Rialtas na hÉireann
Government of Ireland

Participation Exemption for Foreign Dividends

Feedback Statement: Strawman Proposal

April 2024

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Department of Finance
gov.ie/finance

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1. Introduction

A Roadmap for the introduction of a participation exemption to the Irish corporation tax system was published by the Department of Finance on 14 September 2023.[1] The Roadmap committed to the introduction of a participation exemption for foreign dividends in Finance Bill 2024, and to continuing consideration of the policy merits for the introduction of a foreign branch exemption.

In order to inform this process, the Roadmap included a range of detailed technical questions relevant to the design of a foreign dividend exemption and a number of broader policy questions regarding foreign branch exemption regimes. The consultation period ran from 14 September until 13 December 2023. Seventeen responses were received, and have been published on the Department's website.[2]

The purpose of this Feedback Statement is to further progress work to inform the design of key building blocks of the participation exemption for foreign dividends. Responses to the consultation have highlighted the broad range of decisions that are required, and have also illustrated the difficulty of analysing these policy choices on an individual element-by-element basis, without setting each option within the context of an overall participation exemption system. It is also the case that a policy direction in respect of key building blocks of the exemption will need to be made first, to enable consideration of the more detailed conditions and supporting provisions that will be necessary to fully realise an exemption system.

Therefore, in order to provide a more meaningful context within which to consider individual elements, it has been decided to develop a Strawman proposal, setting out a hypothetical example for how a participation exemption for foreign dividends might work in Ireland. The proposal, contained in Section 5 of this document, focuses on key structural elements of the regime, and is prefaced by a summary of the over-arching principles that are informing design considerations for the participation exemption.

[1] https://www.gov.ie/en/consultation/595bb-public-consultation-on-the-introduction-of-a-participation-exemptions-to-the-irish-corporation-tax-system/
[2] https://www.gov.ie/en/publication/3698b-responses-to-the-public-consultation-on-the-introduction-of-a-participation-exemptions-to-the-irish-corporation-tax-system/

2. Background information

Ireland currently operates a worldwide corporate tax regime. A worldwide regime considers all profits, both domestic and foreign source, of a resident entity to be within scope of taxation. Worldwide systems generally allow double tax relief for foreign tax paid on foreign source profits, up to the amount of domestic tax payable on the same income – this is often referred to as a "tax and credit" approach.

Therefore, a domestic tax charge generally only arises on such profits to the extent the domestic tax liability exceeds the foreign tax already paid on the same profits. The detail of Ireland's double tax relief provisions is largely contained in Schedule 24 of the Taxes Consolidation Act (TCA), 1997.

Fully-territorial regimes focus on the taxation of income and gains in the relevant territory only and exempt the foreign source profits of resident entities. There are relatively few fully-territorial regimes globally.

However, there are many jurisdictions, including most EU and OECD member states, which have adopted a limited territoriality in their corporate tax codes, through the exemption method of double taxation relief. This "participation exemption" approach to relief for foreign taxation typically extends to dividends from foreign direct investments and gains from disposals of such investments, and it is sometimes complemented by an exemption for foreign branch profits.

2.1. Foreign dividend participation exemption

A participation exemption for foreign-sourced dividends is a double taxation relief measure, which operates by exempting certain qualifying foreign dividend income received from corporation tax in the hands of the recipient.

Ireland is currently a significant outlier, being the only EU country and one of a very small number of OECD countries that does not operate some form of participation exemption for foreign dividends. Ireland operates what is referred to as a "tax and credit" system, whereby dividends received are subject to Irish corporation tax, but credit is given in Ireland for tax paid in other jurisdictions, up to the amount of Irish tax payable on the income.

Given our competitive corporation tax rate and our comprehensive double tax relief provisions, it is commonly reported by stakeholders that no or negligible incremental tax in Ireland arises on group dividends received. Furthermore, the implementation of the Pillar Two minimum effective tax rate from 2024, introducing a 15% minimum effective tax rate on a jurisdictional basis globally for large corporate groups, is expected to lead to increased taxes incurred in other jurisdictions that would in turn qualify for double tax relief, further reducing the potential for incremental tax in Ireland for in-scope entities.

2.2. Foreign branch profits exemption

Income and capital gains arising in a permanent establishment of an Irish company are generally subject to corporation tax in Ireland on an arising basis. Under the tax system as it currently stands, this would include the profits of foreign branches of an Irish company. As a primary taxing right would generally also apply in the foreign jurisdiction, double tax relief is available for foreign tax suffered in the source jurisdiction, up to the amount of Irish tax payable on those profits.

A branch profits exemption is an alternative method for double tax relief which provides an exemption for branch income and/or gains, to the extent chosen and subject to conditions. Foreign branch exemptions are a feature of many tax regimes globally, albeit they are not as common as foreign dividend participation exemptions.

2.3. Coffey report and actions to date

The 2017 *Review of Ireland's Corporation Tax Code* by Seamus Coffey[3] recommended that, having regard to the additional protections and resulting complexity that were due to be introduced through transposition of the Anti-Tax Avoidance Directives, it would be timely to consider the introduction of a participation exemption for foreign dividends and/or an exemption for foreign branch profits to the Irish tax code.

The years immediately following the Coffey report have seen an unprecedented pace of change in corporate tax systems globally, further complicated by the scale of responses required to the COVID-19 pandemic. However, in late 2021, as a clearer view emerged of the future direction of corporate tax reforms arising from the OECD Two Pillar Agreement, work began to advance on the policy of participation exemptions.

Informed by a consultation that closed in 2022, the September 2023 Roadmap confirmed the intention to introduce a participation exemption for foreign dividends in Finance Act 2024. While policy consideration of the merits of a foreign branch exemption are not yet as fully developed, the Roadmap also confirmed a commitment to more detailed consideration of these proposals in 2024. This process is ongoing, and further engagement with stakeholders on this issue is expected in 2024.

[3] https://www.gov.ie/pdf/?file=https://assets.gov.ie/7255/b275ad7f0874433b9d6d0c54c8f84764.pdf%23page=null

3. Responses to Roadmap consultation – dividend exemption

The Roadmap for the introduction of a participation exemption to the Irish corporation tax system, published in September 2023, also contained a number of detailed consultation questions. Seventeen submissions were received in response to the consultation.

This section contains a high-level overview of some of the key themes arising in stakeholder responses to the questions relevant to a participation exemption for foreign dividends. The responses are available to read in full on the Department's website.[4]

It is to be noted that these are the views of stakeholders and are provided here for the purpose of informing further discussion, they should not be interpreted as being the views of the Department.

General features

- In the submissions received, there was unanimous support for the inclusion of territorial elements into the Irish corporation tax system. However, notwithstanding this fact, most responses also advocated for varying levels of optionality, to allow a taxpayer to elect between a participation exemption and the existing Schedule 24 relief for foreign tax.
- The majority of stakeholders noted the complexity of the current system of double tax relief and advocated that a participation exemption should have limited conditions that can be easily understood and are reasonable to apply and administer.
- It was proposed that, to limit complexity, existing definitions within the tax code should be used where possible when designing the participation exemption.
- Stakeholders advocated for a regime with no geographic restriction as to the location of dividends and no trading requirement in respect of the profits that are the subject of the dividends received.
- The majority of respondents favoured an exemption approach, but some were in favour of a deduction approach, and all favoured relief in respect of the full quantum of qualifying dividends.

[4] https://www.gov.ie/en/publication/3698b-responses-to-the-public-consultation-on-the-introduction-of-a-participation-exemptions-to-the-irish-corporation-tax-system/

Type of dividend/distribution and shares

- Respondents advocated for a broad definition of dividends / distributions to be in scope of the exemption.
- It was proposed that minimum shareholding requirements could draw on existing provisions in legislation, such as section 626B which requires a 5% minimum ownership. Some stakeholders advocated that there should be no minimum holding requirement.

Anti-Avoidance

- Stakeholders were asked about specific anti-avoidance provisions to be incorporated with the participation exemption. The example most commonly considered by respondents was a provision that would deny the exemption for foreign dividends where a deduction for the dividend is claimed in the payor's jurisdiction.
- The majority of respondents also noted that other specific anti-avoidance measures that will have relevance for a participation exemption are already in place, for example ATAD anti-hybrid rules and Ireland's general anti-avoidance rule (GAAR).

Administration

In response to questions about a potential need for transitional arrangements, stakeholders noted that an optional regime would limit the need for such provisions, but that specific provision would be required in respect of unused foreign tax credit carried forward.

Consequential

The responses noted a number of potential consequential impacts which will require consideration as work progresses on the participation exemption for dividends. These include:

- Interest deductibility on borrowings used to acquire foreign shareholdings, the dividends of which may be in scope of exemption.
- Coherence with existing rules for Franked Investment Income and Portfolio Investors.
- The treatment of in-scope dividends for the purposes of the close company surcharge.
- Potential impact on the calculation of undistributed income under CFC rules.
- Respondents also noted that a review and simplification of Schedule 24 double tax relief provisions should still be considered, as it will continue to be of relevance for dividends not within scope of the exemption.

4. Interpreting and Responding to this Strawman Proposal

4.1. Structure of Feedback Statement

This Feedback Statement contains a Strawman proposal which sets out a potential approach to the key initial building blocks of a participation exemption for foreign dividends in Ireland. Readers should not take the key features as definitive. Instead, the intent is to help interested parties to conceptualise plausible approaches to a participation exemption and to facilitate a focused debate around key design issues.

Depending on feedback received and further analysis to be completed, the final design of the participation exemption may closely resemble the Strawman approach or may deviate significantly from it.

In developing this Strawman proposal, the Department has considered responses we have received to the 2021 and 2022 consultations from taxpayers and representative bodies; together with research on participation exemptions in other jurisdictions and inputs from Revenue. A number of general principles which informed the construction of the Strawman proposal are set out in Section 5.

The Strawman proposal does not purport to be a full realisation of a participation exemption for foreign dividends. Rather, it sets out approaches to key building blocks and, once policy decisions have been made on these elements, work can commence on the finer details required to fully realise a complete exemption system. Further stakeholder consultation will take place later in the year as this process continues.

4.2. Consultation Period

The consultation period will run to close of business on **Wednesday 8 May** and any queries or requests for clarification can be directed to businesstaxpolicy@finance.gov.ie in advance of the consultation deadline. Any submissions received after the deadline may not be considered and early engagement is encouraged.

Work will be continuing on development of the participation exemption during the consultation period, therefore early responses are encouraged where possible.

4.3. How to Respond

The preferred means of response is by email to **businesstaxpolicy@finance.gov.ie**. Receipt of e-mail submissions will be acknowledged within 2 working days. If you do not receive an acknowledgement, please contact the Department to confirm receipt of your submission.

If it is not possible to reply by email, or if you wish to make a submission both electronically and in hard copy, submissions may also be sent by post to:

Participation Exemption Feedback Statement
Tax Division – Business Tax Policy
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2, D02 R583

Please include contact details if you are responding by post. Please also indicate whether you are contributing to the consultation process as a professional adviser, business, representative body or member of the public.

4.4. Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Act 2014. Parties should also note that responses to the consultation may be published on the Department of Finance's website.

4.5. Next Steps

The Department of Finance will carefully consider the responses to this Feedback Statement and may invite key stakeholders to meet with them and with Revenue officials, by video conference or in person as appropriate.

It is planned that a second Feedback Statement will be published in mid-2024, to contain draft approaches to the legislation required to introduce a participation exemption for foreign dividends in Finance Bill 2024.

5. The Strawman Proposal

The proposed participation exemption will provide an exemption from corporation tax in respect of qualifying dividends from foreign subsidiaries. It is again noted that the purpose of this Strawman proposal is to set out in some detail how a participation exemption for foreign dividends might work in Ireland, in order to facilitate detailed stakeholder engagement on the overall design. It is one possible approach to the design of an exemption, and should not be relied upon as an indication of the final measure to be introduced in Finance Bill 2024.

In responding to this proposal, it is important that stakeholders consider how individual proposals for change would sit within the overall operation of the system. In this context, stakeholders should be aware that the following inputs and general principles were considered in developing this Strawman Proposal:

- The views of stakeholders, as submitted in response to consultation papers;
- The need to ensure a robust tax regime and to respect international best practices;
- The objective of simplification, including considerations of the ease of administration for taxpayers and Revenue and an objective to use, where appropriate, existing definitions and concepts already present in the tax system; and
- To build on the long-established principles for double tax relief as contained in Schedule 24 TCA 1997.

5.1. Scope of Relief

Strawman Proposal

- Relief will be provided in the form of an exemption from corporation tax. Where qualifying criteria are satisfied, 100% of the dividend will be in scope.
- Entities in scope – the regime will apply to companies within the charge to Irish corporation tax. This includes Irish resident companies and certain non-resident companies carrying on a trade in the State through a branch or agency.
- Qualification for the regime – companies will have flexibility to opt in to the participation exemption regime, with an election to apply for a minimum period of 3 years. The election would apply in respect of all potentially in-scope foreign dividends received by the company during the period in which it is elected in to the exemption.
- Geographic scope – dividends received from companies that are resident for tax purposes in the EU/EEA or jurisdictions with which Ireland has a double taxation agreement will qualify.
- Profits in scope – qualification will not be restricted to dividends derived from trading profits.
- Where the exemption is availed of, a tax credit will not be available in respect of foreign tax paid on the foreign dividend.

Considerations relevant to Strawman approach:

A participation exemption for foreign dividends should allow for a significant administrative simplification for companies, as compared to the current system of double tax relief under Schedule 24. Schedule 24, while complex, allows for the offset of foreign tax paid on foreign dividends received, up to the amount of Irish tax payable thereon. There is no geographic restriction on the source of dividends, however the "tax and credit" nature of the relief provides a protection against double non-taxation.

Notwithstanding the complexity of Schedule 24, it is an effective form of double tax relief that is familiar to many taxpayers, and it is accepted that some taxpayers may wish to continue to use this form of relief. For this reason, a potential approach would be for Schedule 24 to remain the default mechanism for relief, but for taxpayers to have the option to elect in to a participation exemption for a minimum period of e.g. 3 years.

Given the over-arching objective of simplification for both taxpayers and Revenue, and the requirement to ensure a robust regime, the Strawman proposal would see the election option operating at the level of the Irish taxable entity – e.g. a company could elect in to the participation exemption regime and, for the period of the election, all in-scope foreign dividends received by that company would be subject to the participation exemption.

A further consideration is the location and nature of profits in respect of which dividends are received. Schedule 24 operates in respect of worldwide dividends received, however by its nature it provides relief in respect of profits that have been subject to tax in another jurisdiction. The Strawman proposal provides one potential approach to protecting against the use of the regime for double non-taxation, i.e. by limiting the relief to dividends received from EU/EEA or treaty-partner jurisdictions only.

It is noted that, as Ireland has fully implemented the EU Minimum Tax Directive giving effect to the OECD Pillar Two 15% minimum effective tax rate, the profits of global subsidiaries of in-scope Irish companies will be subject to Pillar Two top-up tax in either the local jurisdiction or via another group company. In broad terms, Pillar Two applies in respect of corporate groups with a global turnover of at least €750 million per annum.

5.2. Dividends/distributions in scope

Strawman Proposal

- The exemption will apply to foreign dividends and other types of distributions that represent income from shares or from other rights, not being debt claims, to participate in a company's profits. This includes income from other corporate rights which is subjected to the same tax treatment as income from shares by the laws of the State of which the company making the distribution is resident.

- In broad terms, relief will apply to distributions in the nature of income, such that "capital distributions" within the meaning of section 583 TCA 1997 would not qualify (e.g. a distribution in the course of dissolving or winding up a company).

- Qualification for the exemption will be established by reference to a minimum level of control over the ordinary shares of the foreign subsidiary. Where that qualification has been established, the exemption may also apply in respect of dividends received from that company on other types of shares, such as preference shares. This may require anti-avoidance provisions against artificial arrangements, similar to section 138 TCA 1997 for example.

- Companies must control at least 5% of the ordinary share capital for an un-interrupted period of twelve months up to and including the date of the dividend. Dividends in respect of newly acquired participations may also qualify provided the shares are subsequently held for a period of up to twelve months after the date of the dividend (i.e. a minimum overall holding period of twelve months).

- The 5% control test will be established by reference to up to four criteria; ownership of ordinary share capital (direct or indirect); holding of voting rights; entitlement to profits available for distribution; and entitlement to assets on a winding-up of the company.

- The availability of a participation exemption as set out above is not intended to impact existing provisions relating to portfolio investments in section 21B TCA 1997.

Considerations relevant to Strawman approach:

It will be necessary to define what types of dividends and other distributions that will potentially be in scope of the participation exemption, and the participation criteria required in respect of the relevant shareholding.

With a view to coherence with the existing tax system, it is considered preferable that definitions should, where possible, be based on existing definitions within Irish corporation tax legislation.

A key objective of the participation exemption is to simplify the mechanism for claiming double taxation relief on foreign dividends. As such, it is intended that the exemption will apply to dividends and other types of distributions that would otherwise be eligible for double taxation relief in accordance with Ireland's tax treaty network and Schedule 24 TCA 1997.

When establishing control of a company for tax purposes, it is common for the participation to be determined by factors such as ownership of ordinary share capital, voting rights and entitlement to profits and/or assets. Notwithstanding that ordinary shares are used for the purposes of determining control, it is possible that distributions may also arise in respect of other classes of shares or in other circumstances, and it may be appropriate for a participation exemption to apply in respect of such distributions.

5.3. Anti-Avoidance

Strawman Proposal

- The dividend must not be deductible for tax purposes in any other jurisdiction.
- Dividends received from a jurisdiction on the EU list of non-cooperative jurisdictions for tax purposes, as reflected in the TCA 1997 on the date of the dividend, will not qualify for relief.
- Relief will apply only in respect of the payment of a dividend where it would be reasonable to consider that the payment is made for bona fide commercial purposes and does not form part of any arrangement or scheme of which the main purpose, or one of the main purposes, is the avoidance of tax.

Considerations relevant to Strawman approach:

As is the case with all tax relief provisions, it is expected that anti-avoidance provisions will supplement the operation of a robust participation exemption regime.

The participation exemption aims to relieve economic double taxation resulting from cross-border distributions of profit, but it should not facilitate double non-taxation of those distributed profits.

The exemption will operate within Ireland's existing anti-avoidance framework and anti-base erosion profit shifting (BEPS) measures. A number of provisions exist in the tax code to ensure reliefs are used as intended and that transactions are undertaken for genuine business reasons. Some of these existing provisions may need to be amended, or supplementary provisions introduced, to ensure coherence with a participation exemption regime.

5.4. Administration

Strawman Proposal

- Relief will be available in respect of dividends received in accounting periods commencing on or after 1 January 2025.
- The election to avail of the participation exemption will be made via the Form CT1 corporation tax return and will apply for a minimum period of 3 years in respect of all qualifying dividends received by the company. An election cannot be revoked once made.
- Companies will be required to report foreign dividends subject to exemption as part of the CT1 return.
- The existing Schedule 24 provisions will continue to operate as normal for distributions not in scope of the exemption.
- A company that elects in to the participation exemption may have an amount of unrelieved foreign tax credit carrying forward at the time of the election. This credit would remain available for offset under Schedule 24 provisions against distributions not in scope of the exemption, or for use in future years if the company ceases to elect in to the participation exemption regime.

Considerations relevant to Strawman approach:

The potential need for transitional provisions must be considered on the introduction of any new measure to the tax code. Where the participation exemption operates through the method of election in to the regime, this may limit the extent of transitional provisions required. However, it would at a minimum be necessary to provide rules for the use of any balance of unrelieved foreign tax credit carrying forward at the time of election into the regime.

With regard to administration, and noting that double tax relief may still be claimed in some circumstances, it will be necessary that a company can demonstrate that double tax relief is not inadvertently claimed for foreign tax arising in respect of a dividend qualifying for the participation exemption.

Finally, a number of provisions within the TCA 1997 may be impacted by the introduction of a participation exemption for foreign dividends. As such, consequential legislative amendments may be required to ensure their continued operation in conjunction with the new exemption.

5.5. Points to consider in responding to Strawman proposal

The views of stakeholders are invited in respect of the Strawman proposal outlined above.

Where stakeholders propose that an alternative approach be taken, the proposal should take into account the general principles for the overall approach to the design of the regime as a whole, as set out at the beginning of Section 5, in addition to the specific considerations discussed under each heading above.

Where making reference to features of a participation exemption regime in another jurisdiction, respondents are requested to indicate if the relevant feature is distinct to that jurisdiction or also seen more widely across multiple jurisdictions.

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