PWC'S COMMENTS ON / RESPONSES TO THE CONSULTATION QUESTIONS ASKED

Introduction

Many of the suggested legislative amendments put forward in the Coffey report ("the Report") are borne out of Ireland's obligations as a result of our commitments under EU Directives and the OECD's BEPS reports. As a result of these impending changes, taxpayers in Ireland will experience significant levels of change in fundamental areas of Ireland's tax code over a relatively short period of time. Some of the key changes arising from the Anti-Tax Avoidance Directive ("ATAD"), the wider BEPS agenda, and domestic commitments include:

- Controlled foreign corporation (CFC) rules (1 January 2019)
- PAYE real-time reporting (1 January 2019)
- General Anti-Abuse Rule (1 January 2019, if any changes are proposed)
- Hybrid mismatch rules (1 January 2020)
- Exit Tax amendment (1 January 2020)
- Updates to tax treaties in light of Ireland's options under the Multilateral Instrument (ongoing)
- Increased focus on State Aid (ongoing)
- Interest deductibility restrictions (1 January 2024 at the latest)

In addition to the above, Ireland has already taken certain BEPS related steps such as the introduction of an OECD compliant knowledge development box, country by country reporting, and changes to our residency rules.

Furthermore, Irish taxpayers are also attempting to navigate through substantial changes at an international level, including Brexit, US tax reform, and potential changes to the taxation of the digital economy.

This is all set against the backdrop of changing approaches by jurisdictions that are following Ireland's path by lowering their headline corporate tax rate. This can be seen right across the globe from the US to the UK to Japan. As a result, Ireland must ensure that consideration is given to the economic impact of any changes we make to our tax code, especially in light of what is happening elsewhere.

This period of unprecedented change means that Ireland should take a considered approach to the recommendations set out by Coffey in the Report. Where possible, we would also recommend that a timeline of optional changes (i.e. changes that Ireland is not committed to make as a result of EU Directives or multilateral agreements elsewhere) be provided to give certainty to stakeholders.

Given the sheer volume of change in 2019 and 2020 especially, we would recommend that any other fundamental amendments (such as possible changes to Ireland's transfer pricing regime) are deferred until the end of 2020 at the earliest. This would afford taxpayers the opportunity to assess the impact of items such as CFC and treaty changes, etc., and remain compliant while navigating through this sea of change.

Allowing companies time to consider their current business models and their fit within the rapidly changing global tax landscape will ensure that Ireland continues to benefit from providing stakeholders with certainty and stability.

Key Message – One Headline Corporate Tax Rate

We have responded to the various questions set out in the consultation below but we believe that one key theme runs through many of the recommendations proposed by Coffey – a need to create certainty by moving to one rate of corporate tax for both trading and passive income.

The Report supports the view of successive Ministers for Finance that the three "Rs" of the Irish system (Rate, Regime and Reputation) are underpinned by providing certainty and stability, where possible, to stakeholders. Three of the most significant changes proposed in the Report are that Ireland should:

- introduce CFC rules in line with ATAD;
- update our transfer pricing rules to adopt the 2017 OECD guidelines; and
- extend our transfer pricing rules to non-trading transactions.

Each of these three significant changes, if adopted in isolation, would suggest that Ireland's current system of employing two different corporate tax rates for active and passive income would no longer be fit for purpose, and would lead to significant uncertainty.

Ireland's adoption of CFC rules, and potential move to a territorial regime, would be in line with current international best practice. Recent studies show that 28 of the 35 OECD states operate a territorial tax regime. In addition, it is interesting to note that we are the only OECD country to employ two different tax rates which are determined by whether the income of a company is considered to be trading or passive income. We are also generally an outlier versus our competitors with a separate capital gains tax regime, with a rate of almost three times the standard corporate tax rate (33% versus 12.5%).

The CFC rules that Ireland will adopt will require taxpayers to compare the tax paid in a subsidiary jurisdiction to the tax that would have been paid had the income been earned in Ireland. The existence of multiple rates means that, in some instances, this becomes a subjective test and will not provide clarity to taxpayers.

When the 12.5% rate was introduced, it appears that there was a desire to maintain a higher rate so that passive activities could not avail of this low rate, ensuring that the 12.5% rate attracted substance-based investment. Since that time, there have been two major changes.

Firstly, global tax rates have generally reduced, such that this 25% rate is now at the higher end of the OECD corporate tax rate spectrum. It is noteworthy that, at the time that the 25% rate was set for passive income, it was circa 10% below the OECD average. Recent rate reductions, including that in the US, has resulted in the average OECD corporate tax rate reducing to 22%, which is significantly lower than the 25% "passive rate" in operation in Ireland.

The second significant change relates to the recognition of income, and the truer alignment of profit/taxing rights and substance as a result of the OECD's updated transfer pricing guidelines, which include the outcomes of the work undertaken as part of BEPS actions 8 – 10. The result of these updated guidelines is that it should no longer be possible to earn significant levels of income in a passive manner if the main functions relating to the generation of that income are performed in another jurisdiction. The introduction of DEMPE functions as part of the 2017 Transfer Pricing Guidelines would seek to align profit with substance where intellectual property is located in Ireland.

As such, it can be seen that removing the distinction between passive and trading income, and moving to one fixed corporate rate, would not diminish the need for groups to continue to make substance-based investment in Ireland in order to benefit from the 12.5% corporate rate.

While a removal of the distinction between passive and trading income would be welcomed, it is not envisioned that the concept of trading would be diminished. The concept of trading activities remains key to many of Ireland's corporate offerings, and the integrity of trading and trade facilitators should be

protected. For example, rules associated with trading such as capital allowances or general deductibility would still only apply to trading operations.

It is also important to note that we are not suggesting that Ireland remove the 25% rate for certain other types/streams of income such as those outlined as “excepted trades” under Section 21A TCA 1997, as we understand that there are particular policy concerns underpinning the rate applying to these types of income. Similarly, while not an international norm, we understand the policy considerations for having a separate rate of taxation for capital gains, however, as is mentioned below, there are sound policy arguments to align the rate applying to the disposal of trading assets to the 12.5% which applies to trading income.

While consideration must be given to the significant knock on impacts of extending our transfer pricing rules to non-trade transactions, if such a decision is made, as is proposed in the Report, the mismatch between the two corporate tax rates could lead to significant uncertainty and mismatches in taxation treatment between entities.

Hence, while in the past there were sound policy reasons underpinning the existence of a 25% rate for passive income, due to the changes that Ireland must make, coupled with the other modernising suggestions made in the report, the higher rate on passive income would no longer be required for policy purposes.

Furthermore, the alignment to a single “branded” headline rate of 12.5% would lead to greater certainty and security for stakeholders.

Responses to the consultation questions

Question 1:

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

Ireland's existing General Anti-Abuse Rules contained within Sections 811C and 811D meet the minimum standard GAAR required by Article 6 of the Directive and as such there are no amendments necessary.

Question 2:

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

Please refer to our other document attached which deals with this question and question 10.

Question 3:

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

In addition to having a tax rate of 12.5% for trading income and 25% for non-trading income, Ireland also has a third rate, 33%, for capital gains. This is not in line with international norms.

Clearly, due to changes stemming from the OCED's BEPS actions, a large number of companies have started to re-examine their business models with a view to moving different functions, assets, risks, etc. to locations where they can demonstrate, and maintain, substance. In many instances, this involves moving operations from a number of locations and consolidating operations in one single location.

Ireland's policy has been to attract companies looking to make substance-based investment. When deciding whether to invest in Ireland (or indeed any location), companies look at the tax landscape relating to their investment, the carrying on of operations, and the ease of exit if there is a commercial need to do so. Headline tax rates are often compared as part of this process, and our 33% CGT rate is out of sync with other jurisdictions.

Our experience is that companies that choose Ireland as their base tend to remain here and pay tax on their operations. However, the 33% tax on exit for assets (including, but not limited to, intellectual property) could act as a deterrent for companies that might be considering Ireland as an alternative investment location. We are not competitive internationally in this area and must question whether this may hinder our ability to attract, and retain, the companies that will contribute to our economy in the future.

We propose that by extending the 12.5% rate beyond trading income, Ireland would be able to offer a single competitive rate of 12.5% applying to both trading profits as well as to gains on the sale of trading assets. This would provide certainty and clarity around trading, and would further promote the 12.5% rate.

It will also be important when changes are being made to Ireland's exit taxation rules that any deemed disposals as a result of a migration of residence are treated in the same manner as actual disposals.

As other nations respond to this article in the ATAD, it will be important to ensure that Ireland remains competitive and, as such, we recommend that the actions of others are monitored closely.

To the extent that there is agreement that the alignment of the tax applying to trading profits and trading assets will simplify and maintain our competitive position, we would suggest that this is signalled to stakeholders, as the current uncertainty in this area is unhelpful.

To date, our rules on exit taxation have worked well and the impact on investor behaviours would need to be considered in advance of the proposed rule amendments.

Question 4:

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

Due to the considerable complexities which are likely to arise from the introduction of anti-hybrid rules in 2020, we propose that Ireland takes sufficient time to consider how these rules can be transposed into domestic legislation. The rules will have far-reaching implications. Our experience, from dealing with corporates operating internationally, is that where such rules are drafted broadly, unintended consequences can follow. We would welcome the opportunity to engage with the Department of Finance in the coming months on this matter.

Question 5:

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

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

While it is expected that all OECD member and observer states will ultimately adopt the OECD 2017 Transfer Pricing Guidelines incorporating BEPS Actions 8,9 and 10 ("2017 Transfer Pricing Guidelines"), not all member and observer states have yet done so in their domestic legislation. We recognise the need for Ireland to update our legislation to ensure we stay in line with OECD best practice. However, given the considerable amount of change over the coming years, we would suggest that a change such as this is brought into force from 1 January 2020 at the earliest, at which point Ireland will have greater clarity and consensus on the operation of the guidelines.

Question 6:

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

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

At present, Irish Transfer Pricing rules do not apply to transactions entered into before 1 July 2010. The proposal arising from the Consultation is to consider the extension of the legislation to transactions that were entered into before this date.

As a result of the non-applicability of the transfer pricing rules to businesses operating in Ireland due to the "grandfathering" provision, businesses would likely have relied on this provision not to prepare transfer pricing documentation for those transactions, and to retroactively apply rules to businesses that had previously complied with the existing legislation could be seen to unduly penalise them for being compliant. It would therefore seem to be an equitable solution for such businesses that had relied on grandfathering to be subjected to the transfer pricing rules in respect of those pre 1 July 2010 transactions on a prospective basis only, and for the Department of Finance to give appropriate notice of the date of commencement of such changes.

In line with the comments made within the Coffey report, we would also suggest that Ireland implement this change no earlier than the end of 2020.

Question 7:

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

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

At present, businesses that fall within the European Commission Recommendation 2003/361/EC (6th May 2003) concerning the definition of micro, small and medium sized enterprises ("SMEs") are currently not required to prepare transfer pricing documentation.

While the transfer pricing rules were not applicable, Revenue, via the existing legislation, has the ability to challenge taxpayers under the sections covering the general deduction rules within S81 TCA 1997 or "Control over Residents" within S1036 TCA 1997 on transactions undertaken between related parties. As is pointed out in the Coffey report, the United Kingdom, like Ireland, also uses the current EU definition for SMEs as a means of defining the scope of the exclusion (INTM 412080), but introduces some specific exceptions (per HMRC Manual INTM412070) to that definition as follows:

- An exception that covers countries with which the UK does not have a Double Taxation treaty, and requires the enterprise to be specifically subject to transfer pricing rules in its transactions with these countries.
- Where a transfer pricing notice is issued to an SME by HMRC advising it is subject to the UK transfer pricing rules.
- Where an enterprise elects to be subject to the UK transfer pricing rules.
- Where the SME is party to a Patent Box related claim.

The continued use of the SME definition in 2003/361/EC is common within the EU and, unless modified further by the EC more broadly, would seem to be an appropriate common means of defining the size of SMEs and whether or not transfer pricing rules should apply to them. For clarity, the definition states that a company should be considered an SME if it has less than 250 staff, a turnover not exceeding €50m and a balance sheet value not greater than €43m.

A CSO study for 2014 showed that 99.8% of the total enterprise population in Ireland is attributable to SMEs[1]. It is clear that an overwhelming majority of Irish business would have no experience of preparing transfer pricing documentation. These entities support the economy through job creation and the payment of local taxes, PAYE, PRSI and indirect taxes. The introduction of additional administrative costs and time invested in preparing transfer pricing documentation would appear to be disproportionate compared to the relative size of the entity. Furthermore, it is questionable whether there would be any significant benefit to the exchequer borne out of such a change. As such, we would not recommend that this recommendation in the report is followed.

Question 8:

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

In relation to the extension of transfer pricing rules to non-trading income, what are the key considerations of this proposal?

At the outset, it is important to note that the adoption of this recommendation would represent a fundamental change for Irish taxpayers, and the complications involved for many should not be underestimated. The vast majority of our clients would have some form of intercompany balances or agreements of a non-trading nature, all of which may not necessarily satisfy transfer pricing principles were they to apply. The majority of these balances/agreements would be intra-Ireland and, as such, the application of transfer pricing could lead to unintended consequences and an incommensurate administrative burden. This is clearly not a fair or equitable scenario, and the benefit to the Exchequer would be questionable.

We do recognise, however, that our rules are not in line with international norms, as such it is important to consider the reasons that non-trading transactions were not included within the scope of transfer pricing. At that time, we understand that the higher rate applying to non-trading income of 25% safeguarded against any abuses associated with non-trading transactions. This allowed companies operating in Ireland an easy way to move funds efficiently within Ireland.

Income arising from non-trading transactions is typically subject to a corporation tax rate of 25%, whereas the mainstream corporation tax rate for trading activities is currently 12.5%. If non-trading transactions are to be treated in the same way as trading activities for transfer pricing purposes, this could give rise to potential mismatches in the corporation tax rates applying to the income earned by the originator and the corporation tax rate at which the expense made by the recipient is deductible (25% versus 12.5%). In addition to tax rate mismatches, there exists a risk of double taxation in cases

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[1] http://www.cso.ie/en/releasesandpublications/er/bd/businessdemography2014/

where one company is not afforded a deduction while the counterparty is taxed at either 12.5% or 25% - this is clearly not in line with Ireland's policy goals.

Given the significant complexity associated with this potential change and given that the likelihood of any positive Exchequer benefit is unclear, especially when compared with the complexity such a change would introduce, we would not advise that the recommendation is adopted.

However, if a decision is made to follow the recommendation in the report, it would make it critical that a single rate of tax is applied to both trading and non-trading transactions. Furthermore, it would be important that any such change would be signalled in advance and that transitional rules are introduced. At a minimum, we would suggest that these proposed changes are not made before the end of 2020.

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

Coffey:
Consideration should also be given to extending transfer pricing rules to capital transactions, having regard to whether such an extension would improve the existing provisions which already apply arm's length values to companies' transactions relevant to chargeable gains and capital allowances.

While Irish transfer pricing legislation does not currently apply to capital transactions, we feel that sufficient safeguards exist within our domestic legislation so as to ensure capital assets transfer at market value. The legislation already includes rules that require market value to be used in connection with the disposal of capital assets (S547-S549 TCA 1997) and within the capital allowances rules, such as within S312 (Special Provisions on Certain Sales) and S291A TCA 1997 (Intangible assets). Additionally, the legislation includes other sections such as S623 TCA 1997, which provides that where group relief applied to a prior intra-group transaction, and the chargeable company leaves the group while still holding the asset, this triggers a market value rebasing at the date of the original transfer.

On the basis that businesses subject to Irish Capital Gains Tax and benefitting from capital allowances are already required to meet the current standards of market value, it is arguable that additional regulation is not required. The policy concern that would underpin such an approach is unclear, and it is arguable whether there would be any Exchequer benefit associated. As such, we would not recommend that this proposal is adopted as it could lead to a significant level of additional administration. We suggest that, if there are any specific policy concerns, they are dealt with in a more focussed manner.

Question 9:

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

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

Coffey:
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.

Irish transfer pricing rules, as laid down in the 2010 legislation, have a requirement that the taxpayer "…shall have available such records as may reasonably be required…" (S835F(1) TCA 1997) to determine if the income chargeable to tax under Schedule D has been correctly computed under the rules and for such records to "….be prepared on a timely basis…." (S835F(2) TCA 1997). The transfer pricing documentation obligations are outlined in the Revenue Tax and Duty Manual (Part 35a-01-02).

While it is expected that all OECD member and observer states will ultimately adopt 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 ("2017 Transfer Pricing Guidelines"), not all member and observer states have yet done so in their domestic legislation. To do so alone could disadvantage Irish based businesses/enterprises where a counterparty business to a transaction is located in a jurisdiction that has not yet adopted the 2017 Transfer Pricing Guidelines, or where Irish businesses may be required to prepare additional documentation (such as a Masterfile/Local file) compared to other jurisdictions that have not yet adopted the latest 2017 guidelines.

In light of the significant corporate tax changes (notwithstanding other changes in indirect tax rate, PAYE Real Time Reporting, etc.) to be implemented in the coming years, it should be borne in mind that companies are struggling to achieve certainty on both the operation and the administrative burdens of such new rules. Coupled with international changes such as Brexit, US Tax Reform, digital tax, EU Directives, etc., the compliance landscape stands to change significantly with new compliance requirements for all companies, be they SMEs or multinationals.

To avoid such mismatches and sudden compliance obligations arising, we suggest that Ireland consider waiting until the end of 2020, at the earliest, prior to implementation. In addition, we suggest that companies complying with the transfer pricing documentation rules should have any penalties arising mitigated – this is the case in the United States.

Question 10:

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

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

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

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

Please refer to our other document attached which deals with this question and question 2.