Introduction

We had previously submitted our thoughts and suggestions on the way in which CFC rules could be implemented in Ireland as part of our submission on the Public Consultation Paper which was published by the Department of Finance in 2017 following the Review of Ireland’s Corporation Tax Code earlier that year.

Our submission of 30 January 2018 centred on Ireland choosing the “Option B” approach with a number of complementary exemptions designed to ease the compliance burden in cases where there is clearly no risk of artificial diversion of profit. We proposed that this approach should meet the minimum standard within the Anti-Tax Avoidance Directive, while not preventing the inclusion of income that arises from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage.

We proposed that four entity level exemptions be considered for inclusion as part of the CFC rules and, while we welcome the proposed inclusion of some of these exemptions, there is a need to provide further protection for indigenous and Irish-headquartered businesses to ensure they are not unduly impacted by the new rules. We set out below a short summary of the proposed exemptions and their adoption within the draft CFC legislation recently issued:

Low Profits Exemption & Low Profit Margin Exemption

We had suggested as part of our submission that a low profit margin exemption be implemented on the basis that subsidiaries with both low profits and low profit margins (as defined in the Directive) do not pose profit-shifting risks, and thus should be excluded from CFC. The Tax Strategy Group Corporation Tax paper published on 10 July 2018 noted that an exemption for low profit or low profit margin companies was being considered by the Department. You indicated at our recent meeting that you would consider including provisions to exempt such entities. This is very welcome.

Exempt Period

We welcome the inclusion of an Exempt Period exemption in the Section 6 of the Feedback Statement. However, the proposed period length, being only 12 months, is short in comparison to what we had originally suggested in our submission (a 2 year exempt period). In our view, while 12 months provides some element of certainty and fairness to the taxpayer, it does not provide sufficient time to restructure newly acquired subsidiaries as part of a group acquisition to ensure that these do not fall to be classified as a CFC. Additionally, there are a number of measures included in this section that appear to be unduly restrictive. Please see Appendix I below for further discussion of these measures.

We strongly urge the Department to establish an exempt period of 24 months to promote certainty around the effective date of application and to mitigate against the prospect of retrospective taxation.
A “White List”

There was no mention of white, grey or black lists in the Feedback Statement as published by the Department of Finance. The introduction of a white list would significantly reduce the compliance burden on Irish taxpayers by making clear the territories where business activities are not expected to take place for tax avoidance reasons. The Directive, at paragraph 12 to the preamble, explicitly states that the use of such lists is acceptable. The Tax Strategy Group Papers released earlier this year indicate that ATAD affords a degree of flexibility to implement such a list.

The absence of any reference to a white list in the CFC Feedback statement is therefore disappointing and suggests that such a list will not be included in the forthcoming legislation. We recommend that a white list exemption be introduced from the outset in 2019 and that this be reviewed in the coming years as part of normal legislative reviews by the Department.

Substance

A key exemption called for as part of our submission, and one which balances the implementation of Option B, was a substance based exemption. This would be implemented as an entity level exemption. This would be of particular importance to indigenous Irish companies, Irish Plcs and Irish headquartered multinational companies that have the vast majority of their significant people functions in Ireland. A substance based exemption would provide a safe harbour for such companies who carry on genuine business activities abroad. We suggest that wording such as the below be included accordingly, as proposed in Appendix IV:

“an arrangement shall not be regarded as non-genuine to the extent that the income arises to the controlled foreign company from ongoing activities carried on by it in the ordinary course of its trade or business and supported by the establishment of the necessary premises, staff and equipment in the controlled foreign company’s territory of tax residence”.

Feedback Statement

1. Control

We note that the draft legislation appears to go beyond the minimum standard in addressing the risk of abuse. With regard to Part 1 of the Feedback Statement, it is our view that this section is overly complex and capable of extremely broad interpretation, with unintended consequences, and we have set out our detailed comments in Appendix II.

Control test begins or ceases to be met part of the way through an accounting period

We would also welcome some clarity on how the provisions will operate in circumstances where an entity begins or ceases to meet the control test during its accounting period. As we have not seen the entire provisions, we note that it may be included within Chapter 1 as referenced in the draft provisions relating to the exempt period.
2. Effective Date

It is unclear how the CFC provisions will apply with regard to the effective date of application based on the legislation as drafted in the Feedback Statement. The legislation is silent as to the period for which the rules will first apply. This could allow for the rules to be applied retrospectively and create further complexities around deemed accounting periods. We suggest that the rules apply to entities in respect of accounting periods beginning on or after 1 January 2019. Please see Appendix III for further details.

3. Charging Section

We are disappointed at the missed opportunity in this section to provide a safe harbour for groups with genuine economic activities abroad whose significant people functions are carried out in Ireland. This would ensure that Ireland would not seek to tax anything other than wholly artificial arrangements and would thus ensure that our rules are compatible with the judgement in the case of Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue C196-04. As mentioned above, a substance based exemption would provide a safe harbour for such companies. See Appendix IV for suggested wording for such a measure.

Further clarity is also required in determining the meaning of “significant people functions”. See Point 6 below for further comments.

We note the use of certain words and phrases in the draft legislation that are unusual and could potentially be difficult to interpret. Where these words are used in the context of a test, it is particularly unclear as to what threshold is expected to be met to come within this test. The use of the phrasing “it would be reasonable to consider that the relevant Irish activities were instrumental in generating that income” in ss(9) of Article 7 is a notable example. If such language is intended to be brought into the legislation, we urge the Department of Finance to issue guidance to assist taxpayers with the interpretation of such sections. This would need to be made available at such time as the rules come into force.

We also note some concerns in relation to the meaning of “undistributed income”, both with regard to the assessment of the amount of accounting profits that are available for distribution and to the reference to “distributable profits”. See Appendix V for further comments.

4. “Cash Box” companies

The first signal of rules being implemented to tackle so-called “cash box” companies was the publication of the Tax Strategy Group papers earlier this year. The comments included therein clearly demonstrate that such rules would go beyond the ATAD minimum standard.

“ATAD CFC rules are not sufficient to target ‘cash box’ subsidiaries, cash/capital rich companies with few or no employees in low tax jurisdictions where there are no significant people functions in the State relating to the management of those assets and risks. Should Ireland’s transposition exceed the ATAD standard and develop measures to address such ‘cash box’ companies?”

It is not entirely clear what Part 5 of the Feedback Statement seeks to address apart from cash/capital rich companies. It would appear that this goes against our stated policy objectives to target specific types of companies. We are also cognisant of the fact that, in a post-Brexit world, Ireland will present itself as a global or European headquarter location to many multinational companies who may seek to
relocate from the UK. The imposition of unclear and potentially targeted legislation will not assist in achieving this aim, particularly so late in the legislative process.

We advise that no rules targeting “cash box” companies be brought in at this time but that this be considered as part of the consultation planned for early 2019 on updating Ireland’s transfer pricing rules.

5. Exemptions

See the introduction above and Appendix I for further details.

6. Connected company undertaking Significant People Functions

The term “SPF” is defined as meaning “a significant people function or a key entrepreneurial risk-taking function as construed in accordance with the OECD Report”.

There is little guidance on the meaning of SPF in the OECD Report. We would therefore request that clear guidance be provided on how to interpret the meaning of this term in an Irish context.
Appendix I

Part 6 – Recital 12: Exempt Period

While the proposed exempt period provisions are very welcome, there are a number of aspects to the draft measures which appear to be very restrictive.

Assets held / risks borne during the exempt period

Subsection (2)(c) requires that the assets held and the risks borne by the CFC at any time during the Exempt Period must be equal to or less than the assets held and risks borne at the beginning of the period and their arm’s length values must not have increased in that time.

While we understand that it would be desirable to prevent the placement of further activity in the CFC in the exempt period in order to take advantage of the exemption, the restriction would apply even if the assets held and risks borne at the beginning of the period increase in value. This would appear to be inequitable as there has been no “new assets” put into the company. In addition, this restriction would seem to place a restriction on restructurings that involve the integration of the acquirer and target businesses in any jurisdiction.

We would therefore ask that the scope of this measure be reconsidered to facilitate the growth and development of the entity’s activities. We would suggest a bona fide test could be introduced to protect against arrangements that are put in place with a main purpose of avoiding the CFC charge.

Status of CFC when provisions are introduced

Subsection (6) provides that the exempt period provisions shall not apply where “a controlling company was subject to this part in relation to the controlled foreign company on the date the provisions of this Part came into effect”.

We understand that this is intended to apply in circumstances where the company was a CFC of any controlling company who was subject to this Part of the legislation at the time when the CFC provisions are introduced.

Our interpretation is that, in effect, the exempt period provisions do not apply in relation to a CFC which was controlled by an Irish resident company at the time that these provisions were introduced. We would however appreciate clarification on the meaning of this measure and, if the above interpretation is correct, what is the rationale for such exclusions.

Newly acquired subsidiaries

We note that the Commentary that is included in the Feedback Statement references the fact that submissions made in response to the Coffey / ATAD consultation have noted that “it would be appropriate to allow a ‘grace period’ in respect of newly acquired subsidiaries during which the new parent company can reorganise its business to eliminate the CFC if desired”.

This measure would be very welcome. We would however note that the provisions of subsections (6) and (7) are currently incompatible with this and that a carve-out from these measures would therefore be required.

**Further Exemptions**

**Entities with low profits or a low profit margin**

Paragraph 12 in the preamble to Council Directive (EU) 2016/1164 includes the following comments in the context of the CFC rules:

"With a view to limiting the administrative burden and compliance costs, it should also be acceptable that those Member States exempt certain entities with low profits or a low profit margin that give rise to lower risks of tax avoidance."

You indicated at our recent meeting that you would consider including provisions to exempt such entities. This is very welcome.

"White lists"

Paragraph 12 in the preamble to Council Directive (EU) 2016/1164 also includes the following comments:

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

There are a number of territories where it is readily apparent that the essential purpose of any arrangements are not to secure a tax advantage. We recommend that a “white list” exemption be introduced from the outset in 2019 and that this be reviewed in the coming years as part of normal legislative reviews by the Department.

**Subsidiary investments taxed as trading income**

As outlined at our meeting, in certain circumstances (particularly in the financial services industry), Irish resident companies can treat their investments in overseas subsidiaries as part of their Case I trading activities, such that the return on investment will generally be subject to tax in Ireland in line with its treatment in the financial statements of the Irish company.

The nature of these investments mean that they are typically marked to market for accounting purposes with gains and losses being recognised in the Income Statement of the Irish company on an unrealised basis.

Given that the Irish company would be subject to tax on the unrealised gains recognised in the Income Statement, any CFC attribution in respect of the overseas subsidiary could result in double taxation for the Irish company. We recommend that the final legislation contains provisions to ensure that entities
whose overseas subsidiary investments are taxed on a Case 1 basis, are exempt from any CFC attribution in respect of those overseas subsidiaries.
Appendix II

Part 1: Article 7(1)(a) – Definition of control

As mentioned, we are concerned that the linkage of the control test to the definition of “control” in Section 432 is capable of extremely broad interpretation and may well lead to unintended consequences. We would question whether it would be more appropriate to adopt a control test similar to that set out in Section 11 for the purposes of this draft legislation (and indeed future legislation to be introduced as a result of ATAD) as this would seem to be more in line with what is required under ATAD.

Some of our specific concerns regarding the proposed use of the Section 432 control definition include:

Meaning of “control”

The definition of control in Section 432 (and the broad attribution rules proposed for “associated companies”) mean that, under the proposed legislation, an Irish company could be deemed to have control over another entity, even in situations where it has no shareholding or voting power in that entity.

For example, for security reasons, a third party bank or other financing entity may have rights to the assets of a company on a winding up of that company. The control test in Section 432 could deem that bank or financing entity to have control over the company, even though they have no shareholding or voting power interests in the company.

Meaning of “associate”

The term “associate” which is used in the draft definition of “control” is not defined for this purpose.

If it is intended to have the same meaning as for the purposes of Section 432, this section employs the definition from Section 433 which comprises relatives, partners, trustees and certain persons with interests in trusts. The meaning of “associate” for this purpose thus embodies concepts that are more appropriate for a close company assessment than the CFC assessment, with the references to “partners” and “trustees” in particular leading to the potential for large numbers of essentially unrelated persons being “grouped” together for these purposes. The meaning of “associated” which is used in Part 35 of the TCA in the context of the Transfer Pricing provisions may be more appropriate to this assessment.

However, we would suggest that the attribution of the rights and powers of “associates” may not be necessary based on the proposed addition to be made to Section 432(6) to incorporate the rights and powers of:

(a) any associated company...of such a person

The proposed definition of “associated company” for this purpose is very closely aligned to the meaning of “associated enterprise” in Article 2 Paragraph 4 (Definitions) of the Council Directive.
As Article 7 Paragraph 1 of the Directive, which deals with the meaning of control, focuses on the participation of the taxpayer either itself or together with its associated enterprises, we would suggest that it should be sufficient to attribute the rights and powers of associated companies under subparagraph (a) without the need to extend the attribution further to associates in the manner set out in subparagraphs (b) to (e) of the proposed measures.
Appendix III

Part 3: Article 7(1)(b) – Calculation of the Effective Rate

Corresponding Corporation Tax in the State

At present, the provisions are unclear as to how the tax calculations are to be prepared in circumstances where the CFC existed before its “first accounting period”, as defined for the purpose of this provision.

For example, how are matters such as losses brought forward from earlier years and capital allowances on assets acquired in earlier years to be treated in computing the corresponding chargeable profits in the State? The amount of the foreign tax for the accounting period will likely have taken account of such losses forward and tax depreciation on the assets. If they are omitted from the Irish computation, this could result in a situation where the CFC charge applies even in circumstances where the tax rate in the foreign territory is higher than in Ireland.

In circumstances where a company migrates its residence to Ireland and has, for example, assets qualifying for capital allowances prior to taking up residence in Ireland, it would generally be entitled to claim relief on those assets through the capital allowances regime in Ireland during its tenure as an Irish resident entity. The application of a similar approach in the CFC provisions would mean that the cost of any existing assets owned by the company prior to becoming an Irish CFC may be available to the company when it becomes an Irish CFC and, therefore, the CFC can access the benefit of those capital allowances if and to extent that there are any capital allowances available from that date.

We also note that the test is performed at an entity level and there are no references to fiscal unity consolidation or group relief. We recommend that such circumstances are allowed to be factored in when considering the effective rate test.

Another point that will need to be considered is how to deal with circumstances where there are differences between the rules in the foreign territory and Ireland on matters such as:

- relief for foreign taxes suffered by the CFC,
- credit for foreign withholding tax suffered by the CFC,
- incentives such as R&D tax credits etc.

We would ask that further consideration be given to how to deal with these matters appropriately in assessing the difference between the foreign tax paid for the accounting period and the corresponding corporation tax in the State for that period.
Appendix IV

Part 4: Article 7 – The CFC Charge

Wording of subsection 9(a)(i)

As discussed at our meeting, there appears to be an error in the wording of subsection (9)(a)(i). This sets out one of the circumstances under which the CFC charge shall not apply. In our view, the word “not” in the last line should be removed and it should hence read:

“at no time did the controlled foreign company hold assets or bear risks under an arrangement where it would be reasonable to consider that the essential purpose of the arrangement was to secure a tax advantage...”

Subsection (9) - Additional clarification proposed

As discussed at our meeting, we would request that consideration be given to including a subpart (c) to this subsection to clarify that:

“an arrangement shall not be regarded as non-genuine to the extent that the income arises to the controlled foreign company from activities carried on by it in the ordinary course of its trade or business and supported by the necessary premises, staff and equipment in the controlled foreign company’s territory of residence”.

Calculation of corporation tax on the CFC charge

Subsection (6) provides that corporation tax shall be chargeable on the CFC charge at the rate specified and that “the amount of corporation tax so chargeable shall be reduced by the amount of any creditable tax as determined by [section defining creditable tax].”

The Effective Tax Rate test in Section 2. of the Feedback Statement is performed on the basis of “the amount of foreign tax which is paid by the controlled foreign company”.

It would be helpful to understand how this “foreign tax” and “creditable tax” will be defined and calculated. Some key points that arise would be:

- how credit is provided for the foreign taxes paid by the CFC?
- how this is managed, particularly in circumstances where the payment and filing deadlines in the CFC are not aligned with the chargeable company?
- how income which has been the subject of a CFC charge will be treated in situations where it is subsequently distributed out of the CFC?
- in circumstances where the CFC is disposed of and a CGT charge arises for the Irish parent (for example, because Section 626B does not apply), how credit is to be provided to take account of any CFC charge incurred to date by a chargeable company on the undistributed income of that CFC?
Appendix V

Part 8: Article 7(1)(b) – Definition of undistributed income

Computation of Distributable Profits of the CFC

The assessment of the amount of the accounting profits that are available for distribution must be done without regard to “any prohibition under the laws of the CFC’s territory of residence or otherwise”.

This appears to be very unreasonable as it would bring within the scope of the rules profits that a CFC may wish to distribute but cannot due to legal restrictions. The controlling company could therefore be penalised in these circumstances if the tax analysis would be more beneficial had a distribution been paid up.

We would suggest that this provision be amended to acknowledge that profits which cannot be distributed by virtue of a legal restriction would not be regarded as “distributable profits” for the purposes of subsection (2). This could be supported by an anti-avoidance measure to ensure that, where any scheme or arrangement is put in place that results in a legal restriction being imposed, such a legal restriction would be disregarded.

This could be framed in the following manner:

Remove the wording “notwithstanding any prohibition under the laws of the controlled foreign company’s territory of residence or otherwise” from subsection (2).

Add a new subsection to provide that:

“For the purposes of subsection (2), where a controlled foreign company is subject to any restriction imposed by law as regards the making of distributions, regard shall be had to this restriction in determining the amount included in the accounting profits of the company which are available for distribution to members of the company.

This subsection shall not apply where the controlled foreign company is subject to any restriction imposed by law which arises directly or indirectly as a consequence of any arrangement [as defined in Section 9 of the Feedback Statement] and the main purpose, or one of the main purposes, of the arrangement is to secure that that restriction is imposed by law.”

Relevant Distributions

Under subsection (3)(iii), there is an additional stipulation that the tax referred to above must have been paid. Evidencing that tax has been paid may be difficult in some situations, particularly for territories where the tax payment and filing deadlines are not aligned with Ireland. For example, the corporate tax filing deadline in a number of territories is 12 months after the end of the accounting period. Clarification within the legislation on how to deal with this would be very welcome.
Exclusion of Gains

We discussed at the meeting how the term “undistributed income” is defined by reference to “distributable profits”. However, the latter term can include non-income items such as gains and capital contributions. In some territories, it may also include share premium amounts. You had mentioned that additional legislation had been drafted to clarify the position on this and it would be very helpful to understand if this meets the desired objective.

In addition, the term “distributable profits” is not a term which would be understood in some foreign locations and, accordingly, it would be useful to consider whether it should be a defined term for the purposes of this legislation.