Insurance Ireland Commentary on Department of Finance Consultation regarding a roadmap for the Introduction of a Participation Exemption to Irish Corporation Tax

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INTRODUCTION

Ireland is a thriving global hub for insurance, captives & reinsurance and Insurtech. Ireland's insurance market is the fifth largest in the EU, and our Reinsurance market is the second largest. Our members represent around 95% of the companies operating in the Irish market, making Insurance Ireland a strong leadership voice for the sector.

Insurance Ireland members are progressive, innovative and inclusive, providing competitive and sustainable products and services to customers and businesses across the Life and Pensions, General, Health, Reinsurance and Captive sectors in Ireland and across the globe.

Insurers based in Ireland paid more than €68 billion in claims in 2022 and help to safeguard the financial future of customers through some €300 billion of life and pensions assets. The sector employs some 35,000 people in skilled and well-paid jobs and contributes in excess of €2.7 billion annually to the Irish Exchequer. Ireland is the 4th largest insurance hub in the EU and one of the most important reinsurance centres globally.

Our members also contribute €1.6bn annually to the Irish Exchequer.

The role of Insurance Ireland is to advocate on behalf of our members with policymakers and regulators in Ireland, Europe and Internationally; to promote the value that our members create for individuals, the economy and society; and to help customers understand insurance products and services so that they can make informed choices.

OVERALL OBSERVATIONS

Insurance Ireland welcomes the opportunity to share industry feedback regarding the development of a roadmap for the introduction of a participation to Irish Corporation tax. Insurance Ireland is supportive of a full participation exemption, which includes a branch exemption.

Insurance Ireland members operate on a global scale. There has been a clear trend in the insurance industry for pan-EU structures, i.e. insurance groups that tend to centralise their insurance operations, ideally in one company with a head office in one location and branches in many different EU countries. The resulting capital efficiency can provide a competitive advantage, as compared with a group which has a regulated company in each jurisdiction.

The operating environment for insurance undertakings in Ireland is a key consideration for firms in deciding whether to base operations here. International Groups reach their decision on where to locate their EU head office based on a number of factors, including: the history of the firm in the country, the regulatory environment, ease of doing business, the availability of suitable staff and the cost base – all are clearly important, but clarity in relation to tax is also a factor.

The majority of firms within Insurance Ireland's membership are primarily involved in cross-border activity, servicing over 25 million customers in more than 110 countries. In 2021, Irish insurers assumed nearly 100 billion Euros in gross-written premiums and managed more than half a trillion in assets. Ireland is a major hub for EU and international insurers, from both an operating and a holding company perspective. Irish insurers are the main exporters of life and non-life insurance services of the Union.

Once established in Ireland, cross border insurers with branches find that there can be significant differences in the timing and measure of taxable income between the head office and the branches. For example, some countries have different rules for the timing of tax deductions for insurance reserves and expenses. The mismatches cause tax uncertainty and complication and potentially double taxation, which companies in countries with an exemption system do not face. This has been accentuated by the introduction of IFRS 17 which can result in even greater mismatches between the timing of taxation of income between Ireland and branch locations. As a result Irish based insurers with foreign branches have to deal with more complexity and risk of double taxation than businesses headquartered elsewhere in the EU, which operate a branch exemption regime.

Ultimately, the introduction of a full participation exemption, including an optional branch exemption, would significantly reduce the compliance cost and complexity for both taxpayers and Revenue. Currently, the Irish regime requires a computation for each branch based on Irish tax legislation, with associated double tax relief calculations. To illustrate the complexity of this, tax computations can often be in excess of 100 pages. The insurance industry in Ireland has long been of the view that a branch participation exemption and a simplification of the double tax relief system would be beneficial, and the industry remains of this view. Such a system would be consistent with the taxation regimes which generally apply across Europe. It would be fully compliant with the changes in the Irish tax system as a result of the EU Anti-Tax Avoidance Directive (ATAD).

A recent report[1] published by Milliman, commissioned by Insurance Ireland in October 2023, shows that the number of insurance and reinsurance undertakings based in Ireland has been on a downward trajectory since the peak in 2009. Overall, the number of entities has reduced by 39% since then, with the number of life companies down 42%, the number of non-life companies down 29%, and the number of reinsurers down by 47%. In addition, both the largest international non-life company and one of the largest international life companies have announced their intention to relocate from Ireland. Any initiatives which would reduce complexity, administrative burden and the cost of doing business in Ireland could only support the attractiveness of Ireland as a location for international insurance.

The majority of our responses to the consultation questions relate to the branch exemption given the sector specific considerations. Insurance Ireland remains supportive of the introduction of the dividend exemption, as this will be of benefit both to the insurance industry and Revenue by reducing the administrative burden and complexity.

In response to questions relating to minimum shareholding requirements (q14 -16), trading requirements (q 27-28), portfolio dividends (q 34 – 37) it is worth noting that the UK dividend exemption is very broad for large companies –it generally applies to all dividends, subject to some anti-avoidance provisions i.e.

- Dividends from any company controlled by the recipient
- Dividends paid in respect of non-redeemable ordinary shares – i.e. ordinary shares where neither the issuer or shareholder can call for redemption
- Portfolio dividends
- Any dividend received where it has been paid out of profits which have not been diverted from the UK. Most dividends from UK companies will satisfy this test if they do not fall into one of the other exempt categories.
- Shares treated as loans (i.e. those which fall within the “disguised interest” rules). As “distributions” from such shares will be taxed as interest, they will not also be taxed as dividends.

[1] Protecting tomorrow: the future of the Irish insurance industry (milliman.com)

We would encourage the Department to consider a similar approach for large companies. The risk of double non-taxation or avoidance for large groups is low, especially given the upcoming implementation of Pillar Two that will ensure that the underlying profits are brought into tax.

Consultation Questions

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

As the current system provides for full double taxation relief (provided there are sufficient levels of foreign tax suffered), a full exemption should be provided. The result will be revenue neutral overall (no changes), however it would result in a material reduction in complexity and administration required to complete the process. In addition, we would expect that most foreign dividends will effectively qualify for a participation exemption for Pillar Two purposes. Ireland's regime should be aligned with Pillar Two.

We also note that the introduction of a partial exemption regime would only add to the complexity as it would mean businesses would face the administrative burden of navigating both partial participation exemption rules and the existing credit rules under Schedule 24 TCA 1997.

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

Any holding period requirement should be aligned with the requirements under Pillar Two.

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)?

Refer to question 14

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?

Any such requirements should be aligned with the requirement under Pillar Two.

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

Limiting the applicability of a participation exemption to dividends paid out of trading profits would detract from the competitiveness of Ireland as a destination for investment and would result in significant administration burdens in terms of applying the relief. One of the aims of the introduction of a participation exemption is to remove the current administration burden but this aim would not be achieved if the exemption is restricted to trading profits.

Also, in light of the implementation of recent international tax changes (such as CFC rules, EU blacklists, the Irish outbound payment rules etc) and the imminent introduction of Pillar Two, we do not believe that there is any justification for applying a trading test to the participation exemption for dividends.

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

Refer to question 27 above.

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?

The existing Portfolio Dividend Exemption (PDE) is, in practice, one of very few relieving provisions relevant to insurance businesses operating in Ireland, the removal of which could result in double taxation for certain financial services businesses and therefore additional cost/complexity for those businesses. Notwithstanding its complex application and interaction with other provisions, it is a relief which has helped to attract and retain financial trading business in Ireland and has helped maintain the competitiveness of Ireland’s tax offering for insurance operations.

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

The PDE should be analysed separately from any general participation exemption, particularly where such a participation exemption includes a minimum shareholding or holding period which would be in conflict with the portfolio nature of the PDE.

There are in our view therefore no arguments against the retention of the PDE following the introduction of a participation exemption, with the benefits outlined in our response to Question 34.

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?

The removal of the PDE or the introduction of additional qualification criteria following the introduction of a general participation exemption would be a negative development for the financial services sector. Amendment of the existing PDE legislation should only be contemplated in a scenario where the proposed general participation exemption includes portfolio holdings and does not impose qualifying criteria which are in any respect more onerous than the existing PDE requirements.

Furthermore, the removal of the PDE would disadvantage portfolio investors in favour of more significant shareholders. Often the portfolio investor does not have sufficient information in order to make a claim for double tax relief whereas a more significant shareholder would be in a position to obtain sufficient evidence of underlying or withholding taxes paid. Therefore, if the introduction of a participation exemption required the consequential removal of the PDE the impact would be to remove time/effort for one group of taxpayers and replace it with cost/complexity for a different group. It would be preferable that the system was equally fair/economical to operate for all taxpayers.

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?

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

Given that dividend income is (generally) sheltered by double tax relief, there is in effect no clawback of management expenses under the current regime. Thus, there should be no need to implement such a measure which would add complexity to the regime and a need to track management expenses associated with/not associated with the exempt participation from one year to the next.

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?

Branches are used by Irish companies in multiple jurisdictions – both within the EU/EEA and outside the EU/EEA. This allows (re)insurance firms the flexibility to optimize the group structure and for some groups there are also cost and operational efficiencies in such structures:

- For a regulated insurer (and regulated financial institutions in general), one of the main benefits of a branch structure is capital efficiency. Under Solvency II, insurers operating a branch structure within the EU are required to hold regulatory capital at the level of the parent only. Whereas if a subsidiary structure was chosen each subsidiary will have to hold regulatory capital.
- Overall, the regulatory capital required of a branch structure would be lower than a subsidiary structure – as the branch structure will benefit from diversification of risks.
- For a regulated insurer, another benefit is the ability to pool assets (cash and investment assets) at a head office level. This provides efficiencies of scale, both in terms of access to markets and management cost efficiencies.
- An Irish insurer with branches in EU countries is subject to Prudential regulation only by the Central Bank of Ireland. Whereas separate subsidiaries in those EU territories would be separately regulated by the home state, significantly increasing the burden and cost of regulatory compliance (even if the Solvency II framework is common, there can be differing interpretations across the Union).

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.

Overall for the insurance sector, branches are active and used for insurance, reinsurance and insurance intermediation.

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.

In many cases branch structures are already in operation where they are beneficial from capital efficiency and commercial perspective as outlined above. However, when international groups are considering where to locate certain operations that need to operate via a branch structure, Ireland's current credit regime is a deterrent for those groups in considering Ireland as a location to establish operations.

The administrative burden of calculating double tax relief on an on-going basis is seen as complex and costly, especially given Irish tax is not expected to arise on branch profits where the foreign rate of tax is higher than 12.5%.

That being said, scenarios can arise where double taxation could occur across different taxable periods due to timing differences in the recognition of profits in Ireland and the foreign branch location. This risk of double taxation is of concern to multinational groups and can be a deterrent in choosing Ireland as a location for their European and non-European operations. Our complex credit rules do not provide double taxation relief in some scenarios.

While Tax and Duty Manual Part 35-02-06 seeks to address some scenarios, the administrative practice is complex and burdensome and doesn't cover all situations. It is also not a relief that is set out in legislation but rather a practice that can be amended or withdrawn by Revenue at any time which gives little certainly to taxpayers. As international accounting standards develop, the risk of such timing differences increases. By way of example, the recent introduction of IFRS 17, Insurance Contracts, can give rise to very large timing differences between Ireland and foreign branch locations. This significant issue would be addressed by the introduction of a foreign branch exemption.

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 noted above, where groups are considering where to locate certain operations that need to operate via a branch structure for non-tax reasons, Ireland will be a more desirable location if it has an optional branch exemption regime.

The activities to take place in Ireland in the head office will vary depending on the business in question. However, we note that in many cases, the head office activities and employee headcount can be significant, and this can attract further investment in Ireland by the group in question as Ireland becomes a "hub" for that group.

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.

As outlined in our response to Q54, this would have particular relevance for the Irish (re)insurance sector.

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.

The UK's branch exemption should be used as the model for Ireland's implementation. The UK's system provides for an elective basis which can be taken at any time but is irrevocable. The UK branch exemption also includes non-treaty countries, whereby the profits and losses allocated between the branch and the UK will be based on the OECD model treaty.

The UK legislation also has a number of transitional rules including a rule for companies that had claimed UK tax relief for non-UK branch losses. It allowed the exemption to be effectively deferred until any tax relief granted for those losses in the six years prior to the year the election is made, has been clawed back.

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.**

Transfer pricing
From a transfer pricing perspective, the use of the OECD's 2010 Report of the Attribution of Profits to Permanent Establishments is a long standing practice and was formally codified into Irish law as part of Finance Act 2021. Section 25A TCA 1997 (introduced in Finance Act 2021) sets out the approach/methodology to be used in attributing profits to the branch. It also sets out the documentation requirements. In respect of foreign branches of Irish companies, for participation exemption purposes, a similar approach could also be taken. This would only require a straight-forward addition to existing Irish legislation and it would be consistent with the approach taken in the UK.

Anti-avoidance
In the case of foreign branches, the current worldwide system of double tax relief (i.e. attribution of profits and losses to the Irish head office, with credit being granted in respect of foreign taxes due) should apply, with the option to make an election for branch exemption treatment on a branch by branch basis. To the extent that misallocation of branch profits or losses is a concern, appropriate anti-avoidance provisions could be considered (obviously with recognition of the steps already taken in recent years).

Special regimes
As noted above, the branch exemption should be optional on an election basis. Specific rules should not be required for special regimes such as Life Assurance Companies which are dealt with under Part 26 TCA 1997. Section 718 TCA 1997 is relevant only to Old Basis Business carried on by an overseas branch of an Irish life assurance company. In practice it has very limited application and use and there is no reason to amend the section following the introduction of a branch exemption.

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 foreign branch exemption regime would remove significant administration burden and the risk of double taxation across accounting periods. It would also align the Irish regime with and simplify the Pillar Two calculations. As you are no doubt aware, Pillar Two requires a consolidated ETR by jurisdiction taking into account profits attributable only to that jurisdiction i.e. it does not include profits of foreign branches.

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