that the SPFs related to the business and assets of LuxCo are performed by IrishCo, the Irish company and not LuxCo is considered to control the key business risks and assets of LuxCo. In this example, under OECD transfer pricing principles, where LuxCo exercises very little control over its business risks and assets, it should only be remunerated with a relatively low risk financing return on its capital together with a routine return on its administrative activities related to loan administration.

LuxCo's income from its financing activities which is in excess of these returns should be attributed under transfer pricing principles to IrishCo. This is because IrishCo's profits should reflect a pricing adjustment to reflect the control exercised by it over the key business risks and assets held by LuxCo.

If the arrangements arise in the course of a trade taxed under Case I, Irish transfer pricing principles should require IrishCo to reflect this pricing adjustment. Where Ireland's transfer pricing regime does not extend to these arrangements, the application of transfer pricing principles under a CFC rule should see an equivalent amount of profits taxed under the CFC regime where the arrangements fail the non-genuine arrangements test.

Example 2: Bermudan IP subsidiary

Assume that the CFCCo is based in Bermuda ('BermudaCo'), is not resident for corporation tax

purposes in Ireland and owns intangible assets ('IP') that is exploited by the group. BermudaCo is subject to a nil rate of tax on its profits in Bermuda. It is a CFC.

It is assumed further that the purpose test under a CFC rule is failed in that arrangements are in place with a purpose of artificially diverting income to the CFC. IrishCo must include taxable income under the CFC rule if *non-genuine arrangements* are in place.

BermudaCo licenses out the IP to group entities but does not perform the SPFs in relation to the development, enhancement, maintenance, protection and exploitation (DEMPE functions) of the IP.

Example 2(a)

These functions are performed by employees of IrishCo. BermudaCo has limited commercial presence in Bermuda. It does not have access to resources to perform routine activities in relation to the IP which are also outsourced to group members.

Although BermudaCo is the owner of its IP assets, the extent of the DEMPE functions exercised by IrishCo suggests that, under transfer pricing principles, BermudaCo should only be remunerated for a financing return (which in this example is assumed to be close to a risk free rate of return) from the capital it has invested in its assets. In essence, the Irish parent is considered to control the assets held by BermudaCo such that profits generated by those assets which are in excess of a financing return are considered to be attributable to the exercise by IrishCo of the SPFs (or DEMPE functions) related to BermudaCo risks and assets.

If the IrishCo arrangements arise in the course of a trade taxed under Case I, Irish transfer pricing principles should require IrishCo to reflect this pricing adjustment in its taxable Case I income.

Where Ireland's transfer pricing regime does not extend to these arrangements, the application of transfer pricing principles under a CFC rule should see an equivalent amount of profits taxed under the CFC regime where the arrangements fail the non-genuine arrangements test. This is because this CFC framework taxes under the CFC regime "*amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company",* which is IrishCo in this example.

Example 2(b)

It is assumed that the SPFs described above related to the IP held by BermudaCo are not performed by IrishCo but they are performed, instead, by USCo which is a fellow subsidiary of BermudaCo. In this instance, as there are no SPFs performed by the Irish controlling company but instead by another group member, USCo, no income should be included in the tax base of IrishCo under the Irish CFC regime.

The pricing impact of the functions performed by USCo in relation to the business and assets of BermudaCo is a matter to be addressed under the US transfer pricing regime.

Appendix 2: Overview of branch exemption regimes

	UK	France	Netherlands	Germany
Scope of exemption	Full	Full	Full	Full
Scope – cover income and capital gains	Yes - except non-trade related capital gains realised by a close company (see below)	Yes	Yes	Yes
Subject to tax requirement	No	No. But impact of CFC rules to be considered if the branch benefits from a privileged tax regime i.e. less than 50% of equivalent French corporate income tax	For a Double Tax Agreement (DTA) country, branch exemption applies once the branch meets the threshold for a PE under the treaty. Where branch is in a jurisdiction which does not have a DTA branch exemption provision, a branch exemption is only available if the branch is not a passive activity branch subject to a low rate of tax	Domestic law provides for worldwide taxation of branches. A branch exemption may apply if a DTA provides exemption relief from double tax. Many German DTAs require that the branch is actually subject to tax in the branch jurisdiction for the exemption to apply. German law contains a switchover clause to tax otherwise exempt branch profits if the DTA jurisdiction applies a different treaty interpretation to the profits to exempt them from tax or only subjects the profits to limited tax
Trading requirement	Yes, but can elect for exemption before the branch is established (provided branch activity is in the nature of a trade)	Yes, branch must be engaged in business activity	Yes, sufficient that branch exemption applies under a DTA. For non-DTA branches, must not be passive activities branch with low tax rate	Yes, branch must be engaged in a genuine business activity
Minimum substance requirement	In the case of a DTA, the branch must meet the threshold to	Yes, otherwise branch exemption can be denied	In the case of a DTA, the branch must meet the threshold to	Dependent on whether there is an activity clause in the DTA. Many German DTAs require that the

	UK	France	Netherlands	Germany
	recognise a PE under the treaty. For non-DTA countries, the branch must meet the threshold to recognise a PE under the model OECD treaty		recognise a PE under the treaty. For non-DTA countries, branch exemption may not be available if the branch activities are considered passive activities subject to a low rate of tax	branch is engaged in an active trade or business in order that the exemption method applies under the treaty
Double Tax Agreement (DTA) required with the branch jurisdiction	Only if a "*small*" company	No, French corporate income tax is based on territoriality. French definition of business subject to corporate income tax differs slightly from the criteria set out in most DTAs	No. See above separate conditions for exemption to apply for non-DTA countries	Yes
Trading and passive income included	Yes, where the branch is engaged in a trade, passive income of the branch also exempt	Yes	Yes, once branch exemption conditions are met, passive income attributable to the branch is eligible for the exemption	Yes, but see below where switchover anti-abuse rules can tax a branch with mainly 'passive income'
Loss relief	No	Generally no. Loss relief available only regarding the 'final' losses of EU permanent establishments (PES), but rare in practice	Generally no. Loss relief available only where the branch has ceased and activities discontinued	Generally no. In theory, relief could be available for 'final' losses of EU permanent establishments (PEs) but this is difficult to achieve in practice
Exit tax if asset is transferred to branch	No, but gain on eventual disposal is taxable with the branch exemption applying to the gain attributed to the period	Yes	Accruing unrealised gain on asset transferred reduces branch profit exemption (which operates in manner similar to exit tax). Expected to be	Yes. The exit tax regime provides for a deferral of exit tax payment over 5 years for asset transfers to an EU branch

	UK	France	Netherlands	Germany
	that it was in the branch		aligned with ATAD exit tax regime	
Opt in / opt out regime	Yes - irrevocable election required	No - automatic	No - automatic	No - automatic
Anti-abuse rules	UK must have a DTA with the branch country where the company is a "*small*" company. Exemption does not apply to gains made by close companies (unless gains arise on disposal of assets used for the purposes of the trade of the branch[50]). The CFC rules are adapted to apply to exempt branches in the same way they apply to companies	CFC applies where branch avails of a privileged tax regime	As outlined above, for a branch exemption to apply in a non-DTA country, the branch must not be engaged in passive activities and subject to a low rate of tax which is a rate below 10%, as measured under Dutch tax principles	In addition to preventing a treaty based requalification resulting in nil taxation of branch profits (see above), the switchover clause also applies to tax exempt branch profits where the profits of a branch would have been subject to tax under the CFC regime if they had been earned by a subsidiary instead of a branch. The switchover clause effectively overrides the DTA based exemption for the branch profits

[50] This is the branch equivalent of Irish tax measures at section 590, TCA 1997.

Appendix 3: Suggested wording for the revision of paragraph 9FA, Schedule 24, TCA 1997

The following amendments are suggested to subparagraph (2) of paragraph 7, Schedule 24, TCA 1997. Suggested deletions are illustrated using strike through text with inserted text illustrated as underlined text.

"(2) Where, as respects any foreign branch income of a company for an accounting period, any part of the foreign tax cannot, apart from this paragraph, be allowed as a credit against corporation tax, ~~and accordingly, the amount of the income is treated under paragraph 7(3)(c) as reduced by that part of the foreign tax,~~ then an amount equal to the aggregate of -

where income that is chargeable to tax at the rate specified in section 21(1) for the accounting period is treated under paragraph 7(3)(c) as reduced by any part of the foreign tax which cannot be allowed as a credit, an amount determined by the formula-

$$\frac{100-R}{100} \times D$$

where-

R is the rate per cent specified in section 21(1), and

D is the amount by which that income is so treated as reduced

where income that is chargeable to tax at the rate specified in section 21(1) for the accounting period is not treated under paragraph 7(3)(c) as reduced by any part of the foreign tax which cannot be allowed as a credit, an amount equal to the foreign tax in respect of that income

where income that is chargeable to tax at the rate specified in section 21A(3) for the accounting period is treated under paragraph 7(3)(c) as reduced, an amount determined by the formula –

$$\frac{100-R}{100} \times D$$

where-

R is the rate per cent specified in section 21A(3), and

D is the amount by which that income is so treated as reduced,

shall be treated for the purposes of [subparagraphs (3) and (4)] as unrelieved foreign tax of that accounting period."