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Roadmap to Introduction of Participation Exemption
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
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By email: businesstaxpolicy@finance.gov.ie

Response to technical consultation on participation exemption

Dear Sir/Madam

EY welcomes the confirmation in the Roadmap of September 2023 that Ireland intends to introduce a participation exemption for dividends and that a branch exemption remains under consideration.

About EY

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Introductory comments

Our detailed responses to the questions in the consultation are set out in the Appendix hereto. The following context may be helpful.

J Bollard, N Byrne, I Collins, S Colreavy, S Connellan, A Daly, S Doherty, S Downey, J Gilmore, R Henson, D Hogan, E McCallion, K McLoughlin, N O'Beirne, C O'Donovan, F O'Neill, J Ryan, P Smyth, C Vaughan, P Waters.

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Ireland's lack of an exemption system has been a competitive disadvantage for Ireland for many years. The jurisdictions that Ireland competes with most actively for foreign direct investment (e.g. Netherlands, Switzerland, Luxembourg, United Kingdom, Singapore) all have some form of participation exemption as part of their competitive offering. The introduction of an exemption system will complement Ireland's role as regional headquarters, international operations and/or treasury functions.

The implementation of the global minimum tax under Pillar Two is going to erode some of Ireland's competitive advantage, so the need for change is pressing. Our comments on the design of the participation exemption are strongly focused on the competitiveness imperative.

The existence of Pillar Two supports a case for a wide general exemption system with minimal conditions and associated complexity.

Optionality will be an important feature of a competitive regime.

Conclusion

We look forward to further engagement with the Department through the upcoming Feedback Statement and would be happy to meet to discuss the content of this submission.

Yours sincerely

Ernst & Young

Appendix

Responses to Questions in the Consultation

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.***

   The years since the introduction of the 12.5% rate have seen Ireland begin to compete for wider forms of business activity than in the 1990s and before, and technological advances mean that geographical functions can become highly dispersed. Increasingly Ireland is seen as a multipurpose location for MNEs.

   Competing jurisdictions seeking to play a similar role typically have a holding company regime including 100% participation exemption for dividends. For Ireland this will be an important improvement to aid competitiveness. Streamlining of holding, operating and treasury operations including efficient repatriation mechanisms can lead to significant cost savings. The ability to centralise all activities in one location is attractive.

   The introduction of a participation exemption for dividends, is of itself, not expected to prompt immediate changes to existing group structures. Instead, it will have an effect over time, as and when future decisions on holding structures fall to be taken (e.g. as a result of M&A transactions, legal entity rationalisation, law change, business change etc.).

   For example, a group with a regional operating hub in Ireland that acquires another business may decide to integrate its European operations, prompting a review of the combined legal entity ownership structure. A more competitive holding company regime may lead to Ireland scoring better against a competing jurisdiction (such as Netherlands, UK or Switzerland) than would otherwise be the case. Over time, the holding company regime is also likely to deepen investment ties resulting in direct and indirect economic benefits.

   The current Irish double tax credit regime is seen as a disincentive for multi-national groups, in terms of using Irish holding companies within their structure, as it slows down a group's ability to repatriate cash (i.e., by virtue of the necessity to manage the complexities of the foreign tax credit system as part of achieving tax efficiency).

   Tax changes in the United States in 2017 have meant that profit repatriations are more frequent than was previously the case. Therefore, ease of repatriation has increased in significance as a feature of competitive holding company jurisdictions. With a suitably designed regime, we are likely to see a steady (rather than sharp) increase in the use of Irish holding companies, consistent with Ireland's role as a regional headquarters jurisdiction.

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.***

A country designs its tax regime to suit its own circumstances, including the jurisdiction's particular role in international investment, and various other policy choices, e.g. what is required to promote investment and defend the domestic base, how individual shareholders are taxed etc. Almost invariably the design has evolved over time. Therefore, we believe that the starting point in the design of an Irish participation exemption should be to set some design principles before deciding on specific features of the regime.

We submit the following list of design principles:

1. The new regime should be designed consistent with Ireland's role as a small, open economy, and its shape informed by Irish fiscal and other policy priorities.
2. Of course, it must comply with European Union law and should comply with other international tax norms.
3. So far as possible the new regime should remove the competitive disadvantage caused by the imposition of tax and related foreign tax credit rules, particularly the complexity arising from Schedule 24. However, it appears logical that a direct replacement of underlying tax relief in Schedule 24 should have a similar scope, i.e. (briefly) 5% of ordinary share capital[1], with group attribution and extension to other classes of shares.
4. The dividend/distribution exemption should effectively replace the tax and credit system for the vast bulk of dividends/distributions from foreign subsidiaries etc., and result in no worse outcomes than the present system.
5. Exceptions to the above should only arise to the extent that that (a) the taxpayer opts out of exemption and into a (simplified) tax and credit system (or chargeable gain computation in the case of a capital distribution), or (b) the distribution in question does not meet the conditions for exemption because of a clear rule informed by a specific policy reason.
6. Conditions or calculations which are difficult to administer without materially altering the tax outcome should be avoided. This includes many of the procedures required by Schedule 24, such as computation of effective tax rates, distinguishing between income/capital, trading/passive income, identifying which pool of profits is the source of a distribution, and what underlying tax is allocated to a given distribution etc.

When comparing with other jurisdictions, the variety of perspectives and rules means that in many cases the detail is not directly relevant to the Irish design, but at a high level it can be observed that most countries' legislation contains a broad-based exemption that applies to most returns on equity. While various factors may be relevant, the route to exemption may vary depending on the country of source, type of income, how taxed, percentage shareholding or ownership period. It is unusual for one of these factors alone to preclude the exemption.

Based on a review of other jurisdictions, and informed by the design principles above, we have the following comments on potential features of a new regime.

i. The exemption should not be limited to distributions from "relevant territories" (i.e., treaty and EU jurisdictions) and should potentially apply to distributions from both EU and non-EU jurisdictions.

[1]Schedule 24 paragraph 9 applies the test in the applicable tax treaty, and adds that a parent's ownership can be taken into account for that test, while in non-treaty cases paragraph 9A(4) sets a threshold of 5% of ordinary share capital of the dividend payer held by the Irish recipient or its parent

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ii. The exemption should not be limited to dividends out of trading profits. This is not a design feature that is seen in other EU jurisdictions and involves complexity of (a) identifying which pool of profits is concerned, and (b) applying a test that is unfamiliar to international investors.
iii. The exemption should not be limited to distributions from any one class of shares.
iv. The exemption should not distinguish between 'income' and capital' distributions.
v. The regime should allow for a degree of optionality by providing an “opt out” election to taxpayers.
vi. As with Schedule 24, paragraphs 9 and 9A(4)(b), no holding period should be applied for the purpose of qualifying for the exemption[2].
vii. As with Schedule 24, paragraphs 9 and 9A(4)(b), a 5% percentage of ownership test should be applied, but as discussed further below, a similar but different exemption should be available for portfolio dividends.

The above are addressed in further detail in our responses to various questions below.

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.***

As indicated above, underlying tax relief in Schedule 24[3] is available based on conditions in a double tax treaty, or a 5% of ordinary share capital threshold (both of which can be met by the recipient’s parent), with no holding period, and without regard to the character of the underlying income source. This seems to us to reflect existing policy choices, and therefore may be suitable for adaptation as part of the new regime.

We also believe that there may be merit in using some existing fundamental concepts and definitions, due to their familiarity, such as the definitions of ‘shares’ and ‘ordinary share capital’ thus reducing the need to devise new definitions etc.

We are of the view that neither section 626B nor section 21B of the Taxes Consolidation Act 1997 should be used as a model for the purposes designing the Irish participation exemption. There are certain provisions within these sections that we specifically believe should not feature in the contemplated regime. See further detail at question 5 in this regard.

In furtherance to the wider ongoing review of the Irish corporate tax code, we believe consideration should be given to revising the conditions of section 626B to align same with the conditions of this new regime (e.g. to remove or widen the scope of the residence condition, and to simplify the trading condition). Again, see question 5 and 13 for further detail in this regard.

The policy rationale for s129A of the Taxes Consolidation Act 1997 should be reviewed, and its impact reduced. In its present form it is already a rather blunt instrument for the policy goal it seeks to achieve[4]. Once the exemption system is enacted it is hard to see the logic of a rule that forces a dividend from an Irish resident to be taxable where it would have been exempt if received from a non-resident.

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[2] Or at most the holding period should not exceed 12 months and should comply with the Parent Subsidiary Directive, i.e. by allowing that period to be completed after the receipt of the dividend.
[3] E.g., paragraphs 8, 9A(4)(b) etc.
[4] The provision narrowly defines ‘profits’ which can lead to the provision applying in a manner which appear inconsistent with the intended purpose of the section.

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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?***

Complexity should be avoided by using simple rules, and limiting conditions to those which serve a specific policy purpose. Any conditions that are applied need to rely on data that will be readily available and verifiable, rather than necessitating detailed analysis or computation. This has consequential impact on the conditions of the participation exemption as discussed at questions 5 and 13.

Given the current international tax climate, and Ireland's implementation of a wide variety of complex international tax legislation[5] we are sceptical of the suggestion that a participation exemption offers aggressive tax planning opportunities. Any such risk is substantially dealt with by other tax reforms. Other countries will have had the first opportunity to tax the profits of a foreign resident company, and Pillar Two will apply a minimum tax rate of 15% (at least provided the group is in scope).

In particular, we observe that:

i. A move to a participation exemption for dividends will not result in a loss to the Exchequer as practically no taxes are collected under the current regime.
ii. At one time the Irish double tax credit regime was seen as a backstop, such that profits diverted out of Ireland would be taxed if ever remitted. CFC rules however were seen as the main solution to this, and indeed international transfer pricing rules have also been strengthened to the point that CFC rules are arguably little more than a backstop to those transfer pricing rules.
iii. ATAD, ATAD II and implementation of the MLI[6] have also considerably reduced the scope for aggressive tax planning, with further legislation to be enacted before year end covering outbound payments and Pillar 2.

The anti-avoidance approach should be limited to narrowly focused rules that address any specific abuse that is identified, rather than seeking to have a complex framework that addresses every potential eventuality. A rule such as that required by Article 1 of the Parent Subsidiary Directive[7] may be sufficient:

> *"2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.*
>
> *"3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality"*[8]

[5] Transfer pricing, CFC rules, anti-hybrid rules, interest limitation rules, Pillar Two etc
[6] Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, made effective in Ireland by section 826(1E) Taxes Consolidation Act 1997
[7] Directive 2011/96/EU as amended by Council Directive (EU) 2015/121
[8] This wording is also contained in s831(7) and already applies to a taxable dividend receipt within the scope of the Directive.

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Specified jurisdictions

5. ***What are your views on the potential scope of jurisdictions that should be eligible for an Irish participation exemption?***

Schedule 24 applies regardless of which country is the source of the dividend. The same principle should apply to the exemption, i.e. it should be possible for a dividend from any country[9] to qualify. In particular, it should not be limited to the European Union, or countries with which Ireland has a tax treaty. For commercial and business reasons multinational groups operate in an extensive number of territories, including non-treaty and non-EU jurisdictions. The exemption should effectively recognise that Ireland does not have primary taxing rights over profits earned outside Ireland and therefore should apply on the repatriation of profits from all jurisdictions.

Having said that, in the case of some jurisdictions, it may be appropriate for the residence status of the payer of the distribution to result in simplification of the applicable conditions. This is the approach of the Parent Subsidiary Directive, which requires countries with a participation exemption to exempt a dividend received by a 'parent' company from a 'subsidiary' that is located in another Member State, with limited additional conditions[10].

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?***

As noted previously, it is rather difficult to discern what is an international norm on participation exemption with any degree of specificity.

The United Kingdom is an obvious reference point for Ireland given that:

- It is also a modern, open economy with significant inward investment and headquarters activity.
- Its tax regime shares common roots with the Irish system, and retains similarities of legislative architecture, including legacies of attempts to reconcile the UK FII GLO[11] case law with a credit regime.
- It introduced a distribution exemption in 2009, which is relatively recent.

Wider discussion of the UK regime is outside the scope of this document, and this point of comparison should not be taken as a recommendation of a full mirroring of the UK regime.

For present purposes it is sufficient to note that under the UK regime the residence of the payer has limited significance, and largely features in rules to support anti-avoidance measures in certain bilateral treaties. We recommend that Ireland should follow this feature of the UK regime.

[9] With the possible exception of countries on the so-called EU black list.
[10] In particular, there is no question of testing what taxes have been paid on the profits, it is sufficient that the entity is subject to tax.
[11] Franked investment income group litigation order.

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?***

No, the scope of qualifying jurisdictions for a participation exemption should be broader than that of existing Irish reliefs relating to foreign subsidiaries. As with underlying tax relief under Schedule 24 it should potentially be available for a dividend from a resident of any country. See response to question 5 above.

Method of relief

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?***

An exemption may be simpler to administer (particularly if it framed as the proposition that a dividend is generally exempt unless one of a series of exceptions applies).

Relief for the full amount or only part of the dividend

9. ***In your view, should an Irish dividend participation exemption provide a full or partial exemption? Please provide reasons for your answer.***

EY is of the view that the dividend participation exemption should provide for a full exemption, as a partial exemption would be disadvantageous for Ireland from a competitiveness perspective. Belgium, for example moved from a 95% exemption to a full exemption in 2018 for precisely this reason.

Furthermore, a partial regime begs the question of how tax would be computed on the non-exempt portion, and what credit, if any, would be allowed against it. Finally, a partial exemption would offend against the design principle that the exemption system should offer no worse outcomes than under Schedule 24.

Type of dividend/distribution and shares

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?***

EY is of the view that the participation exemption should in principle apply to all dividends and distributions.

The exemption should be crafted as broadly as possible subject only to a carve out for dividends which are deductible for the payer, or to which targeted anti-avoidance rules apply. See further detail in the responses below.

11. ***Should a participation exemption apply to both income and capital distributions and, if so, how should a capital distribution be defined?***

    Yes, the participation exemption should apply to both 'income' and ‘capital' distributions. The application of a distinction between the aforementioned under Irish tax law can be a complicated exercise which ignores business reality and the policy rationale for the exemption (i.e., being to reduce complexities in the current regime). As the exemption should apply to all dividends and distributions, it should not be necessary to distinguish between 'income' and ‘capital' and therefore no specific definition of a ‘capital distribution’ should be necessary.

    In this regard, we note that in 2010 (but with retrospective effect to 2009) the UK distribution regime was extended to capital as well as income distributions by simply deleting the subsection that excluded capital distributions, and thus avoiding any need for such definition.

12. ***Is there a rationale for extending a participation exemption to other classes of shares beyond distributions in respect of ordinary share capital?***

    Yes, EY is of the view that the exemption should not be limited to distributions from any one class of shares. An equity interest in an entity can take a variety of legal forms through which the holder of that interest can become entitled to receive a distribution, e.g., ordinary shares, preference shares, redeemable share capital, membership interest, profit sharing certificates, etc.

    A dividend which may have been funded from profits which have already been subject to tax should not be excluded from exemption on the basis of this detail, at least provided that any ownership threshold is met. Schedule 24 allows underlying tax relief for dividends received from any class of shares in some ownership structures[12].

    On this basis, and to ensure Ireland adopts a broad-based regime and does not differentiate one holding from another, income from all classes of shares should be eligible for the exemption, subject to any targeted anti-avoidance rules (e.g. that the dividend should not have entitled the payer to a tax deduction).

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.***

    No, as detailed in our responses to a number of the other questions herein, we are of the view that the dividend exemption regime should not be directly aligned with the provisions of the section 626B participation exemption.

    As referred to above, section 626B exempts a gain on ‘shares’ where the taxpayer meets a threshold of holding 5% of “ordinary share capital”. This feature of allowing the exemption to a wider class of shares than those required to meet any ownership threshold is worth considering.

    With respect to section 626B, we believe that the list of ‘relevant territories’ is unduly restricting and are therefore we are advocating that the dividend exemption regime apply to dividends from both EU and non-EU territories and without requiring the existence of a double tax treaty.

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[12] Section 626B also sets a clear distinction between “shares” to which the exemption applies, and “ordinary share capital” which is the basis for the ownership condition.

Additionally, the trading test in section 626B is unduly burdensome and given that 'trading' is a concept which is largely unique to the Irish tax code relative to our OECD counterparts, it is difficult to apply to foreign subsidiaries.

Minimum shareholding requirements

14. What are your views on the application of a minimum holding period in respect of participations qualifying for exemption?

We are of the view, aligned with the provisions in section 21B and schedule 24 TCA 1997, that no holding period should be applied.

If there is some policy imperative of which we are not aware, a minimal holding period only should be applied. In aligning with other sections of the legislation, we believe that a 12-month holding period would be sufficient for this purpose, that being a continuous holding period of 12 months at any point within which a relevant dividend is received. In line with other EU jurisdictions and other provisions in Ireland's legislation, the time period in which the participation is held by other group entities, as well as the ownership period after the distribution should be taken into account for the purposes of the computation of the 12-month period.

The Parent-Subsidiary Directive default treatment is for there to be no minimum holding period, but by bilateral agreement, Member States **may** add a condition for a minimum holding period. However, it requires that such holding period can be no longer than 2 years, and it must take into account the ownership period after receipt of the dividend.

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)?

See response to question 14 above. It seems to us that this is required by the Parent Subsidiary Directive, at least as regards intra-EU dividends. We see no reason to limit that treatment to intra-EU dividends.

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?

For dividends other than portfolio dividends (on which see our responses to Questions 34 to 37), it seems appropriate to align with existing provisions of the Irish tax legislation in order to minimise policy change. In this regard, we believe that a 5% shareholding or 5% entitlement to voting rights in the subsidiary should be sufficient as in Schedule 24 paragraph 9A(4)(b). The 5% shareholding should be broad enough to cover holdings of ordinary share capital and similar securities.

In line with other EU jurisdictions and other provisions in Ireland's legislation, in assessing the percentage of ownership criteria, any ownership in the relevant subsidiary held by a company or companies related to the taxpayer should also be taken into account. Once the ownership threshold is met, the exemption should be available for distributions of all classes of shares held by the Irish company, subject of course to other conditions being met.

Optionality

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.***

    Yes, EY is 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, for the following reasons:

    - It ensures maximum flexibility for Irish holding companies, with a broader regime placing Ireland in a strong competitive position as a holding company location for multinational groups.
    - The capital structure of a number of companies includes bona fide third-party financing, predicated on dividends forming part of taxable income. Such companies would find it very difficult to change their capital structure in the event that a mandatory exemption regime is introduced. There is a variety of reasons why companies have organised their capital structure in such a manner, each of which is specific to the company in question but important none the less, e.g., dividend income falling within the scope of EBITDA for the purposes of the interest limitation rules.

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

    Common themes in our responses to the questions in this consultation are the importance of the flexibility and broadness of the new regime, and the lack of opportunities for aggressive tax planning that it offers. On this basis, to ensure maximum flexibility, optionality to apply the current systems should be allowed, by election, on a particular dividend (in whole or part) and accounting period by accounting period basis.

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

    For the reasons set out in the response to Question 4, we do not foresee that the new regime creates opportunities for aggressive tax planning, whether that regime provides for optionality or not.

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

    EY believes that the dividend exemption should follow the international norm, which is that it should apply unless and to the extent that the taxpayer elects otherwise. It is however imperative that taxpayers are allowed the longest reasonable period to decide, e.g., 2 years as it the case with a number of other Irish legislative claims and provisions.

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

    An election should apply for all of the above, i.e., on a subsidiary by subsidiary, dividend by dividend (in whole or part) and accounting period by accounting period 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?

No, the election should be revocable at the taxpayer's discretion to maximise flexibility. As noted in the response to Question 20 above, with respect to the making of an election, taxpayers should be provided with a reasonable period of time to make such decision, e.g., a period of 2 years after the return filing deadline for the period in question.

As noted in the response to Question 21 above, an election should apply on a subsidiary by subsidiary, dividend by dividend (in whole or part) and accounting period by accounting period basis. As such, each dividend declared should necessitate a separate election and therefore an election should not be deemed to apply for a specific minimum period of time.

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?

The main rationale for optionality is the long history of a credit regime, and the fact that taxpayers may have organised their affairs accordingly. We are not aware of any comparable country that has transitioned to an exemption system more recently than the UK.

Interest limitation

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?

No, provided that there is optionality in any new regime introduced. See response to Question 17 above.

Subject to tax rule

25. How should a participation exemption be designed in order to prevent double nontaxation? 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?

For the purposes of the Irish anti-hybrid rules, shares in a company and similar ownership rights (not being securities) in entities other than a company qualify as a 'financial instrument'. A deduction without inclusion mismatch under section 835AJ arises where the mismatch is attributable to differences between the domestic and foreign tax in the characterisation of (i) the financial instrument, or (ii) payments made under the financial instrument. In the event that a dividend payment is respected as a dividend by both a payer and payee jurisdiction and the payer is entitled to take a tax deduction for the payment, the resulting mismatch should not fall within the scope of section 835AJ as it should not be regarded as attributable to a difference in the characterisation of the payment between the two jurisdictions.

In order to manage double non-taxation in the above instance, a dividend for which the payer obtains a tax deduction should not be eligible to qualify for the participation exemption. This is a common feature of the participation exemption rules of other EU jurisdictions.

Again, given that in the current international tax climate some other territory will have had first opportunity to tax the profits out of which a dividend is paid we see little need for a subject to tax rule. If, however, there is some policy imperative that we are not aware of, then we would suggest that, similar to the Parent Subsidiary Directive, a simpler version of the test should apply to most companies.

Substance in Ireland

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?***

We do not believe that it is appropriate for a participation exemption to be used to try and manage against economic substance concerns. These should be appropriately dealt with through the transition of the proposed "Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU" into Irish tax law. Ultimately, once this Directive is agreed, Ireland will need to apply it to all Irish holding companies, regardless of whether the participation exemption applies to same.

Trading requirement

27. ***What are your views on a potential condition of exemption whereby relief only applies to certain trading companies?***

We do not agree with the exemption only applying to certain trading companies and would advocate against such a condition being included. 'Trading' is a concept which is largely unique to the Irish tax code relative to our OECD counterparts. Under the current rules, e.g., for the purposes of section 21B and section 626B, the application of a 'trading' clause requires businesses to assess the foreign operations through an Irish lens and make broad based assumptions in respect of same. The inclusion of a 'trading' requirement would therefore complicate the new regime, leading to uncertainty for businesses, both of which are directly counter to the key objectives of a territorial regime.

28. ***Should a participation exemption align with trading criteria applicable in other foreign subsidiary related reliefs such as section 21B and 626B? Please elaborate.***

No. See response to Question 27 above.

Transitional arrangements

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?***

EY is of the view that no lead-in time is necessary. As advocated in our response to the 'Consultation on a possible move to a Territorial System of Taxation' in 2022 and what continues to be our position, is that Ireland should introduce the new regime as soon as feasibly possible.

The Irish credit regime was historically seen by policymakers as a back stop against the possibility that another jurisdiction may not exercise its taxing rights or that profits may be artificially diverted away from Ireland. The introduction of CFC rules and the two-pillar solution however provide a safeguard in this respect by way of removing the incentive for companies to engage in such activities. Given that the CFC rules came into effect from 1 January 2019 and Pillar Two takes effect from 1 January 2024, the transition to a territorial regime is already delayed and therefore, we would advise against unnecessarily delaying it further to allow for a 'lead-in period'.

The only question for us is whether the exemption should apply to distributions received on or after 1 January 2025, or to accounting periods beginning on or after that date. We recommend the former.

30. Would you still be in favour of introducing a participation exemption if unutilised foreign tax credits were lost?

We refer back to our response to Question 17. EY is of the view that unutilised foreign tax credits should not be lost/denied under an optional regime (i.e. a system in which businesses are allowed to choose whether to apply an exemption or to retain the current system of taxing foreign dividends and claiming a foreign tax credit).

Under an optional regime, where a company chooses to retain the current system of taxing foreign dividends and claiming a foreign tax credit, unutilised foreign tax credits should be allowed to be offset against, or carried forward and offset against, tax arising on taxable dividends.

31. Are there other transitional arrangements that should be considered?

We have nothing specific to note at this time. EY however recognises that the technical complexity associated with legislating for a participation exemption will mean that further technical changes may be required over a number of years to ensure the exemption applies as intended.

Franked investment income

32. In your view, what are the main opportunities or issues in applying similar treatment to domestic and foreign dividend exemption regimes?

The current Irish rules and legislative provisions relating to franked investment income are very broad, and for good longstanding policy reasons. We appreciate that a change to the treatment of foreign dividends may prompt a review of the treatment of domestic dividends, but we have seen no substantive discussion of this to date. We therefore believe that any such review can wait until after the foreign dividend exemption is enacted, and perhaps as part of a wider review of the corporate tax regime. If there is to be a change to the treatment of franked investment income it should be the subject of focused consultation.

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?

EY's view on this matter is outlined in response to Question 32 above.

Portfolio investors

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?*

As we noted in the paper that we prepared for the Department of Finance in 2014[13] the Irish corporate tax system is path-dependent evolving from a series of policy decisions made over the past 200 years. One feature of this is the exemption from Irish corporation tax treatment of franked investment income:

> *'A system that reduces the tax paid by a shareholder on a dividend to reflect that tax paid by the company is called an imputation corporate tax system. A system that does not give such a credit is called a classical corporate tax system. Ireland was an imputation system, sometimes fully and sometimes partially, until 1999 when it switched to a full classical system. A further method of avoiding this double taxation is to tax the company but to make any dividends tax exempt for the shareholder.'*

The portfolio dividend provision in section 21B fulfils an important function in the Irish tax system as a bridge for certain dividends between the exemption for domestic dividends and the fact that for dividends from non-Irish companies a credit for taxes suffered may not be available where a shareholding is less than 5%. The provision in 21B is more restrictive than Schedule 24 in terms of global shareholdings and range of countries. The provision was, to a certain extent, a reaction to the UK FII GLO where it was argued that the UK tax difference between UK and non-UK dividends was contrary to EU law.

35. *What are the arguments for or against retention of a portfolio exemption following the introduction of a participation exemption?*

Removing the portfolio dividend provision would make Ireland less attractive for certain local and global financial market participants, insurance companies, private equity and others. At the same time, the exemption for FII would, in our view, also have to be removed entirely or in similar circumstances. This would impact on investment in Irish companies by Irish corporate investors; resulting in profits being double taxed at the investee level and again when distributed at the corporate investor level. This could have the ironical result that investing in Irish companies from outside Ireland could become more attractive than Irish corporate investment. This would also mean that the proposed participation exemption had more direct consequences for Irish in-country investment than might be expected.

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?*

We do not see that consequential amendment or removal of the portfolio dividend provision would be required. Such changes would adversely impact on certain taxpayers in Ireland who understood that the Irish system was predictable and consistent between local and global investment.

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?*

The introduction of Pillar Two is effectively a parallel and potentially different treatment of the same income. Pillar Two should ensure, for many taxpayers, that the effective tax rate in Ireland, including

[13] Link: The historical development and international context of the Irish tax system

portfolio dividends, should not be less than 15% under international rules. Under Pillar 2, the dividend exclusion rule does not apply to Short-term Portfolio Shareholdings (that is holdings of less than 10% (profits, capital reserves, voting rights) and held for less than 12 months when the dividend is paid). Therefore, for certain portfolio dividends section 21B and Pillar 2 are aligned and for other situations they are not aligned. Modifying section 21B merely changes that alignment in other ways.

Furthermore, within the existing system there are substantial anti-avoidance rules in place in relation to the purchase and sale of securities over dividend dates, the denial of deductions for withholding tax etc. We note that these anti-avoidance rules are not a feature of Pillar Two, which could result in even higher effective tax rates under the domestic rules than under Pillar Two if section 21B was modified.

Alignment with existing Irish reliefs for foreign subsidiaries

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?

See responses to various questions above in this respect. As noted, Ireland should adopt a broad-based exemption regime, i.e., broader than the current Irish substantial shareholding exemption rules for capital gains and the rules relating to the taxation of dividends falling within the scope of section 21B. However, the basic gateway for access to underlying tax relief in Schedule 24 (i.e. 5% of ordinary share capital) may be suitable for adaptation.

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?

No, it is not necessary that a participation exemption for dividends must align with the qualifying conditions for the participation exemption on gains under section 626B. Where a distribution meets the relevant conditions for exemption, it should be exempt. If the transaction is a sale or disposal of shares, then it is not a distribution, and should be deemed to fall within the scope of Irish capital gains tax, with possible exemption where the conditions of section 626B are met.

Conversely, a capital distribution is still a distribution and could qualify for the exemption (assuming other conditions were met). This should take priority over section 626B.

Furthermore, section 591A should serve as a reasonable targeted anti-avoidance measure against transactions aggressively seeking to extract dividends from a company (with same falling within the scope of the participation exemption for dividends) in connection with a disposal of shares in that company (which may not qualify for exemption under section 626B). It is not anticipated that additional anti-avoidance measures should be required under the new regime in this respect.

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?

Certain EU jurisdictions apply consistent rules to the application of the participation exemption for both dividends and gains, however there is a considerable number of jurisdictions that apply different rules depending on whether item is dividend or gain. These jurisdictions then of course have their own rules to distinguish between dividend and gain.

As set out in our responses to numerous questions above, we believe that the Irish distribution exemption should be as simple as possible and avoid the extra work involved in making such distinctions, particularly given that they do not lead to materially different outcomes.

As part of the continuous ongoing review of the Irish corporate tax code, for simplification purposes, consideration should be given to widening the scope of the current Irish capital gains participation exemption (section 626B) to align with the dividend participation exemption.

Deductibility of expenses related to exempt income

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

We see little case for limiting such deductions. At present, expenses of management of a resident investment company are deductible in computing profits for corporation tax purposes whether or not the investments give rise to material amounts of income, and regardless of the tax treatment of that income. Furthermore, franked investment income is explicitly exempt from the rule that management expenses must be set against income before being surrendered by way of group relief.

As the Irish participation exemption regime should not differentiate the treatment of Irish and foreign dividends, the provisions of the above legislation should be updated to include all dividends falling within the scope of the Irish participation exemption, as opposed to just franked investment income.

Attempting to limit deductions would result in outcomes worse than the present, which offends against one of our suggested design principles. It would also involve additional levels of complexity as the entity incurring such expenses will often be several tiers higher in the ownership structure than the entity receiving the exempt dividend.

Close company surcharge

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

The current rules provide that, without affecting the meaning of 'franked investment income', a dividend or other distribution by a company is not to be regarded as 'investment income' for the purposes of the close company surcharge if the close company to which it is paid would be exempt from tax on any gains on the disposal of those shares under section 626B at the time the dividend or distribution is made.

Consideration should be given as to whether the provisions in section 434 should be updated such that a dividend or other distribution is not to be regarded as 'investment income' for the purposes of the close company surcharge if that dividend or distribution meets the conditions of the dividend participation exemption regime or alternatively, to retain the current rules. The rationale for this is similar to that for the election in s434(3A), i.e. that such a dividend cannot reduce a surcharge for the payer, and therefore should not trigger one for the recipient. This should be considered and reviewed in the context of the ongoing policy rationale for the close company surcharge.

Specific tax regimes

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.

These provisions would interact with a number of other provisions in the Irish tax code, including section 110, life assurance companies, tonnage tax rules, unit trusts, offshore funds rules, purchase and sale of securities.

The potential impact could be considerable and certain provisions such as section 110 may require additional special rules (to allow for an exemption, deny an exemption or allow for optionality).

The key element here in most cases, will be to allow for taxpayer optionality.

Qualifying companies within the meaning of section 110 are often used in conjunction with an ICAV or other regulated fund as the asset holding company. It is in this context that we typically see a qualifying company holding shares. A qualifying company should be able to avail of any dividend exemption. If the policy decision is made that certain dividends should not be subject to tax in Ireland, there is no rationale for excluding a qualifying company. This could be dealt with either specifically in section 110 itself or alternatively in the new provisions.

It would also be timely to consider an extension of the franked investment income provisions of section 129 to specifically include a qualifying company.

To the extent that there is an extension of the CGT participation exemption of section 626B, it would also make sense from a policy perspective to ensure that a qualifying company is not subject to tax in the same manner as a holding company.

The point has been made by EY and others in the context of the Funds Sector 2030 Review that Ireland should adapt and remain competitive to maintain its position as a leading asset management jurisdiction. While tax matters form part of Funds Sector review, the detailed work on the implementation of the territorial regime is the appropriate forum to consider the technical and policy points arising in this context.

44. What amendments, if any, would be required to those provisions in order to ensure their continued operation in conjunction with a participation exemption?

Provided optionality is given, no special rules should be required, other than those already specified above (for example, in relation to deductions). Certain existing practices such as those for life assurance companies may need to be reviewed/updated.

Anti-avoidance rules

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

EY is of the view that any anti-avoidance provision should be drafted to specifically target identified forms of potential abuse rather than setting onerous conditions applicable to all dividends. See response to question 4.

We are not aware of tax avoidance opportunities that are afforded to taxpayers merely by the existence of the participation exemption, after all, the vast majority of countries have such an exemption in place already.

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

Nothing additional to note here. See response to Question 45 above.

Controlled Foreign Companies

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?***

It is important to bear in mind, the CFC rules are seen to largely act as a backstop to the Irish domestic transfer pricing rules. Given the breadth of the current Irish transfer pricing regime, our experience is that CFC rules are very rarely invoked. On this basis, we see little need to strengthen them in response to a dividend exemption, unless it is to widen the scope beyond undistributed income.

Anti-hybrids / Non deductibility in payor jurisdiction rule

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?***

Ireland's anti-hybrid rules are ATAD compliant at present. ATAD requires Member States to neutralize a mismatch for a payment under a financial instrument (i.e. the payor should deny a deduction, otherwise the payee should tax the receipt). Like the Irish rule in section 835AJ, this applies only if the mismatch outcome is due to a difference in characterization between the jurisdictions of payor and payee.

See additional commentary in response to Question 25.

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?***

The participation exemption rules in a number of other EU jurisdictions provide that where the jurisdiction of the subsidiary allows a tax deduction for dividend payments or the subsidiary has an option to treat a dividend payment as tax deductible, the payment should not be eligible to qualify for the participation exemption.

Interaction with Pillar II of the OECD Inclusive Framework

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

Under Pillar Two, intra-group dividends are not generally treated as part of GloBE Income. On this basis, any taxes paid on those dividends are treated as a covered tax of the payer, not the payee.

This means that an Irish holding company could pay Irish tax on its dividend income at 25% which would be completely ignored in computing any GLOBE top-up tax on Irish trading profits.

In more complex cases it may be more difficult to identify which portion of an Irish company's corporation tax liability is attributable to dividend income, e.g., if you have special deductions that are allocated (e.g., para 4 of schedule 24) to the company.

More importantly, our view is that the profits of a company that is within scope for Pillar Two will almost certainly bear tax at the minimum rate, even if that entirely takes the form of a top-up tax. Concerns about aggressive tax planning should therefore be significantly allayed for such companies, particularly after the introduction of the UTPR.

Transfer Pricing

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

    We have not identified any such impacts. Dividends typically do not fall within the scope of Ireland's transfer pricing regime given they are funded from residual profits for which there is no comparable price on the open market and for which no such price is required to be computed.

Multilateral Instrument provisions

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

    At this point we have not identified any such need.

Any other issues

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?***

    EY would like to reiterate the importance that Ireland adopts as broad-based an exemption regime as possible, utilising concepts that are recognised internationally rather than just in Ireland in order to minimise associate complexities with the regime.

Foreign branch exemption

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?***

    Irish head office and branch structures are very common in the financial services sector. Many global financial institutions have regional or global head offices in Ireland and branches through the EU and beyond. This allows the institution to avail of the regulatory 'passport' to establish branches through the EU, this provides regulatory, capital, tax and operational advantages. This issue became particularly prominent after Brexit, when a number of institutions had to move their EU head offices from the UK to EU locations.

This structure is common for banks, insurance companies and other types of regulated entities. Irish regulated entities with non-Irish branches include many household names[14].

It is important to note that branches are not located just in the EU, but many regulatory, operational etc. advantages also exist to establish branches beyond the EU. One of the most common locations to locate branches is the UK (London). It is not uncommon for an Irish head office to have branches in 20 or more countries.

It also may be worth recalling that Ireland had a branch exemption previously for certain large financial institutions; this was repealed in 2010 (section 847 TCA 1997).

Outside the financial sector, a branch structure is less typical, and is generally used if there is a desire to avoid using a local company for cost, legal, regulatory or operational reasons (e.g. it may be desirable for customers to contract with a larger legal entity).

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.*

The size of, for example, banking branches would range from a single sales-person to large operations employing hundreds. In the financial services sector all branches would be trading (in Irish tax terms); some will be full scale banking/insurance/etc. operations, others localised activities or particular business divisions. For example, there may be branches in Paris, Frankfurt and/or London serving global markets, a branch in Poland providing back-office support and smaller teams in Spain, Italy, Switzerland servicing local customers.

Indeed, the use of branches for sales and marketing activities is not uncommon across a variety of non-financial sectors. The UK is the commonest location for this profile, but other European countries are also frequently encountered, and occasionally also Asian jurisdictions such as Singapore or Hong Kong.

Almost invariably a foreign branch is carrying on some business activity[15], that forms part of the trade of the Irish legal entity. It is not uncommon for the branch to have some level of passive income, e.g. from placing cash received on a local deposit pending disbursement of expenses. This type of passive income is normally regarded as part of the branch profits by the local tax jurisdiction, and in our view ought to be treated accordingly by the head office jurisdiction. Wholly passive branches are extremely rare.

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.*

The driver for the use of a branch is generally a local country issue, which takes priority over any Irish tax issue. Very occasionally an investor considering establishing an Irish operation with a foreign branch structure may take a negative view of the worldwide system for taxing foreign branches.

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[14] . Useful links: Passporting for Credit Institutions | Central Bank of Ireland Brexit and the EU banking sector: from the fundamental freedoms of the Internal Market to third country status (europa.eu) Passporting In/Out for Solvency II | Central Bank of Ireland

[15] Some foreign branches do not result in local taxable presence, e.g. because the activities are 'preparatory' in nature. We do not regard these as 'passive', but neither would such presence normally result in the availability of a branch exemption in the head office jurisdiction.

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?***

As mentioned in our response to Question 56, the decision to use a branch is generally driven by local business issues rather than Irish tax issues. For an Irish group which already has a local presence via subsidiaries law change of itself is unlikely prompt a change in structure. Instead the trigger is likely some shift in the local business or regulatory dynamics.

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.***

For the reasons outlined above, a branch exemption would be particularly attractive to regulated financial services groups. The current treatment, where branches are taxable in Ireland with a credit for non-Irish tax suffered, in our experience, does not result in any additional tax in Ireland on the branch profits but does add to the compliance burden and a certain level of uncertainty, despite that experience. For example, the interaction of local tax depreciation, losses forward, differences between local tax accounting and IFRS can result in widely different effective tax rates (as measured under Irish rules) across Europe versus headline corporate tax rates; given the ability to pool and carry forward excess credits, this does not result in material levels of additional Irish tax but this could occur and this possibility does curtail investment into the Irish head office.

A branch exemption should also include corporation tax on capital gains (for example on the sale of goodwill of a branch).

Having said that, it is important to note that the industry would not favour a compulsory branch exemption. Having optionality is extremely important as some head office-branch business strategies will require, for example, a degree of ability to use losses in the head office location.

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.***

Directionally, the UK branch taxation regime may be a suitable approach, providing for a degree of optionality for the taxpayer. All global institutions in the financial services sector will be familiar with that regime.

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.***

Much depends on how the exemption is designed, particularly as regards its interaction with the tax regimes of the foreign branches. Provided it is suitably crafted, we believe that minimal changes would

be required elsewhere in Irish tax legislation, and the exemption will make little difference to the Irish tax regime or Exchequer returns.

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?***

A branch exemption will become more important in the Pillar Two environment where under the QDMTT non-Irish branches will not be taxable under QDMTT rules in Ireland. A non-Irish branch taxable in Ireland under domestic corporate tax rules and not taxable under the QDMTT would result in significant complexity for the taxpayers. This is particularly acute as the perceived incentives for taxing or not taxing particular types of income and allowances for expenses will then be different under the two systems; which may result in complex transfer pricing controversy between Ireland and the branch location.

Pillar Two is also an important protection for the Irish tax system with a branch exemption, removing incentives to move assets or activities to branches with lower effective tax rates (under international rules) than Ireland.