Roadmap to the Introduction of a Participation Exemption

December 2023

Contents

Introduction 4

Part I – Dividend participation exemption 8

Part II – Foreign branch exemption 28

Introduction

Ireland should introduce both a participation exemption for foreign dividends and a foreign branch exemption. The exemptions should be offered on an elective basis, at the option of the taxpayer

At present, Ireland is the only EU Member State and one of only four OECD countries[1] without a participation exemption for foreign dividends. In addition, many of our international peers have already introduced an exemption for foreign branch profits.

While Ireland's 12.5% rate of corporation tax remains an attractive feature for many investors, it will be less important for some, who currently contribute a proportionally higher amount of tax revenues to the Exchequer. Therefore, other parts of the corporation tax system must be enhanced.

As multinational enterprises review their international operations in light of the global implementation of the Pillar Two GloBE Rules, we strongly believe that now is the time to introduce both exemptions. We welcome the Minister signalling in the Roadmap[2] that the dividend exemption will be introduced from 1 January 2025. For multinational groups considering what restructuring they may need to do on foot of the Pillar Two Rules, this clear signposting will be helpful when clarifying the potential benefits of establishing or retaining Irish entities in their structure.

It is important that every effort is taken to streamline and simplify the Irish corporation tax system to maintain Ireland's attractiveness and competitiveness as a location of choice for global businesses.

Currently, Ireland taxes Irish resident companies on a worldwide basis, with credit given for underlying foreign taxes. The requirement for companies with international subsidiaries or operations to navigate the very complex foreign tax credit rules is burdensome and results in little by way of tax yield for Ireland. In fact, the associated complexity has disincentivised many multinational groups from choosing Ireland as an international headquarters location.

The Irish corporation tax regime has undergone significant change in recent years, mainly arising from the transposition of the EU Anti-Tax Avoidance Directive (EU ATAD). The implementation of the Pillar Two GloBE Rules[3] will further reshape the tax landscape for the world's largest businesses. It is therefore opportune to introduce a participation exemption for foreign dividends and a foreign branch exemption.

We also believe that it would be opportune to review the eligibility criteria for the existing capital gains tax substantial shareholding exemption. Unfortunately, the existing regime is not as competitive as the regimes on offer in the UK and a number of key EU countries. The introduction of a participation exemption for foreign dividends presents an excellent opportunity to upgrade the capital gains tax substantial shareholding exemption.

[1] Chile, Korea, and Mexico (Tax Foundation (2021): [Appendix-Anti-Base-Erosion-Provisions-and-Territorial-Tax-Systems-in-OECD-Countries.pdf (taxfoundation.org)]

[2] Roadmap for the Introduction of a Participation Exemption to Irish Corporation Tax
[3] Introduced by Finance (No.2) Act 2023

Foreign dividend participation exemption

We recommend that an exemption for foreign dividends be introduced. It should take the form of a deduction for the full amount of the foreign dividend.

Our recommendations on the design of the eligibility criteria for the foreign dividend participation exemption are set out below:

5% ownership – the ownership test should be by reference to ownership of ordinary share capital and entitlement to participate in profits and assets available on a winding up of the company.

Minimum holding period – any holding period requirement should be aligned with the existing holding period requirement in the substantial shareholding exemption. The foreign dividend participation exemption should apply from the date of acquisition, provided the shares are ultimately held for the minimum holding period.

Qualifying jurisdictions – the exemption should apply to dividends and distributions made by:

- Companies within the scope of GloBE should be eligible for the participation exemption, regardless of the location of the payor company.
- Companies outside the scope of GloBE should be eligible for the participation exemption where the payor is located in a jurisdiction which is not included on the EU list of non-cooperative jurisdictions for tax purposes.

Classes of shares – the participation exemption should apply to dividends and distributions made on all classes of shares, once the 5% ownership requirement is satisfied with respect to ordinary shares.

Distributions on shares – the participation exemption should apply to all types of dividends and distributions (income and capital) made by a company, and not be confined to dividends.

No trading test requirement – the participation exemption should apply to all dividends and distributions, whether made out of trading or non-trading profits.

An elective regime – the participation exemption should apply automatically where the relevant conditions are satisfied. However, taxpayers should retain the right to elect not to apply the exemption to specified dividends and distributions.

It will be important that the foreign tax credit system is retained as a backstop for companies that elect not to avail of the exemption. However, simplification of the foreign tax credit provisions in Schedule 24, TCA 1997 is required, in conjunction with the introduction of the participation exemption for foreign dividends.

Interaction with other tax provisions

- Portfolio dividend exemption (Section 21B, TCA 1997) – the exemption for portfolio dividends should be retained in its current form.
- Franked investment income (Section 129, TCA 1997) – the exemption for franked investment income (FII) should be retained in its current form.
- Interest deduction rules – in line with international norms, no further restrictions to the deductibility of interest and financing costs should be introduced, on foot of the introduction of a participation exemption for foreign dividends.
- Anti-hybrid rules – Ireland's anti-hybrid rules are sufficiently comprehensive to accommodate a foreign dividend participation exemption and should not be amended.
- CFC rules – an amendment to Ireland's CFC rules would be required to ensure compliance with EU law.
- Schedule 24, TCA 1997 – the existing double tax credit regime under Schedule 24, TCA 1997 should be simplified. The foreign tax credit regime will continue to be important for taxpayers who elect out of the dividend exemption as well as taxpayers in receipt of royalties, interest, lease rental income, gains etc.
- Section 138, TCA 1997 – this provision was introduced to remove certain tax advantages attaching to certain artificial preference share arrangements. As the provision is now redundant, it should be removed.

- Section 129A, TCA 1997 – this provision will become obsolete on the introduction of the foreign dividend exemption. It should either be deleted or amended to exclude dividends paid out of foreign profits which would have qualified for the foreign dividend exemption had the company not ceased to be resident outside of Ireland.
- Tonnage tax regime – Ireland should retain the tonnage tax regime and the current treatment of dividends paid by an "overseas company" under that regime.
- Section 110 companies – the foreign dividend participation exemption should apply to foreign dividends and distributions receivable by Section 110 companies.
- Substance requirements – in line with international norms, no specific substance requirements need to be incorporated into the foreign dividend participation exemption rules.

Foreign branch exemption

Our recommendations on the design of the eligibility criteria for the foreign branch exemption are set out below:

Qualifying jurisdictions – the exemption should apply to foreign branches as set out below:

- Companies within the scope of GloBE should be eligible for the foreign branch exemption for all foreign branches, regardless of their location.
- For companies outside the scope of GloBE, they should be eligible for the foreign branch exemption where the branch is located in a jurisdiction which is not included on the EU list of non-cooperative jurisdictions for tax purposes.

Trading test – the exemption should only be available for branches carrying on a trade.

Taxable presence – the foreign branch should be required to have a taxable presence in the jurisdiction in which it is located.

Income and gains – the foreign branch exemption should apply to both trading profits and capital gains arising on assets held or used for the branch trade.

Cessation and post-cessation receipts – the foreign branch exemption should apply to profits arising on a disposal or closure of the branch, including post-cessation branch trading receipts.

No foreign tax relief – no double tax relief should be available for foreign taxes paid on exempt foreign branch profits.

An elective regime – the foreign branch exemption should apply automatically where the relevant conditions are satisfied. However, taxpayers should retain the right to elect not to apply the exemption on a branch-by-branch basis.

It will be important that the foreign tax credit system is retained as a backstop for companies that elect not to avail of the exemption. However, simplification of the foreign tax credit provisions in Schedule 24, TCA 1997 is required, in conjunction with the introduction of the foreign branch exemption.

Losses – in circumstances where the losses of a foreign branch have been relieved against other profits for Irish tax purposes, the foreign branch exemption should not be available for that branch until such time as that branch has generated taxable profits at least equal to the losses so relied.

Transparent entities – it should be made clear in the law or guidance that a corporate participant in a tax transparent entity, may avail of the branch exemption on their share of any foreign branch profits arising to the tax transparent entity.

Interaction with other Irish provisions

- CFC charge – the CFC rules would need to be amended to bring foreign branches availing of the exemption within scope of the rules.
- Exit tax – the exit tax rules should be amended to capture a transfer of assets between head office and branch where Ireland ceases to have any taxing rights over the transferred asset.
- Schedule 24, TCA 1997 – the existing double tax credit regime should be simplified. The foreign tax credit regime will continue to be important for taxpayers who elect out of the branch

exemption as well as taxpayers in receipt of royalties, interest, lease rental income, gains etc.

- Double tax treaties – the introduction of a foreign branch exemption should not necessitate a renegotiation of any of Ireland's tax treaties, it can be introduced by means of changes in domestic legislation alone.
- Transfer pricing – Irish transfer pricing rules should apply to the transactions of a foreign branch.
- Capital allowances – it will be necessary to amend the relevant capital allowances provisions to ensure that transfers of assets by an Irish head office (or another Irish company) to an exempt foreign branch gives rise to a balancing event.
- Asset transfers to an exempt branch – it will be important that asset transfers by an exempt foreign branch (i.e., where the foreign branch exemption is availed of) to the Irish head office (or another Irish company) are treated as an acquisition for Irish corporation tax purposes.

Part I – Dividend participation exemption

Structural Considerations

Consultation question

1. Would the introduction of a participation exemption for dividends prompt changes to current or future corporate group structures? Please provide details of relevant considerations, including information on group structures and sectors as appropriate.

Key recommendations

Ireland should introduce a participation exemption for foreign dividends and distributions to:

- ✓ maintain its competitiveness as a location of choice for both Irish domestic enterprises seeking to expand internationally and international groups seeking a base in the EU
- ✓ reduce the compliance and administrative burden on multinational enterprises
- ✓ ensure certainty for businesses on the amount of Irish tax payable on repatriated profits

Simplification of the Irish corporation tax system is necessary to maintain Ireland's attractiveness as a location of choice for both Irish domestic enterprises seeking to expand internationally and for foreign direct investment seeking a base in the European Union.

At present, Ireland is the only EU Member State and one of only four OECD countries[4] without a participation exemption for foreign dividends. Currently, Ireland taxes Irish resident companies on a worldwide basis, with credit given for underlying foreign taxes. The requirement for companies with international subsidiaries or operations to navigate the very complex foreign tax credit rules is burdensome and results in little by way of tax yield for Ireland.

The introduction of a participation exemption for foreign dividends would reduce the compliance burden for Irish companies with foreign operations. This would also provide a greater incentive for multinationals to centralise international operations under an Irish (regional) headquarter company and choose Ireland as a global hub for other operations, for example R&D activities.

[4] Chile, Korea, and Mexico (Tax Foundation (2021): Appendix-Anti-Base-Erosion-Provisions-and-Territorial-Tax-Systems-in-OECD-Countries.pdf (taxfoundation.org)

Design Features

Consultation questions

2. Are there design features in other jurisdictions that operate a dividend participation exemption regime that should or should not feature in the design of an Irish regime? Please provide details.
3. Are there design features in other reliefs provided for in the Taxes Consolidation Act, 1997 that should or should not feature in the design of an Irish participation exemption? Please provide details.

Key recommendations

- ✓ Ireland should align the minimum shareholding and holding period requirements for the dividend exemption to those conditions that apply under section 626B, TCA 1997. This includes the attribution of group shareholdings
- ✓ The dividend exemption should apply automatically, with companies having the option to opt-out of the exemption by indicating on their annual tax return

As noted in the introduction, most EU countries already have participation exemptions in place for foreign dividends. Many of those countries also have an exemption for capital gains arising on participations in companies. For those EU countries that have participation exemptions in place for both foreign dividends and capital gains, the qualifying conditions tend to be aligned, particularly, the minimum shareholding and holding period requirements[5].

We recommend that the qualifying conditions for the foreign dividend exemption should be aligned with those applied under Section 626B, TCA 1997, with some amendments:

- **Scope of the exemption**: The exemption should take the form of a deduction for the full amount of the foreign dividends. This would be consistent with the approach adopted by Belgium and Canada which apply their foreign dividend exemptions on a deduction basis.
- **Minimum holding period**: A 12-month holding period should be adopted, similar to that in Section 626B. The exemption should apply from the date of acquisition of the qualifying participation, provided that it is subsequently held for the requisite minimum period. We note that the minimum holding period differs across jurisdictions. Several European countries do not apply a minimum holding period requirement, for example, Germany, the Netherlands, and the UK, to avail of their equivalent exemptions.
- **Minimum shareholding requirement**: In line with Section 626B the foreign dividend participation exemption should apply to foreign dividends (and distributions) where the Irish resident company (alone or with other group members[6]) directly or indirectly holds or is entitled to at least 5% of the ordinary share capital, profits and assets available on a winding up of the payor company.
- **Trading requirement:** We do not consider that a trading test should need to be satisfied in order to be eligible for the exemption.
- **Shares deriving value from land or similar rights**: There is no need to apply a different treatment to dividends or distributions paid in respect of shares that derive their value from land, mineral rights or similar interest. In this regard, we consider that such a restriction should not be included in the foreign dividend exemption.
- **Election basis:** The exemption should apply automatically where the relevant conditions are satisfied. However, the taxpayer should have the option to opt-out of applying the exemption

[5] See France, Germany, Luxembourg, the Netherlands, Portugal, Spain, and Sweden.
[6] See group ownership provisions in Section 626B, TCA 1997

by indicating so in its annual tax return. This is similar to the approach under Section 21B, TCA 1997.

Further information on the qualifying conditions is outlined below.

Consultation question

4. How can complexity be reduced in the design of a participation exemption, while also ensuring the objectives of the regime are achieved and eliminating opportunity for aggressive tax planning?

Key recommendation

✓ Ireland should align the minimum shareholding and holding period requirements for the dividend exemption to the conditions under section 626B

Ease of administration will be critical to the design of an effective participation exemption. Companies are already struggling to deal with the complexity that has resulted from the pace of change to the corporate tax landscape as a result of ATAD, BEPS and the plethora of other changes that have been made over recent years.

We believe that complexity would be minimised by aligning the design of the foreign dividend participation exemption with Section 626B, which makes provision for the substantial shareholding exemption. Those rules are already well understood by companies. Some modifications would be required:

- to broaden the definition of a “relevant territory” for the purposes of subsection (2)(b), as recommended in our response to Question 6,
- to disapply the trading requirement in subsection (2)(c), and
- to disapply the specified asset restriction contained in subsection 3(d).

We believe that no additional anti-abuse provisions are required. There are comprehensive anti-abuse provisions already in place (including Section 811C, TCA 1997).

Qualifying jurisdictions

Consultation questions

5. What are your views on the potential scope of jurisdictions that should be eligible for an Irish participation exemption?
6. Should Ireland seek to align with international norms and, if so, what other country or countries should Ireland seek to align with in terms of the list of specified jurisdictions that qualify for a participation exemption?
7. Should the scope of qualifying jurisdictions for a participation exemption align with the scope of existing Irish reliefs relating to foreign subsidiaries, such as relief under section 21B or the section 626B participation exemption for gains?

Key recommendations

The list of qualifying jurisdictions should be wider than the European Economic Area (EEA) and treaty countries:

- ✓ For companies within scope of GloBE / EU Minimum Taxation Directive, there should be no restriction with respect to the location of the payor company
- ✓ For companies not within scope of GloBE / EU Minimum Taxation Directive, if a restriction is required, it should be limited to jurisdictions on the EU list of non-cooperative jurisdictions for tax purposes

Ireland's new foreign dividend exemption needs to be best in class. A number of key competitor EU countries, and the UK, designed their participation exemptions for foreign dividends to be broad in scope. For example, the Netherlands[7] does not restrict the availability of their exemptions by reference to the location of the payor company. Where other EU countries apply a jurisdictional restriction, they generally limit it to jurisdictions on the EU list non-cooperative jurisdictions for tax purposes or a similar list.

We recommend that the scope of the jurisdictions which would qualify for the participation exemption is broader than the jurisdictions currently provided for under Section 21B[8] or Section 626B[9].

For companies within scope of GloBE / EU Minimum Taxation Directive, we recommend that:

- No restriction should apply with respect to the location of the company paying the dividend as under the Pillar Two GloBE Rules as applied within the EU all profits, irrespective of location, is being taxed at a minimum rate.

For companies not within scope of GloBE / EU Minimum Taxation Directive, we recommend that:

- The exemption should apply to dividends paid by companies located in all jurisdictions. If a restriction is required, this should be limited to companies located in jurisdictions included on the EU list of non-cooperative jurisdictions for tax purposes. However, where the dividend is paid by a company located in a jurisdiction included on the EU list of non-cooperative jurisdictions for tax purposes, the exemption should nevertheless apply where the paying company has substantial level of economic substance in that jurisdiction. This will ensure that the Irish foreign dividend exemption is considered efficient and attractive when compared to similar exemptions in place in other countries.

As some countries do not have a concept of tax residence, the 'location' of the payor company should be determined by reference to where the company is tax resident, incorporated or managed and controlled. Instead, these countries levy corporate tax on companies by reason of domicile, place of management, incorporation or any other criterion of a similar nature.

Provision should be made to allow a dividend to be traced through any number of intermediate companies to determine whether it has been paid by a company located for tax purposes in a qualifying jurisdiction.

[7] The UK only applies a restriction on the location of the payor with respect to dividends received by a small or micro company as defined in the Annex to EU recommendation 2003/361

[8] "Relevant territory" is defined as an EU Member State, a country with which Ireland has a double tax treaty in force, a country with which Ireland has signed a double tax treaty which has yet to come into force or a country which has ratified the Convention on Mutual Assistance in Tax Matter

[9] "Relevant territory" means a Member State of the EU, a territory with which Ireland has a double tax treaty in force or a territory with which Ireland has signed a double tax treaty which has yet to come into force.

We also recommend that the definition of a "relevant territory" applied for the purposes of substantial shareholding exemption in Section 626B be amended to align with the above for capital gains tax purposes

Method of relief

Consultation questions

8. A participation exemption could operate as an exemption, in that the income is excluded from the charge to tax, or alternatively the income could be included in scope but with a deduction in arriving at taxable income. In your view, are there any advantages and/or disadvantages for one method of relief over the other? Are there other methods of relief that should be considered?
9. In your view, should an Irish dividend participation exemption provide a full or partial exemption? Please provide reasons for your answer.

Key recommendation

✓ The Irish foreign dividend exemption should apply on a deduction basis on the full amount of dividends received

Exemption or deduction

Our preference is that the exemption would operate on a deduction basis on the full amount of the dividend and distribution income. The income would be included, but with a deduction in arriving at taxable income. This method would be more compatible (than the exemption method) with the tax requirements in other countries. For example, the deduction method may be preferred by a shareholder in the Irish company that wishes to demonstrate that the dividends were "subject to tax", or who falls within the scope of a controlled foreign company (CFC) regime.

Belgium and Canada apply their foreign dividend exemption on a deduction basis.

Full or partial relief

The Irish foreign dividend exemption should apply to the full amount of the foreign dividend or distribution that it is entitled to. This approach would align with that followed by most other EU Member States. A partial exemption would leave Irish companies at a competitive disadvantage to companies located in most other EU countries that have participation exemptions in place.

Type of dividend / distribution and shares

Consultation questions

10. What should the scope of a participation exemption be in terms of the type of dividend or other distributions that may qualify? What are the specific types of distributions that you envisage should or should not be eligible for exemption?
11. Should a participation exemption apply to both income and capital distributions and, if so, how should a capital distribution be defined?
12. Is there a rationale for extending a participation exemption to other classes of shares beyond distributions in respect of ordinary share capital?
13. Should a dividend exemption only apply in respect of shares which, if disposed of, would qualify for the section 626B participation exemption? Please provide details in support of your response.

Key recommendations

- ✓ The foreign dividend participation exemption should apply to all types of dividends and distributions in respect of all share types, including preference shares
- ✓ Modifications to Section 626B would be required, if the foreign dividend exemption is to be designed to apply only in respect of shares which, if disposed of, would qualify for the Section 626B substantial shareholding exemption

With regard to the scope of the exemption as it relates to the type of dividend / distribution, we recommend the following:

- **Distribution on shares** – the foreign dividend exemption should apply to all types of dividends and distributions including distributions out of income profits and capital gains, to the extent that they are categorised as income of the recipient for Irish tax purposes. The exemption should apply to deemed distributions, distributions in specie, and capital distributions[10], to the extent that they are categorised as income of the recipient for Irish tax purposes.
- **Types of shares** – once the shareholder company meets the basic ownership requirement for the participation exemption to apply, the foreign dividend exemption should apply to distributions and dividends on all classes of shares held by the shareholder, including preference shares. This would align with the approach already followed in relation to the substantial shareholding exemption.

  It would be reasonable to provide that the exemption will not apply where the payor is entitled to a tax deduction for the dividend or distribution. This is aligned with the anti-hybrid rules adopted under the EU ATAD.
- **Section 626B** – it would be reasonable to apply the ownership requirements for the purposes of the foreign dividend exemption. However, as set out in our response to Question 4, there are other aspects of Section 626B which we believe would need to be modified before it could be applied for the purposes of the foreign dividend exemption. In particular, it would be necessary to:
  - broaden the definition of a "relevant territory" for the purposes of subsection (2)(b), as recommended in our response to Question 5,
  - disapply the trading requirement in subsection (2)(c), and
  - disapply the specified asset restriction contained in subsection 3(d).

Minimum shareholding and holding requirements

Consultation questions

14. What are your views on the application of a minimum holding period in respect of participations qualifying for exemption?
15. Are there circumstances in which dividends received shortly after a share acquisition should qualify (for example if the shares are subsequently held for a pre-determined length of time)?
16. Should a participation be determined by reference to a percentage of ownership, voting rights and/or other criteria? What is the appropriate percentage of participation that should apply and why?

[10] See definition of capital distributions contained in Section 583, TCA 1997

Key recommendations

- ✓ The minimum holding period should be aligned with the holding period requirement in Section 626B
- ✓ The exemption should apply from the date of acquisition of the qualifying participation, provided that the relevant shares are ultimately held for the minimum holding period
- ✓ The ownership test should be by reference to the ordinary share capital, entitlement to profits and to assets on a winding up of the company

We recommend that the minimum participation / shareholding and holding period requirements to avail of the foreign dividend participation exemption be aligned with those in Section 626B. As those requirements in Section 626B are already well understood by companies, this approach would simplify the practical implementation of the new provision.

It will be important that the exemption applies from the date of acquisition of the qualifying participation, provided that the relevant shares are ultimately held for the minimum holding period. To do otherwise would involve unnecessary complexity. It would lead to companies either applying the existing foreign tax credit provisions or delaying the dividend payments. It is worth noting that several European countries do not apply a minimum holding period requirement, for example, Germany, the Netherlands, and the UK to avail of their equivalent exemptions.

Optionality

Consultation questions

17. Are you in favour of allowing businesses to choose whether to apply an exemption or to retain the current system of taxing foreign dividends and claiming a foreign tax credit? Please outline the key reasons in support of your answer.

18. Having regard to the above, if you are in favour, please outline your views on what basis optionality would operate.

19. What anti-avoidance measures should apply in order to deter and prevent aggressive tax planning with regards to an optional exemption regime?

20. Should a participation exemption apply automatically once qualifying criteria is met, or should a business elect to apply the exemption?

21. Should an election apply on a subsidiary by subsidiary, dividend by dividend, year to year or other basis?

22. Should an election be irrevocable once made?

    a) If not, what are the circumstances in which you would wish to opt-out of the exemption regime (and revert to the current system of taxing the income and claiming a double tax credit)?
    b) If an election were to be revocable or apply for a specific minimum time period, what is the appropriate minimum length of time that an election should apply for?

23. Are there examples of other jurisdictions, in addition to the UK, that allow optionality in relation to their participation exemption and if so, what are the key features that would or would not be suitable in Ireland?

Key recommendations

- ✓ The foreign dividend exemption should apply automatically, with the taxpayer given the option to opt-out of the exemption (i.e., elect not to apply the exemption) and apply the existing foreign tax credit system
- ✓ The election should apply on a dividend-by-dividend basis
- ✓ The election should be revocable on a yearly basis, with the company revoking the exemption in its annual corporation tax return

We recommend that the participation exemption should apply automatically where the relevant conditions are satisfied. However, taxpayers should have the right to elect not to apply the exemption to specified dividends and distributions. The election should be available on a dividend-by-dividend basis.

Enabling companies to make an election to opt out of the exemption on a dividend-by-dividend basis would provide greater flexibility. Circumstances will arise where companies may wish to opt for a specific dividend to be taxed under the existing arrangements (with a credit for foreign taxes) to better integrate with the rules that may apply in other jurisdictions (e.g., CFC rules).

It will be important that the foreign tax credit system is retained as a backstop for companies that elect not to avail of the exemption. However, simplification of the foreign tax credit provisions in Schedule 24, TCA 1997 is required, in conjunction with the introduction of the participation exemption for foreign dividends.

We believe that the existing anti-avoidance measures contained in Irish tax law, including the measures adopted under EU ATAD and the soon to be enacted Pillar Two GloBE Rules ensure that Ireland's anti-avoidance framework is sufficiently robust.

Trading requirement

Consultation questions

27. What are your views on a potential condition of exemption whereby relief only applies to certain trading companies?
28. Should a participation exemption align with trading criteria applicable in other foreign subsidiary related reliefs such as section 21B and 626B? Please elaborate.

Key recommendation

- ✓ A trading test / requirement should not be an eligibility criterion to qualify for the foreign dividend exemption

We believe that a trading test should not be included as an eligibility criterion for the participation exemption.

From a competitiveness perspective, Ireland's new foreign dividend exemption needs to be best in class. Imposition of a trading requirement would not align with that objective. Most jurisdictions that already have a participation exemption for foreign dividends in place do not apply a trading test[11]. Most countries draw no tax distinction between trading profits and other profits.

Furthermore, the imposition of a trading requirement would greatly complicate the practical operation of the exemption. Each time a dividend is received an exercise would need to be carried out to trace the ultimate source of the profits from which the dividend was paid, potentially

[11] For example, France, Germany, the Netherlands and the UK do not apply a trading requirement as part of their foreign dividend exemption.

through many layers of indirect subsidiaries in many countries. This would give rise to unnecessary complexity and negate the benefits of introducing the exemption.

Interaction with other provisions

Interest limitation

Consultation question

24. Would the potential for an increased interest expense restriction as a result of the exemption of dividend income influence your view on the desirability of a participation exemption?

Key recommendation

- ✓ We support the introduction of a foreign dividend participation exemption
- ✓ It is also imperative that a corporation tax deduction will continue to be available for investment. Furthermore, the rules should be simplified in light of the introduction of the interest limitation and anti-hybrid rules in accordance with the EU ATAD

Interest expense is a significant cost of doing business for most companies and has a significant impact on their business strategy. The cost of finance often operates as a barrier to investment. As a result, it can inhibit the ability of companies to grow and achieve international scale. This in turn can have a significant adverse impact on the creation of employment opportunities and economic prosperity. It is therefore no surprise that a core feature of most corporate income tax regimes, including the Irish corporation tax regime, is the availability of an interest deduction for borrowings used to acquire or invest in other companies.

With the introduction of the OECD Pillar Two GloBE Rules, it is critical now more than ever that Ireland does not fall behind its competitors by reducing the value of its offerings to businesses. The availability of tax relief for interest forms an important part of the coherent and successful tax policy of establishing Ireland as a location of choice for global businesses. It has also enabled the scaling of Irish businesses through international expansion.

Restricting tax relief for interest incurred on borrowing used to acquire or invest in other companies upon introduction of the foreign dividend exemption would be a significant and damaging departure from current policy in this area. Many other countries that have participation exemptions in place, including France, Luxembourg, and the UK, do not restrict the deductibility of interest incurred on debt used to fund share acquisitions. It is imperative that an Irish corporation tax deduction is maintained for borrowings used to fund investments in other companies. In fact, the applicable rules should be simplified in light of the introduction of the EU ATAD interest limitation and anti-hybrid rules.

Subject to tax rule

Consultation question

25. How should a participation exemption be designed in order to prevent double non-taxation? Are there provisions of the current Irish corporation tax system, such as Controlled Foreign Company (CFC) and anti-hybrid rules, that could be enhanced in order to support this aim?

Key recommendation

✓ We believe that Ireland's CFC and anti-hybrid rules are sufficiently comprehensive to accommodate a foreign dividend exemption

The introduction of the foreign dividend exemption should not necessitate changes to the comprehensive CFC and anti-hybrid provisions that Ireland has in place. This is on the basis that the exemption will not apply to foreign dividends received from companies falling within the scope of the EU list of non-cooperative jurisdictions, in circumstances where they are not otherwise within scope of GloBE Rules / EU Minimum Taxation Directive.

Substance in Ireland

Consultation question

26. What considerations are relevant to the design of substance requirements for a participation exemption that could be effective in promoting Ireland as a holding location for companies with economic substance in Ireland?

Key recommendation

✓ Specific substance requirements are not required. Introducing a complex restrictive regime would undermine Ireland's potential attractiveness as a preferred holding company location for global businesses

The introduction of specific substance rules for an Irish resident holding company seeking to avail of the foreign dividend participation exemption would conflict with the approach followed by most other countries that have made provision for such an exemption. Introducing a complex and restrictive regime would undermine Ireland's potential attractiveness as a preferred holding company location for global businesses.

If substance requirements are introduced, this should be done separately as part of a coordinated approach with other EU Member States.

Transitional arrangements

Consultation questions

29. Should there be a lead-in period before a participation exemption regime is introduced? If so, what is an appropriate length of lead-in time that should apply?
30. Would you still be in favour of introducing a participation exemption if unutilised foreign tax credits were lost?
31. Are there other transitional arrangements that should be considered?

Key recommendations

- ✓ A lead-in period for the foreign dividend exemption is not required
- ✓ The participation exemption should apply to foreign dividends received on or after 1 January 2025 as outlined in the Roadmap published by the Department of Finance
- ✓ Taxpayers should have the right to elect on a dividend-by-dividend basis not to apply the exemption to specified dividends and distributions and to claim foreign tax credit relief

A lead-in period for the foreign dividend exemption is not required. The exemption should apply to foreign dividends received on or after 1 January 2025, as outlined in the Roadmap published by the Department of Finance on 13 September 2023.

As recommended in our response to questions 17 to 23, taxpayers should have the right to elect on a dividend-by-dividend basis not to apply the exemption to specified dividends and distributions. Irish companies in receipt of foreign dividends should be allowed to fully utilise foreign tax credits in circumstances where the foreign dividend exemption is not applied. However, simplification of the foreign tax credit provisions in Schedule 24 is required, in conjunction with the introduction of the participation exemption for foreign dividends.[12]

Consequential impacts

Franked investment income

Consultation questions

32. In your view, what are the main opportunities or issues in applying similar treatment to domestic and foreign dividend exemption regimes?
33. Would you be in favour of aligning the tax treatment of domestic and foreign dividend exemption regimes, if this meant additional qualifying conditions would apply to the treatment of exempt domestic dividends?

Key recommendations

- ✓ The FII exemption should be retained in its current form
- ✓ Different qualifying conditions should apply to the foreign dividend exemption and the FII exemption
- ✓ The FII exemption should apply to Irish sourced dividends paid in respect of preference shares

The FII exemption has been in place in Ireland for many years and is very broadly understood. The exemption operates in a broad manner to ensure that the profits of Irish companies are not subject to double corporate taxation. Therefore, we recommend that the breath of the FII exemption is not narrowed in line with the proposals for the foreign dividend exemption.

It is logical that the scope of the foreign dividend exemption would be more focussed than the FII exemption. The policy intention of the FII exemption is to prevent double taxation of the same profits in Ireland. However, the policy intention behind the foreign dividend exemption is more nuanced and is intended to promote Ireland as an international holding company location and alleviate unnecessary complexity in circumstances where very often no additional Irish tax would

[12] See the response to question 53.

be collected due to the availability of foreign tax credits. It is not unreasonable that the foreign dividend exemption would not apply to <5% shareholdings (subject to our comments below in relation to the portfolio exemption).

Section 138, TCA 1997 – preference dividends

Section 138 was introduced to remove certain tax advantages attaching to certain artificial preference share arrangements. As the provision is now redundant, it should be removed.

Portfolio investors

Consultation questions

34. What are the main advantages to the State and to businesses in the application of the portfolio exemption in its existing form under section 21B?
35. What are the arguments for or against retention of a portfolio exemption following the introduction of a participation exemption?
36. What would your views be on the introduction of a participation exemption if it required consequential amendments to, or removal of, the portfolio exemption?
37. What modifications or anti-avoidance provisions could be introduced to the tax treatment of portfolio investments in Ireland should a participation exemption exclude portfolio holdings?

Key recommendations

- ✓ The portfolio dividend exemption is an important feature of the regime for financial traders and should be retained in its current form
- ✓ The foreign dividend exemption should be introduced to sit alongside the portfolio dividend exemption
- ✓ The UK, our nearest competitor, operates a portfolio dividend exemption alongside a foreign dividend exemption

The scope of the portfolio dividend exemption provided for in Section 21B, TCA 1997 is limited and only applies to dividends which are taxable as trading income. The exemption is an important feature of the tax regime which enhances Ireland's competitiveness as a location for insurance companies, banking and securities traders. It greatly reduces the administrative burden for high frequency / volume share trading undertaken by such companies.

The portfolio dividend exemption should be retained in its current form and operate alongside the foreign dividend exemption. The UK, our nearest competitor, operates a portfolio dividend exemption alongside a foreign dividend exemption.

Alignment with existing Irish reliefs for foreign subsidiaries

Consultation questions

38. To what extent should criteria for a foreign dividend exemption align with criteria for other reliefs related to foreign subsidiaries, such as section 21B and section 626B reliefs?

39. Should a participation exemption for dividends align with the qualifying conditions for the participation exemption on gains under section 626B? If not, what are your views on a scenario where a participation in a subsidiary qualifies for one relief but not the other?

40. What are the features in other jurisdictions that operate participation exemptions for both dividends and gains that would or would not work well in Ireland?

Key recommendations

- ✓ The criteria for the foreign dividend exemption should be broadly aligned with Section 626B TCA 1997, subject to a number of important modifications
- ✓ The foreign dividend exemption should apply automatically where the relevant conditions are satisfied. However, taxpayers should retain the right to elect not to apply the exemption on a dividend-by-dividend basis

As outlined in our responses to questions 2 to 16 above, we recommend that the qualifying criteria for the foreign dividend exemption be aligned with Section 626B, subject to the following modifications:

- The foreign dividend exemption should apply automatically where the relevant conditions are satisfied. However, taxpayers should retain the right to elect not to apply the exemption on a dividend-by-dividend basis, by making an election in their annual corporation tax return similar to the process under Section 21B. See further detail in the responses to questions 17 to 23 above.
- The trading test / requirement in Section 626B should not be an eligibility criterion to qualify for the foreign dividend exemption. See further detail on this in our responses to questions 27 and 28 above.
- The list of qualifying jurisdictions would need to be widened. Foreign dividends and distributions received from a company falling within the scope of the GloBE Rules should be eligible for the exemption irrespective of where it is tax resident, as should dividends received from other foreign companies, provided they are not located in a jurisdiction which is included on the EU list of non-cooperative jurisdictions for tax purposes. See further detail on this in our responses to questions 5 to 7 above.
- The restriction contained in Section 626B (3)(d) relating to disposals of shares deriving their value from certain Irish specified assets (Irish real estate etc.) would not be relevant to the foreign dividend exemption.

Unnecessary complexity should be avoided in the design of the qualifying criteria for the foreign dividend exemption.

Deductibility of expenses related to exempt income

Consultation question

41. What are the considerations in support of or against allowing a deduction for expenses related to exempt foreign dividend income?

Key recommendation

✓ No changes are required

No changes are required.

Tax relief is only available for expenses related to dividend income in very limited circumstances:

- Where the dividend income is taxable as a trading receipt, but subject to the deductibility restrictions contained in Section 81, TCA 1997.
- Where the dividend income is taxable as investment income, where the expenses are deductible as expenses of management in accordance with Section 83, TCA 1997.

The deductibility rules currently in place are sufficiently restrictive. The UK, which already has a foreign dividend exemption in place, continues to operate a similar approach in relation to expenses of management.

Close company surcharge

Consultation question

42. What are the considerations in relation to applying a close company surcharge in a regime incorporating a participation exemption for foreign dividend income?

Key recommendation

✓ In view of the treatment applied to dividends paid between Irish resident close companies, we recommend that the existing exclusion in place for certain foreign dividends in Section 434 TCA 1997 be broadened to include all foreign dividends which qualify for the foreign dividend exemption (or would so qualify but for an election)

Section 434(3A), TCA 1997 provides that where an Irish resident close company pays a dividend, or makes a distribution, to another Irish resident close company, the companies may jointly elect to have the dividend disregarded for the purposes of the close company surcharge.

Section 434(1), TCA 1997 provides that a dividend or other distribution received by an Irish company from a non-resident company will not be regarded as “investment income” for the purposes of the close company surcharge, if any chargeable gain arising on a disposal of its shares in that company would be exempt from corporation tax under Section 626B at the time the dividend or distribution is being made.

In view of the treatment applied to dividends paid between Irish resident close companies, we recommend that the existing exclusion in place in Section 434 for certain foreign dividends be broadened to include all foreign dividends which qualify for the foreign dividend exemption (or would so qualify but for an election).

Specific tax regimes

Consultation questions

43. Please identify any corporation tax legislative provisions that could be affected by a change in how foreign dividends are taxed, along with consideration of the potential implications.
44. What amendments, if any, would be required to those provisions in order to ensure their continued operation in conjunction with a participation exemption?

Key recommendation

✓ Ireland should retain Section 697H and the current treatment of dividends paid by an "overseas company"

Tonnage tax regime

The tonnage tax regime is a scheme whereby, as an alternative to charging corporation tax on certain profits of a qualifying shipping company, a tax charge is levied each year based on a notional profit that is computed as profit per day according to the net tonnage of the ships operated by the company. The scheme was introduced to encourage maritime business and allows Irish-based companies to compete with EU competitors benefiting from tonnage tax regimes in their jurisdictions. The rules are contained in Part 24A (sections 679A – 679Q) and Schedule 18B, TCA 1997.

Section 697H, TCA 1997 provides that where an overseas tonnage tax company makes a distribution to its Irish tax resident parent company and that parent company is also a qualifying company for Irish tonnage tax purposes, subject to certain conditions being satisfied at the date of the distribution, the distribution may be regarded as "relevant shipping income" for Irish tonnage tax purposes. Where Section 697H applies, the distribution would not be subject to additional corporation tax in Ireland (including the close company surcharge). We note that other EU countries, for example, Denmark and Germany have a similar provision in their domestic tonnage tax regimes, as do the UK and Norway. It is important that Section 697H is retained in its current form to allow Irish based shipping companies to remain competitive with their European counterparts.

As noted previously, Section 697H, TCA 1997 applies only where certain conditions (as specified in the legislative provisions) are satisfied by the overseas tonnage tax company at the date of the distribution. If these conditions are not satisfied at the date of the distribution, the dividend would not be regarded as "relevant shipping income" for Irish tonnage tax purposes and would instead, be regarded as foreign dividend income in the ordinary way for Irish corporation tax purposes. Therefore, we also recommend that qualifying tonnage tax companies be allowed to claim the foreign dividend exemption with respect to dividends and distributions that do not meet the criteria to be regarded as "relevant shipping income" under Section 697H.

Part 28 TCA 1997

Part 28, TCA 1997 contains provisions in relation to the tax treatment applicable to certain holdings of shares and securities. It will be necessary to clarify the non-application of these provisions where a dividend is eligible for the foreign dividend exemption.

Anti-avoidance rules

Consultation questions

45. What type of anti-avoidance provisions should be incorporated into a participation exemption in order to eliminate opportunities for tax avoidance?

46. Are there features of existing anti-avoidance provisions that could be enhanced in order to support this aim?

Key recommendation

✓ Specific anti-avoidance measures are not required as there are sufficient measures already in place as implemented under EU ATAD and Ireland's general anti-avoidance rules (GAAR)

The Irish corporation tax regime already incorporates adequate tax measures to deter the use of the participation exemption for inappropriate purposes. These include the various measures introduced to give effect to the EU ATAD rules and the general anti-avoidance rules (GAAR) contained in Section 811C, TCA 1997.

In addition, the implementation of the Pillar Two GloBE Rules will mean that profits of large MNEs are taxed at a minimum level.

Controlled Foreign Companies

Consultation question

47. Are there other legislative amendments required to CFC rules in order to ensure they are robust enough in the context of a participation exemption?

Key recommendation

✓ To ensure that the Irish CFC rules remain compliant with EU law, it will be necessary to amend Section 835Q to provide that where an Irish company avails of the foreign dividend exemption in respect of a dividend received from a CFC, the dividend will not be treated as reducing the undistributed income of the CFC for the purposes of the CFC rules

Currently, a CFC charge may arise where a CFC has undistributed income from non-genuine arrangements put in place for the essential purpose of avoiding tax, and relevant Irish activities (i.e., significant people functions (SPFs) or key entrepreneurial risk-taking functions (KERTs) in the State) are performed by an Irish resident company that controls the CFC (controlling company) or a company connected to the controlling company.

In those circumstances, the undistributed income of the CFC is reduced, for the purposes of the Irish CFC charge, by distributions made by the CFC to Irish tax resident persons and distributions made to persons tax resident in a relevant Member State[13], provided that the distribution is taxed in that Member State.

[13] "Relevant Member State" means a state, other than the State, which is a Member State of the European Union, or not being such a Member State, a state which is a contracting party to the EEA Agreement.

Currently, the CFC rules do not specifically require that the distributions made by the CFC to Irish persons be subject to tax[14], on the basis that they are in any event generally subject to tax. However, the introduction of the foreign dividend exemption will lead to a potential mismatch between the treatment of distributions made by the CFC to Irish companies and distributions made to other EU persons.

Accordingly, to ensure that the Irish CFC rules remain compliant with EU law, it will be necessary to amend Section 835Q to provide that where an Irish company avails of the foreign dividend exemption in respect of a dividend received from a CFC, the dividend will not be treated as reducing the undistributed income of the CFC for the purposes of the CFC rules[15].

Anti-hybrids / Non deductibility in payor jurisdiction rule

Consultation questions

48. What modification, if any, would be required to anti-hybrid provisions in order for Irish tax rules to remain ATAD compliant in conjunction with a participation exemption?
49. Are there specific features of anti-hybrid regimes in other jurisdictions that have a participation exemption that Ireland should adopt in addition to our existing anti-hybrid regime?

Key recommendation

✓ The introduction of the foreign dividend exemption should not require any changes to be made to Ireland's anti-hybrid rules to remain ATAD compliant

The anti-hybrid rules apply to counteract non-taxation outcomes resulting from the use of hybrid entities or instruments.

The introduction of the foreign dividend exemption should not require any changes to be made to Ireland's anti-hybrid rules to remain ATAD compliant.

Interaction with Pillar II of the OECD Inclusive Framework

Consultation question

50. Are there features of the Pillar II regime that should be considered and taken into account when designing a dividend participation exemption?

Key recommendation

✓ In line with the approach for 'Excluded Dividends' under the Pillar Two GloBE Rules, the foreign dividend exemption should not impose a trading test for the payee company

The Pillar Two Rules and the EU Minimum Taxation Directive provide that 'Excluded Dividends' are excluded in the calculation of a jurisdiction's GloBE Income.

Under both sets of rules, the term 'Excluded Dividends' is defined as meaning dividends or other distributions received or accrued in respect of an Ownership Interest, except for:

[14] This on the basis that currently, Irish tax resident companies are subject to corporation tax on foreign dividends.
[15] In accordance with Article 8(5) of the EU ATAD rules, distributions made to the controlling company are only taken into account in computing undistributed income where the distributions are included in the taxable income of the controlling company CL2016L1164EN0020010.0001.3bi_cp 1..1 (europa.eu)

a. a Short-term Portfolio Shareholding [a holding which is both less than 10% and held for less than one year], and
b. an Ownership Interest in an Investment Entity that is subject to an election under Article 7.6. [taxable distribution method – not relevant in Ireland].

There is no requirement for 'Excluded Dividends' to be paid out of trading profits. Therefore, including a trading requirement in the foreign dividend exemption would not be aligned with the Pillar Two rules.

We believe that the foreign dividend exemption should be pitched at the level of a 5%. Most other EU countries that have a foreign dividend exemption in place apply it at the level of a 5% holding, or in some cases have no minimum holding requirement. To apply a holding requirement above 5% would be uncompetitive.

Transfer pricing

Consultation question

51. Do you foresee potential impacts arising from moving to a participation exemption for Ireland's transfer pricing regime?

Key recommendation

✓ We do not foresee any impact on Ireland's transfer pricing regime arising from the introduction of a foreign dividend exemption

We do not foresee any impact on Ireland's transfer pricing regime arising from the introduction of participation exemption for foreign dividends.

Multilateral Instrument provisions

Consultation question

52. Do you foresee a need to adopt any provisions of the Multilateral Instrument in conjunction with a participation exemption?

Key recommendation

✓ We do not foresee any need to adopt any provisions of the Multilateral Instrument on the introduction of a foreign dividend exemption

The introduction of a foreign dividend exemption should not necessitate the renegotiation of any of Ireland's double taxation treaties. The foreign dividend exemption can be introduced by changing domestic law only.

We do not foresee any need to adopt any provisions of the Multilateral Instrument on the introduction of a foreign dividend exemption. Article 8 of the MLI (Dividend Transfer Transactions), which was adopted by Ireland, applies a 365-day test with respect to the application of the reduced withholding tax rates provided for in tax treaties. Where this provision is also adopted by Ireland's tax treaty partners, the reduced withholding tax rate only applies where the ownership conditions have been met throughout a 365-day period that includes the day of payment of the dividend. This holding period is aligned with our recommendation of a minimum holding period of 12 months.

Any other issues

Consultation question

53. In your view, are there any other relevant considerations that should be taken into account in the design of a participation exemption for foreign dividends, or the integration of the exemption into the existing corporation tax regime?

Key recommendations

- ✓ Ireland should overhaul its existing double tax credit regime under Schedule 24, TCA 1997, in addition to introducing a foreign dividend exemption
- ✓ Section 129A, TCA 1997 should be amended to allow dividends paid out of foreign profits to qualify for the FII exemption

Amend Section 129A, TCA 1997

The introduction of the foreign dividend exemption should lead to Section 129A, TCA 1997 becoming redundant.

Section 129A removes from the scope of the FII exemption distributions paid between Irish tax resident companies out of profits earned by the paying company while it was resident outside the State. Such distributions are subject to tax in a similar way as foreign-sourced dividends. The introduction of a foreign dividend participation exemption will make this provision obsolete. This is on the basis that the dividends would have qualified for the participation exemption had the company paid the dividend when it was not resident in the State.

We recommend the deletion of Section 129A, TCA 1997. Alternatively, the section should be amended to allow the application of the FII exemption where the qualifying conditions of the participation exemption are met.

Section 110

We see no logical reason why the foreign dividend exemption should not by applied to foreign dividends received by a qualifying Section 110 company. This should be made clear when the law is drafted. In addition, it should be confirmed in law that the FII exemption also applies to Irish source dividend income received by a qualifying Section 110 company.

Simplification of Schedule 24, TCA 1997

The double tax relief rules should be simplified by amending Schedule 24 TCA 1997 as follows:

- Rewrite the legislative measures which underpin the operation of the credit relief regime to make them easier to read and more straightforward to administer in practice.
- Permit taxpayers to designate the profits out of which a dividend is paid for foreign tax credit purposes, without a requirement for the designation to be reflected in the underlying dividend resolutions. This would greatly simplify the associated administration.
- Remove the distinction between relief under a tax treaty and unilateral relief and provide a single mechanism for double tax relief.
- The Revenue's practice in relation to the operation of paragraph 9I, Schedule 24, TCA 1997 ('para 9I') needs to be brought into line with evolving case law insights to be drawn from the UK courts[16] on the interpretation of the rules[17] which led to the introduction of paragraph 9I.

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[16] 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.
[17] Test Claimants in FII Group Litigation v Commissioners of the Inland Revenue, C-446/04.

- Simplify the operation of double tax credit relief for cases within scope of paragraph 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. The existing operation of the rules is unnecessarily complex.
- Confirm in law the entitlement to deduct excess and unused creditable foreign taxes under general tax principles.
- Simplify 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.
- The competitiveness of the regime for double tax credit relief should be enhanced by providing for:
    - the calculation of the net income measure (which operates to limit the amount of credit relief) by reference to net margins from the specific source of profits instead of by reference to the margins of the trade as a whole,
    - the offset of excess unused credits against other income of the trade, and
    - the pooling surplus tax credits for use in future periods.

Part II – Foreign branch exemption

General

Questions

Consultation questions

54. Are foreign branches currently used by Irish companies? If so, in what jurisdictions are those branches located? What are the current advantages of or reasons for using a branch structure?
55. What activity is carried out in the foreign branch structures? Responses should include, for example, sectoral information, whether activity is trading or passive, etc.
56. If foreign branch structures are not currently used, are there specific features of the Irish tax code that influence this decision? If so, please provide detailed information.
57. If an exemption for foreign branch profits were introduced, would a restructuring to use foreign branch structures be considered by existing Irish groups, and if so for what reason(s)? What substantial activities would take place in Ireland?
58. Would a foreign branch exemption be of particular relevance to any sectors? If so, please describe the sector(s) and outline the relevant considerations.

Key recommendation

✓ Branch structures are also commonly used, particularly in the financial services sector. The absence of a foreign branch exemption is a notable limitation in the Irish tax code which needs to be addressed. Going forward, the Irish tax treatment of profits arising from the conduct of foreign business through a branch should be aligned with the position where a foreign subsidiary is used (assuming that a foreign dividend participation exemption will be introduced).The introduction of a foreign branch exemption regime would present taxpayers with less barriers to the conduct of business in new markets from Ireland

Branch structures play a critical role in the Irish regulated financial services sector. They are very commonly used by financial services companies (particularly by banks and insurance companies) operating on a pan-EU basis. Once a bank or financial services firm is established and authorised in Ireland, it can apply for the right (“a passport”) to provide certain defined services throughout the EU, or to open branches in other countries across the EU, with relatively few additional authorisation requirements. Where an Irish financial services company passports its services into other EU countries, it remains “prudentially regulated” by the Irish regulator or supervisor. As a result, a branch structure is a much less costly and complex business model for the conduct of pan-EU financial services activities.

Branch structures are also commonly used by Irish companies outside the regulated financial services sector, particularly by companies expanding into a new market for the first time. Many companies entering a new market do not wish to commit resources required to establish a local subsidiary until the commercial viability of doing business in that market has been validated.

Given that many other EU countries already have a foreign branch exemption in place, the absence of an equivalent Irish exemption is a notable limitation in the Irish tax code. We are aware that it has put off certain international financial services groups from locating head-office operations in Ireland. This can have far-reaching consequences as the presence of key senior executives in Ireland has been shown to inevitably lead to an expansion of the range of activities conducted from Ireland.

The introduction of a foreign branch exemption would remove a lot of the existing complexity associated with the operation of a branch structure by an Irish company. The existence of differing local income and expense recognition rules across the EU can give rise to significant differences in the timing and measure of taxable income[18], resulting in considerable uncertainty and complexity with regard to the foreign tax credit position in Ireland. The introduction of a foreign branch exemption regime would present taxpayers with less barriers to the conduct of business in new markets from Ireland.

In our view, it would make no sense not to align the Irish tax treatment of profits arising from the conduct of foreign business through a branch with that of using a foreign subsidiary (assuming that a foreign dividend participation exemption will be introduced).

Consultation question

59. What features of tax exemptions in other jurisdictions that operate both participation and branch exemption should Ireland consider?
    Please include:
    a) the name of the relevant jurisdiction;
    b) details of the features; and
    c) why those features should be considered.

[18] 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.

Key recommendations

- ✓ Qualifying jurisdictions –
  - Companies within the scope of GloBE should be eligible for the foreign branch exemption regardless of its location
  - For companies outside the scope of GloBE, they should be eligible for the foreign branch exemption where the branch is located in a jurisdiction which is not included on the EU list of non-cooperative jurisdictions for tax purposes
- ✓ Trading test – the exemption should be available for trading branches
- ✓ Taxable presence – the branch must have a taxable presence in the branch jurisdiction
- ✓ Income and gains – the exemption should extend to branch trading profits and capital gains
- ✓ No foreign tax relief – relief for foreign taxes incurred on branch profits should not be available where the exemption applies
- ✓ Elective regime – the foreign branch exemption should apply automatically, where the conditions are met. However, companies should retain the right to elect not to apply the exemption on a branch-by-branch basis
- ✓ Losses – generally, where a company has obtained relief for trading losses incurred by a foreign branch for Irish corporation tax purposes, the foreign branch exemption should not apply to an equivalent amount of its profits
- ✓ Transparent entities – clarity should be provided that a corporate participant in a tax transparent entity can avail of the branch exemption on their share of the foreign branch profits

Based on our knowledge of the operation of foreign branch exemption in other countries, we believe that the following design features should be reflected in the Irish foreign branch exemption:

Qualifying jurisdictions

Similar to our recommendations for the foreign dividend participation exemption, the definition of qualifying jurisdictions for the foreign branch exemption should be delineated for companies within scope of GloBE and those outside the scope of GloBE.

- For companies within scope of GloBE / EU Minimum Taxation Directive, to align with the Pillar Two GloBE Rules, which will see all profits, irrespective of location, being taxed at a minimum rate, companies within scope of the GloBE rules should be eligible for the foreign branch exemption irrespective of the location of the foreign branch.
- For companies not within scope of GloBE / EU Minimum Taxation Directive, the exemption should apply to branches located in all jurisdictions. If a restriction is required, this should be limited to branches located in jurisdictions included on the EU list of non-cooperative jurisdictions for tax purposes. However, where the branch is located in a jurisdiction included on the EU list of non-cooperative jurisdictions for tax purposes, the exemption should nevertheless apply where the branch has substantial level of economic substance in that jurisdiction.

Trading test

The branch exemption should be available for a trading foreign branch only. The foreign branch exemption introduced by the UK operates on similar basis.

Taxable presence

The branch exemption would not be available unless the branch has a taxable presence in the branch jurisdiction.

Income and gains

The foreign branch exemption should apply to trading profits arising to the branch (including post cessation receipts) as well as capital gains arising on the disposal of assets held by or for the branch or upon a sale or cessation of the branch business. The foreign branch exemptions introduced by France and the UK operate on similar basis.

No foreign tax relief

Relief for foreign taxes incurred on branch profits should not be available where the exemption applies.

An elective regime

The foreign branch exemption should apply automatically where the relevant conditions are satisfied. However, taxpayers should retain the right to elect not to apply the exemption on a branch-by-branch basis.

It will be important that the foreign tax credit system is retained as a backstop for companies that elect not to avail of the exemption. However, simplification of the foreign tax credit provisions in Schedule 24, TCA 1997 is required, in conjunction with the introduction of the foreign branch exemption.

Losses

Generally, where a company has obtained relief for trading losses incurred by a foreign branch for Irish corporation tax purposes, the foreign branch exemption should not apply to an equivalent amount of its profits. The foreign branch exemptions introduced by Italy and the UK operate on similar basis.

However, in accordance with EU case law precedent[19], any ‘final’ and otherwise unused losses existing on the termination of a foreign branch should remain available for offset against Irish profits.

Transparent entities

Where an Irish tax resident company conducts a business through a transparent entity, such as a partnership, and the business gives rise to a taxable branch presence abroad, it should be confirmed in the law (or in Revenue guidance) that the corporate partner will be able to avail of the branch exemption on its share of the foreign branch profits and gain.

[19] 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.

Consultation question

60. Please outline the potential consequential considerations you envisage would be required should a foreign branch exemption be introduced, including the potential impact on:

    a) transfer-pricing provisions;
    b) anti-avoidance measures, including but not limited to ATAD/anti-BEPS measures;
    c) special tax regimes for particular sectors or structures (for example, Part 26 TCA 1997 which deals with Life Assurance Companies); and
    d) any other Irish tax code provisions.

Key recommendations

- ✓ Irish transfer pricing rules should apply to transactions of a foreign branch where it avails of the foreign branch exemption
- ✓ A foreign branch that avails of the foreign branch exemption should be brought within the scope of the CFC rules
- ✓ The Irish Exit Tax rules should be amended to ensure that a transfer of assets from a head office to its branch is within scope of the exit tax charge
- ✓ Ireland should retain the “worldwide system of taxation” provisions contained in Section 835AB, TCA 1997 with respect to the anti-hybrid rules
- ✓ The rules for double tax relief for branch profits contained in Schedule 24, TCA 1997 should be simplified
- ✓ Asset transfers by an exempt foreign branch to the Irish head office should be treated as an acquisition for Irish corporation tax purposes
- ✓ Amend the relevant capital allowances provisions to ensure that asset transfers by an Irish head office to an exempt foreign branch gives rise to a balancing event

Transfer pricing

It will be necessary to extend the application of the transfer pricing rules to intra-entity transactions involving a foreign branch, including transactions with its head office and other branches. In practice, this should not give rise to significant issues for most businesses given that:

- Article 7 (Business Profits) of the OECD Model Tax Convention provides for the attribution of profits to a permanent establishment using the arm’s length principle; and
- The BEPS - Pillar Two Rules treat branches and permanent establishments as a separate “constituent entity”. Furthermore, those rules require that transactions between constituent entities to be consistent with the arm’s length principle.

CFC rules

A CFC charge may arise where a CFC has undistributed income from non-genuine arrangements put in place for the essential purpose of avoiding tax, and relevant Irish activities (i.e., significant people functions (SPFs) or key entrepreneurial risk-taking functions (KERTs) in the State) are performed by an Irish resident company that controls the CFC (controlling company) or a company connected to the controlling company.

Where a foreign branch exemption is adopted, Section 835I, TCA 1997 will need to be amended to provide that, where the foreign branch exemption is availed of in respect of the branch, the foreign branch will fall within scope of the CFC charge. This should ensure that the Irish CFC rules are compliant with the EU ATAD[20].

Exit tax rules

Section 627, TCA 1997 imposes an exit tax charge in certain circumstances.

Currently, as Irish resident companies are taxable in Ireland on a worldwide basis, the exit charge does not arise on the transfer of an asset from the Irish head office of an Irish resident company to a foreign branch. This is because the assets remain within the Irish tax net (which is one of the scenarios provided under Article 5 of the EU ATAD rules).

In order to ensure that the Irish exit tax rules remain ATAD compliant, if Ireland introduces a foreign branch exemption, it will be necessary to extend the exit charge to transfers of assets from the Irish head office of an Irish resident company to a foreign branch, where that branch avails of the foreign branch exemption.

It will be important that the branch exemption is introduced on an elective branch-by-branch basis. Otherwise, some companies may not have the resources available to fund the exit tax that would arise. As foreign branches that do not avail of the foreign branch exemption would continue to be subject to Irish corporation tax, they should remain outside the scope of the exit charge.

Hybrid rules - double deduction rules

No changes are required to the hybrid rules contained in Part 35C of TCA 1997, including in particular, Section 835AB, TCA 1997.

Section 835AB disapplies the rules in place to prevent a double deduction mismatch, in circumstances where there is dual inclusion. The introduction of an elective foreign branch exemption should not require any changes to be made to Section 835AB. As currently drafted Section 835AB would only apply in the case of a foreign branch, where it is subject to tax in Ireland. If an election is made to avail of the foreign branch exemption, then Section 835AB would not apply in respect of it. Therefore, no change to Section 835AB is required.

Tax treaties and the BEPS Multilateral Instrument

The introduction of a foreign branch exemption should not necessitate the renegotiation of any of Ireland’s double taxation treaties.

Ireland reserved its right not to apply Article 10 of the BEPS Multilateral Instrument - ‘Anti-abuse Rule for Permanent Establishment Situated in Third Jurisdictions’. Accordingly, the introduction of a foreign branch exemption should have no MLI impact on Ireland’s tax treaties.

Other consequential amendments

- Amend Section 26 TCA 1997 – General scheme of corporation tax

  Currently Section 26, TCA 1997 provides that a company resident in the State is chargeable to corporation tax on its profits wherever arising. That provision will need to be amended to provide for an election mechanism for the claiming of the foreign branch exemption on a branch-by-branch basis.

  Section 26 will need to be amended to go on to provide that where an election is made to avail of the exemption in respect of a foreign branch, that:

  - the trading income arising directly or indirectly through or from that branch;

[20] Article 7(1) of EU Council Directive (EU) 2016/1164 of 12 July 2016, as amended, provides that the CFC rules apply to Permanent Establishments CL2016L1164EN0020010.0001.3bi_cp 1..1 (europa.eu)

- any other income arising from property or rights used by or held by or for that branch; and
- any chargeable gains attributable to that branch

are exempt from corporation tax.

- Asset transfers between an Irish company and an exempt foreign branch

  Where an asset is transferred by an exempt foreign branch (i.e., where the foreign branch exemption is availed of) to the Irish head office (or another Irish company), the transfer should be treated as an acquisition for Irish corporation tax purposes.

  In addition, it will be necessary to amend the relevant capital allowances provisions to ensure that transfers of assets by an Irish head office (or another Irish company) to an exempt foreign branch gives rise to a balancing event.

- Simplification of the double tax credit relief for foreign branch profits

  The double tax relief for foreign branch profits contained in Schedule 24, TCA 1997 should be amended as follows:

  Excess foreign tax – in the case of a taxable foreign branch (i.e., where an election to apply the exemption is not made in respect of the branch), a corporation tax deduction should be available for foreign corporate income tax paid on branch profits to the extent that it exceeds the capacity of the company to claim credit relief (e.g., because of losses in the Irish company as a whole). This would require an amendment to Section 81, TCA 1997).

  Pooling of foreign tax credits – amend the calculation of the unrelieved foreign tax in paragraph 9FA, Schedule 24, TCA 1997 ('para 9FA') in relation to taxable branches to ensure that credit relief is available for foreign taxes paid 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. However, following the amendment of paragraph 7(3)(c), Schedule 24, TCA 1997 by Finance (No.2) 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.

  Foreign tax on branch losses – 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, TCA 1997.

  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, the operation of these amendments 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 carry 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.

  This can be rectified for taxable foreign branches (i.e., where an election to avail of the foreign branch exemption is not made in respect of the branch) 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).

Consultation question

61. The international corporate tax landscape has undergone and is continuing to undergo significant reform. What impact do current and proposed future reforms have on your rationale for a transition to a foreign branch exemption?

Key recommendations

- ✓ Simplification of the Irish corporation tax system should be a key goal for the government
- ✓ Adoption of a foreign branch (and dividend) exemption will reduce the administrative and compliance burden for multinational enterprises operating in Ireland

There has been an unprecedent level of change across the Irish corporate tax landscape in recent years. Many corporates are struggling to cope with the compliance obligations and complexity arising from implementation of the EU ATAD rules, the Pillar Two GloBE rules and the plethora of other tax changes that have been made.

It is now time to stand back and see what can be done to simplify the corporate tax landscape. There are a range of unnecessary provisions across the tax code that give rise to needless complexity. In many cases they have been superseded by ATAD and the Pillar Two Rules which have been layered on top of the existing rules. In other cases, there are provisions which serve no real purpose in the protection of the tax yield for the State.

It is essential for both FDI and indigenous business that Ireland is a leader in maintaining a simple, clear and efficient tax system which reduces the administrative cost burden for taxpayers to the greatest extent possible. Adoption of a foreign branch (and dividend) exemption would be a positive step forward in the reduction of the administrative and compliance burden for corporates with international operations.

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