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Roadmap to Introduction of participation exemption
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13 December 2023

To whom it may concern:

Roadmap to Introduction of participation exemption

We are writing in response to the September 2023 consultation published by the Department of Finance: 'Roadmap for the Introduction of a Participation Exemption to Irish Corporation Tax'.

The Irish Funds Industry Association (Irish Funds) is the voice of the funds and asset management industry in Ireland. Founded in 1991, our vision is that Ireland will be the premier location to enable and support global investing through its reputation for trust, capability and innovation. Our 150+ member firms are involved in all aspects of the establishment, management and servicing of investment funds which deploy capital around the world, support saving and investing across economies. The funds industry in Ireland is a leading location in Europe and globally, employing over 17,000 professionals and providing services to over 8,500 Irish regulated investment funds with assets of €3.7 trillion.

Introductory comments

Whilst Irish regulated funds do not, for the most part, pay income, corporation or capital gains tax in Ireland (noting that investors will be subject to the tax regimes of their own jurisdictions), many of our members have Irish and non-Irish subsidiaries, joint ventures and branches within their corporate structures and as such, we anticipate that the introduction of a dividend participation exemption and foreign branch exemption of taxation could have a significant impact for the industry.

As explored in greater detail in our responses to the Consultation's questions below, we recommend that Ireland introduces exemptions into its domestic legislation such that the receipt of foreign dividends and foreign branch profits will not be taxed in Ireland where certain qualifying conditions are met.

In addition to introducing exemptions from Irish taxation for foreign source income, as previously noted by Irish Funds, in order for Ireland to be successful as a domicile for private asset funds, it is critical that Ireland modernise our approach to the following:

- Align withholding tax regime for regulated Investment Limited Partnerships ("ILPs") to the regime afforded to other regulated funds.
- Develop a special asset holding company with specific gateway tests/qualifying criteria to ensure a fit for purpose asset holding company.

Finally, we recommend that Ireland updates the corporation tax treatment of capital gains on disposals of shareholdings. This should be effected by means of the following changes:

- Clarifying the interpretation and application of 'the scope of corporate reorganisation and reconstruction reliefs' where shareholders are otherwise tax exempt on income and gains from the company;
- Repeal of section 591A[1] which applies to the ambiguously defined concept of 'abnormal dividends'; and
- Reform of the existing capital gains tax exemption for substantial shareholdings in Section 626B to simplify and broaden the exemption thereby bringing Ireland's regime in line with similar international regimes, such as those operated in the UK and Luxembourg.

Case for a participation exemption

A participation exemption provides for an exemption from corporation tax on foreign dividends, foreign branch profits or foreign capital gains derived as a result of holding certain investments, provided certain qualifying conditions are met. It supports a territorial corporate tax base versus the imposition of corporate tax on a worldwide tax basis. Given the changing international tax and business landscape, and specifically taking into account the introduction of the global minimum effective tax rate under Pillar Two, Brexit, US tax reform and the global implementation of the OECD BEPS agenda, international asset managers are now considering appropriate locations for their operations, with a preference for onshore jurisdictions where they can match their regulated management substance with their asset owning entities; a trend which will likely continue given the proposed introduction of the third EU Anti-Tax-Avoidance Directive (ATAD III).

When compared to other European asset management centres, Ireland is considered an outlier. It is the only EU Member State without a participation exemption and is also one of five OECD Member States that does not operate some form of dividend participation exemption (the other four countries being Chile, Israel, Korea and Mexico) and taxes foreign income on a worldwide basis, with relief from double taxation provided based on a credit system. In the quest to attract foreign direct investment into Ireland, this mismatch against the international standard puts Ireland at a considerable competitive disadvantage.

When considering a participation exemption from the perspective of the Irish tax base, it is important to note that any dividends paid from an Irish company to another Irish company are already classed as 'franked investment income' and are not subject to tax in the hands of the recipient company. Any foreign dividends (including foreign branch profits) received by an Irish tax resident company are taxed at a rate of 12.5% / 25% depending on whether the income is regarded as trading or non-trading in nature (although this can be reduced to 0% in certain circumstances where the Irish recipient is a trader in securities). However, in the majority of cases, foreign dividend income is effectively exempt from Irish taxation through foreign tax credit relief. However, the calculation of this relief is very complex and burdensome to administer. It is particularly difficult to manage with respect to joint ventures, non-controlled shareholdings and income arising from multiple jurisdictions as the information required to compute the foreign tax credit may not be available to the Irish taxpayer. This added complexity acts as a major disincentive for Ireland as a holding

[1] Unless otherwise indicated, all legislative references are to the Taxes Consolidation Act, 1997.

company location for asset managers.

Furthermore, as you will be aware, the Government undertook a review of Ireland's corporation tax regime in 2017 ('the Coffey Report'), which was carried out by Seamus Coffey, an independent expert, appointed by the Minister for Finance. While the overall output of the Coffey Report stated that Ireland's current corporate tax system is transparent and fit for purpose, there were three main recommendations noted by Coffey, as well as a clear road map and time frame for Ireland to implement important international reforms.

In respect of the first two recommendations, Modernise Transfer Pricing and Intellectual Property Regime, recent Finance Acts have seen new provisions enacted into Irish legislation following these recommendations. The third recommendation fell under the heading of 'Competitive Territorial Regime'. In this regard, the Coffey Report specifically recommended simplifying the taxation of foreign income.

From a timing perspective, Brexit has presented a substantial opportunity to Ireland and specifically the Irish funds industry to encourage relocation of regulated business to Ireland. Accordingly, a point that is raised consistently by international businesses looking at relocating out of the UK, is that it is important that Ireland's tax regime is competitive and fit for purpose when compared to the other major European locations such as Luxembourg, the Netherlands and Germany, as well as Switzerland and the UK.

It is anticipated that private assets as an asset class will continue to grow significantly over the next 5 years. Private assets in a funds context is an area where Ireland has traditionally not been successful in attracting foreign investment, with private assets fund managers generally favouring the UK or Luxembourg. Establishing Ireland as a hub for private assets is particularly relevant at this moment in time, given the role that private assets played in the support of SMEs post the COVID 19 crisis. Putting Ireland, and domestic Irish enterprises in the spotlight for private assets firms is an important opportunity for the wider Irish economy with respect to the need for liquidity in the Irish market, along with the funds industry specifically, as discussed in more detail below.

Given the increased role private assets is expected to play in the growth of the international funds industry over the next 5 years, it is vitally important to the safeguarding of the Irish funds industry that Ireland is in a position to compete with other European fund centres to attract these managers to Ireland and protect employment in the Irish funds industry. While private asset funds are generally structured via a partnership vehicle, a holding company (opaque vehicle) will generally be used for each investment beneath the partnership to segregate assets and risks. In this regard, a participation exemption in a private assets context is crucial, as sufficient information to comply with Ireland's existing foreign tax credit regime will not be available in many cases, given the joint venture / minority holding nature of the investments.

In order to have a functioning partnership product, it is also necessary to have a competitive holding company structure. While the introduction of a participation exemption is crucial, it is but one step in modernising Ireland's approach to offer a successful domicile for private asset funds and we recommend further amendments are made to the existing Irish holding company regime to ensure it is fit for purpose for the asset management sector.

Ireland's current withholding tax regime with respect to payments of dividends to partnerships is complex and unclear. Clarity is needed to ensure repatriation to the partners in a partnership in an efficient manner and the withholding tax regime for regulated ILPs should be aligned to the regime afforded to all other regulated funds.

As noted above, we recommend that Ireland updates the corporation tax treatment of capital gains on disposals of shareholdings. We recommend that the dividend participation exemption should mirror the modified section 626B substantial shareholding exemption (as outlined in further detail throughout this response document). In particular, the requirement for the paying company/group to be "trading" should be removed. In our view retaining the "trading requirement" and replicating it in the dividend participation exemption could fatally undermine the participation exemption. While we have not considered this scenario in our response in detail, if removing the requirement is not done, rather than mirroring the criteria for the section 626B substantial shareholding exemption, a better alternative might be to align the new dividend participation exemption to the Pillar Two participation exemption for 'excluded dividends'.

In addition, given the recent introduction of the multilateral instrument into Ireland and the proposed introduction of ATAD III, private assets managers are focused on establishing their regulated substance in the same jurisdiction as their asset owning entities. In this regard, Ireland risks not being successful in attracting private assets managers to establish their regulated operations in Ireland (and the creation of substantial employment and corporate tax revenues for the State), where our tax regime is not fit for purpose and operationally practical.

Finally, the public consultation on a Territorial System of Taxation was released by the Department of Finance in December 2021. A number of industry bodies, including Irish Funds and other stakeholders provided responses to the queries raised as part of the Feedback process. A number of respondents addressed the policy benefits that could be achieved by the introduction of a participation exemption and branch exemption, including a simplified tax compliance process, greater certainty for businesses and enhancing Ireland's attractiveness as an investment location. In light of the above, it is our view that now is the right time for the introduction of the participation exemption in Ireland.

We remain at your disposal to discuss or provide additional detail on our responses which are set out below.

Yours faithfully,

Michelle Spencer
Director of Member Services

Part I – Dividend participation exemption

Structural Considerations

General Features

Q1. 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 Irish foreign tax credit regime (which is a patchwork of rules that have evolved over a number of decades) works such that in most cases Irish companies will not pay tax on dividends received from foreign subsidiaries as credit is given for both foreign withholding taxes incurred on those dividends as well as tax paid on the underlying profits out of which the dividends are paid. Moreover, in the case of dividends received from EU subsidiaries, additional tax credits are available which effectively 'top up' the available tax credits in certain circumstances.

As a result, Ireland could, in theory, be considered to be an attractive holding jurisdiction for a group (or subgroup of an international group). However, the complexity underpinning the foreign tax credit regime imposes a significant administrative and compliance burden on companies. As a result Ireland may be a relatively less attractive jurisdiction for group holding companies when compared to jurisdictions with a straightforward participation exemption. Thus, the introduction of an Irish participation exemption for dividends, coupled with the other technical amendments mentioned above, might result in international groups reorganising their affairs to use Ireland as a holding company jurisdiction in situations where, at present, they do not.

Q2. 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.

The regime should be simple, understandable, and its conditions capable of being applied without the need for extensive inquiry into the tax affairs and business operations of the paying company and providing full clarity to taxpayers as to its applicability.

Based on our observations of participation exemptions in other jurisdictions, we recommend that the dividend participation exemption should mirror the section 626B substantial shareholding exemption with a number of modifications implemented to section 626B. In particular:

- The exemption should not be limited to gains on shares of companies which are tax resident in EU or treaty countries. Instead it should be extended to apply to shares in all subsidiaries (appreciating that it may be appropriate to exclude certain jurisdictions that are on the EU non-cooperative list or similar).

- The nature of the activity of the subsidiary should not be a deciding factor in relation to the availability of the exemption. In particular, we do not think that the limitation imposed by section 626B that the subsidiary be carrying on trading activities should be retained.

Having such a requirement artificially imposes an Irish tax concept (*i.e.,* the distinction between trading and non-trading activities) onto the operations of another subsidiary where with a 5% shareholding it may be difficult or impossible to clearly delineate whether or not this condition is met. Moreover, we see no particular policy reason to limit the application of the exemption to companies which happen to be carrying on an activity which had it been carried on in Ireland, would have been taxed at the 12.5% rate.

Assuming that the above recommendations are adopted then the substantial shareholding exemption and the dividend participation exemptions would have the following (principal) features:

- The investor (*i.e.,* the company making the disposal / receiving the dividend) must be a "parent" of the investee at the time of disposal (or have been a "parent" within the 2 year period immediately prior to the disposal).

- The investor would be considered to be a "parent" of the investee if, for a continuous period of at least 12 months, it:
  - (I) holds, directly or indirectly, not less than 5% of the investee's ordinary share capital;
  - (II) Is beneficially entitled to not less than 5% of the investee's profits available for distribution to equity holders; and
  - (III) would be beneficially entitled, on a winding up, to not less than 5% of the assets of the investee available for distribution to equity holders.

- In determining whether this condition is satisfied, a company which is a member of 51%+ group is to be treated as holding any shares held by other members of the same 51%+ group and as having the same entitlements to any rights enjoyed by that other group member arising from it holding those shares.

The existing exclusions in section 626B would be retained such that the exemption would not apply to:

- gains which are otherwise exempt or transactions which would otherwise be deemed to occur for a consideration such that no gain or loss arises;
- shares deriving their value or greater part of this value from "specified assets" i.e., Irish land and buildings, or Irish minerals or any rights, interest or other assets in relation to mining or searching for minerals[2];
- assets attributable to certain life business funds; or
- gains arising on foot of a deemed distribution under the "exit tax" rules which apply where companies migrate their residency out of Ireland.

[As noted above, it is appreciated that it may be appropriate to exclude certain jurisdictions that are on the EU non-cooperative list or similar.]

[2] Anti-avoidance rules apply to certain arrangements which attempt circumvent this exclusion from the exemption by means of transferring money or certain other assets to a company in order to dilute the value of its specified assets relative to its total value.

Q3. 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 set out in our response to question 2, we believe that the dividend participation exemption regime should apply the same conditions as that in the existing substantial shareholdings exemption but with a number of modifications to that regime applied (and mirrored in the dividend participation exemption rules).

In summary:

- The exemption should not be limited to gains on shares of companies which are tax resident in EU or treaty countries. Instead it should be extended to apply to shares in all subsidiaries (appreciating that it may be appropriate to exclude certain jurisdictions that are on the EU non-cooperative list or similar).

- The nature of the activity of the subsidiary should not be a deciding factor in relation to the availability of the exemption. In particular, we do not think that the limitation imposed by section 626B that the subsidiary be carrying on trading activities should be retained. Having such a requirement artificially imposes an Irish tax concept (*i.e.,* the distinction between trading and non-trading activities) onto the operations of another subsidiary where with a 5% shareholding it may be difficult or impossible to clearly delineate whether or not this condition is met. Moreover, we see no particular policy reason to limit the application of the exemption to companies which happen to be carrying on an activity which had it been carried on in Ireland, would have been taxed at the 12.5% rate.

Assuming that the above recommendations are adopted then the substantial shareholding exemption and the dividend participation exemptions would have the following (principal) features:

- The investor (*i.e.,* the company making the disposal / receiving the dividend) must be a “parent” of the investee at the time of disposal (or have been a “parent” within the 2 year period immediately prior to the disposal).

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  - (I) holds, directly or indirectly, not less than 5% of the investee’s ordinary share capital;
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  - (III) would be beneficially entitled, on a winding up, to not less than 5% of the assets of the investee available for distribution to equity holders.

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- shares deriving their value or greater part of this value from “specified assets” i.e., Irish land and buildings, or Irish minerals or any rights, interest or other assets in relation to mining or searching for minerals;
- assets attributable to certain life business funds; or
- gains arising on foot of a deemed distribution under the “exit tax” rules which apply where companies migrate their residency out of Ireland.

[As noted above, it is appreciated that it may be appropriate to exclude certain jurisdictions that are on the EU non-cooperative list or similar.]

Q4. 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?

As set out in our responses to questions 2 and 3, we believe having a regime for dividend participation exemption which applies the same conditions as those for substantial shareholding exemption (with certain modifications) should allow for a straightforward exemption regime.

We do not believe that the substantial shareholding exemption is the subject of any material misuse or abuse (given the existing protections in that legislation) and, as a result, we do not expect that the application of a dividend participation exemption which applies a similar framework as outlined in this response and is in line with international norms should represent a vector for aggressive tax planning. As noted in our introductory comments, in our view Ireland is an outlier by not having an exemption of this type in its domestic legislation.

Specified jurisdictions

Q5. What are your views on the potential scope of jurisdictions that should be eligible for an Irish participation exemption?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company’s jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company’s business activities.

Q6. 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 discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities.

When compared to other European asset management centres, Ireland is considered an outlier. It is the only EU Member State without a participation exemption and is also one of five OECD Member States that does not operate some form of participation exemption. The urgency of the need for the introduction of a competitive territorial regime of double tax relief in line with international norms should therefore not be understated.

The framework adopted by the UK is a good starting point for an Irish dividend participation exemption. The UK introduced a dividend income exemption with effect from 1 July 2009. Most foreign dividends received by UK companies are exempt from corporation tax as a consequence of the application of the dividend income exemption. Their system achieves the goals of simplicity and operability that we have outlined above as core goals for the system. Furthermore, as they introduced their system in 2009 it was well tested within an EU law context while the UK was still a member of the EU.

As noted above, the effect of the existing Irish foreign tax credit regime is such that in a great many cases no Irish corporation tax is payable in respect of foreign dividends. Even in situations where there are dividends from low tax countries they will often qualify for pooling under that regime such that excess credits from one jurisdiction can be used to shelter dividends from another jurisdiction where the available tax credits would not otherwise fully shelter the Irish corporation tax.

We note also that in situations where dividends are receivable from a low tax jurisdiction, the introduction of controlled foreign company ("CFC") rules in the Irish tax legislation a number of years ago should act as an anti-avoidance mechanism to prevent the misuse of a participation exemption regime.

For these reasons, we do not believe that the participation exemption regime should be limited to EU and treaty countries. That said, we appreciate that it may be necessary to exclude certain jurisdictions such as those on the EU non-cooperative list.

Q7. 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?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities.

If the section 21B model is nevertheless applied, it would be essential not to limit to the application of the exemption to jurisdictions that have a domestic concept of tax residence (as is presently the case in section 21B). This would unfairly limit the application of the exemption based on whether the jurisdiction concerned has to use a tax residency concept.

Method of relief

Q8. 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?

While an exemption is slightly simpler, the deduction method helps to eliminate uncertainty about such income being 'subject to tax'.

More particularly, access to treaty based reliefs is often predicated on the company concerned (here an Irish tax resident company) being 'subject to tax' in Ireland. Relevant case law would support the interpretation in Ireland that a company will be considered 'subject to tax' in respect of income even if that particular income is exempted so long as the company is within the charge to corporation tax on the income. Thus, particular policy choices (such as the application of a participation exemption on dividends) does not mean that a company is not subject to tax. However, the possibility exists that a tax official in a foreign tax authority might interpret this phrase differently (not least because it could be translated in a number of different ways) such that they might conclude that a participation exemption in respect of dividends means that the subject to tax test is not met. To avoid this confusion, a system of inclusion with deduction may be helpful.

Relief for the full amount or only part of the dividend

Q9. In your view, should an Irish dividend participation exemption provide a full or partial exemption? Please provide reasons for your answer.

In our view a full exemption is much more preferable.

As noted in the Corporation Tax Roadmap published in September 2018 (and updated in September 2021), Ireland's current system of worldwide taxation, with relief provided by way of foreign tax credits, is deeply complex while also quite generous. This results in a situation where a great deal of effort is needed to apply the rules but, when that is done, they typically result in very little incremental tax being paid to the Irish exchequer. In particular, the additional foreign tax credit for dividends from EU resident companies effectively grants a relief equivalent to a participation relief in many cases already, but in a very complex fashion.

A move towards a territorial system should simplify tax compliance and provide greater certainty for businesses, while enhancing Ireland's attractiveness as an investment location with only a negligible (if any) loss of tax revenue.

Type of dividend/distribution and shares

Q10. 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?

In our view all distributions in respect of shares should be considered to be in scope of this exemption from corporation tax where the relevant conditions are satisfied (see our response to question 2).

[We appreciate that it might be considered necessary to limit the application of the exemption in a situation where a tax deduction is available to the paying company in respect of the relevant distribution. In such an eventuality, we think it would be appropriate to limit the application of the exemption by the amount of the tax deduction available to the paying company. Where the dividend participation exemption is implemented by means of taxing a foreign dividend but with a matching tax deduction, the limitation of the application of the exemption could be easily integrated into the exemption by reducing the amount of the deduction available to the Irish recipient company by the amount of the tax deduction available to the paying company.]

Subject to the foregoing, we see no policy reason to draw a distinction between dividends on different classes of shares (such as ordinary shares and preference shares) as the choice to use ordinary or preference shares would be a commercial decision and there is no particular reason to apply a different tax policy in either case (noting our above commentary in relation to tax deductible distributions).

Q11. Should a participation exemption apply to both income and capital distributions and, if so, how should a capital distribution be defined?

All distributions should be covered. An in-scope capital distribution should be defined to include any capital distribution not subject to corporation tax on capital gains.

Q12. Is there a rationale for extending a participation exemption to other classes of shares beyond distributions in respect of ordinary share capital?

As discussed in our response to question 10, we see no policy reason to distinguish between different types of distributions or different types of share class. The reasons for different forms of distributions or choices between share class will be a commercial one and where the tax treatment for the paying company is the same there is no policy reason for Ireland to treat those distributions differently insofar as a participation exemption regime is concerned.

Q13. 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.

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities (*i.e.,* the requirement for the paying company/group to be "trading" should be removed).

Minimum shareholding requirements

Q14. What are your views on the application of a minimum holding period in respect of participations qualifying for exemption?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

In summary:

- The investor (*i.e.,* the company making the disposal / receiving the dividend) should be a "parent" of the investee at the time of disposal (or have been a "parent" within the 2 year period immediately prior to the disposal).

- The investor would be considered to be a "parent" of the investee if, for a continuous period of at least 12 months, it:
  (I) holds, directly or indirectly, not less than 5% of the investee's ordinary share capital;
  (II) Is beneficially entitled to not less than 5% of the investee's profits available for distribution to equity holders; and
  (III) would be beneficially entitled, on a winding up, to not less than 5% of the assets of the investee available for distribution to equity holders.

- In determining whether this condition is satisfied, a company which is a member of 51%+ group is to be treated as holding any shares held by other members of the same 51%+ group and as having the same entitlements to any rights enjoyed by that other group member arising from it holding those shares.

We also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities.

Q15. 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)?

While we believe it is appropriate to have an ownership period (*i.e.,* 12 months as set out section 626B in relation to the substantial shareholding exemption from capital gains tax), we see no reason why it should be necessary for that ownership period to have passed before a dividend can qualify for a participation exemption.

In our view so long as that ownership period is ultimately satisfied, any dividend received prior to that period having lapsed should nevertheless qualify for exemption. In the event that the period has not passed it is a straightforward matter for tax on that dividend to be collected as, in many cases, the tax return for that period will not yet have been filed or in other circumstances it is easy to amend the relevant corporation tax return.

We see no policy reason to adopt a different approach as doing so would artificially encourage groups to defer payment of dividends which they would otherwise have made for good commercial reasons until the passing of an arbitrary time period (*i.e.,* 12 months). We submit that there is no benefit to the Irish Exchequer or any concern from a tax aggressiveness standpoint to adopting this approach.

Q16. 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?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

In summary:

- The investor (*i.e.,* the company making the disposal / receiving the dividend) must be a “parent” of the investee at the time of disposal (or have been a “parent” within the 2 year period immediately prior to the disposal).

- The investor would be considered to be a “parent” of the investee if, for a continuous period of at least 12 months, it:

  (I) holds, directly or indirectly, not less than 5% of the investee’s ordinary share capital;
  (II) Is beneficially entitled to not less than 5% of the investee’s profits available for distribution to equity holders; and
  (III) would be beneficially entitled, on a winding up, to not less than 5% of the assets of the investee available for distribution to equity holders.

- In determining whether this condition is satisfied, a company which is a member of 51%+ group is to be treated as holding any shares held by other members of the same 51%+ group and as having the same entitlements to any rights enjoyed by that other group member arising from it holding those shares.

We also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company’s jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company’s business activities.

Optionality

Q17. 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.

We are in favour of allowing optionality in respect of this exemption. This may be relevant in cases where an Irish holding company has a number of participations which do not qualify for the exemption (and in circumstances where the Section 21B exemption does not apply). Such a taxpayer might acquire a shareholding which qualifies for the participation exemption however it may make more sense for them not to exempt that dividend but instead use the existing foreign tax credit rules (including the foreign tax credit pooling rules) to better manage their overall corporation tax position. We do not consider that allowing such optionality represents a vector for aggressive tax planning. Rather it represents a sensible policy choice by Ireland.

Q18. Having regard to the above, if you are in favour, please outline your views on what basis optionality would operate.

In our view the exemption should apply on a dividend-by-dividend basis. The default application of the exemption with an 'opt out' condition may be the simplest administrative approach.

Q19. What anti-avoidance measures should apply in order to deter and prevent aggressive tax planning with regards to an optional exemption regime?

In our view the anti-avoidance measures in section 626B should be applied.

Q20. Should a participation exemption apply automatically once qualifying criteria is met, or should a business elect to apply the exemption?

In our view it should be automatic (but with an option to disapply).

Q21. Should an election apply on a subsidiary by subsidiary, dividend by dividend, year to year or other basis?

As set out in our response to question 18, in our view it should be on a dividend-by-dividend basis.

Q22. 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?

See our response to questions 16, 17, and 18. In particular:

- An Irish holding company might wish to opt-out of the exemption regime (and revert to the current system of taxing the income and claiming a double tax credit) in a case where that Irish holding company has a number of participations which do not qualify for the exemption. In circumstances where the Section 21B exemption does not apply, such a taxpayer might acquire a shareholding which qualifies for the participation exemption however it may make more sense for them not to exempt that dividend but instead use the existing foreign tax credit rules (including the foreign tax credit pooling rules) to better manage their overall corporation tax position.

- The election should be revocable and subject to normal rules for amendment to corporation tax returns.

Q23. 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?

In our view the availability of an option to disapply the participation exemption is appropriate from an Irish perspective.

As noted, our existing foreign tax credit regime often results in no additional Irish corporation tax being paid but its complexity makes it unattractive. A participation exemption regime should substantially improve Ireland's position in this regard. However, as discussed in our responses to questions 16 and 17, there are circumstances where it may make sense for a particular taxpayer to continue to use the foreign tax credit regime.

In our view there is no policy reason to prevent a taxpayer from choosing between the participation exemption and the use of the foreign tax credit regime.

Interest limitation

Q24. 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?

In our view this issue should be adequately addressed if, as discussed in our response to question 8, the regime is implemented such that the foreign dividends are included in the taxable income of the Irish company but a tax deduction is afforded against them.

Even if this approach is not adopted such that there may be a reduction in the deductibility of interest under the interest limitation rules, in our view the implementation of a participation exemption regime should nevertheless proceed.

Subject to tax rule

Q25. 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?

The consultation notes that CFC rules are commonly used in territorial systems to prevent the artificial diversion of profits offshore. Accordingly, CFC rules are not an uncommon feature of a territorial/part-territorial tax regime which would include a regime that provides for a participation exemption and/or a foreign branch exemption.

We believe that Ireland's CFC rules would not require amendments to cater for the introduction of a participation exemption on dividends.

Substance in Ireland

Q26. 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?

As discussed in our response to question 2, in our view the qualifying conditions for the exemption should be aligned with Section 626B rules *i.e.,* available if tax resident and ownership criteria met.

We note that the application of a participation exemption in Ireland is a domestic tax matter and is unconnected with any of the ATAD III proposals which relate to the application of foreign withholding taxes which is a matter for the jurisdiction of tax residence of the paying company concerned. We do not believe that similar conditions are typically included in participation exemptions in other countries.

Trading requirement

Q27. What are your views on a potential condition of exemption whereby relief only applies to certain trading companies?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities.

In particular, we submit that the requirement that subsidiaries carry on (mostly) trading activities (*e.g.*, trading) is obsolete and difficult to administer in complex group structures and will be difficult to apply to dividends whose source might be from multiple layers down a structure in a group with both 'qualifying' and 'non-qualifying' profits.

Q28. Should a participation exemption align with trading criteria applicable in other foreign subsidiary related reliefs such as section 21B and 626B? Please elaborate.

As set out in our response to question 27, in our view the trading criteria should be removed from section 626B and the dividend participation exemption regime should have the same criteria as the reformed section 626B.

In the event that a trading criteria were retained, we would recommend that the approach in section 21B whereby dividends may be deemed to come out of trading profits where certain conditions are met is adopted in the dividend participation exemption regime in order to attempt to simplify its application insofar as possible.

Transitional arrangements

Q29. 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?

We do not consider that there is any need for a lead-in period before a participation exemption regime is introduced.

In our view significant transitional issues ought not arise where the regime is optional. If not optional, we recommend the publication of legislation by mid 2024 and implementation of the legislation with effect from 1 January 2025.

Q30. Would you still be in favour of introducing a participation exemption if unutilised foreign tax credits were lost?

In the event that a dividend qualifies for the proposed participation exemption, we do not foresee an issue with the loss of unutilised foreign tax credits connected with that dividend so long as the option to disapply the exemption is enacted.

Q31. Are there other transitional arrangements that should be considered?

Transitional arrangements should have regard to the use of carried forward foreign tax credits from previous years.

Consequential impacts

Franked investment income

Q32. In your view, what are the main opportunities or issues in applying similar treatment to domestic and foreign dividend exemption regimes?

In our view, the exemption under Section 129 in respect of distributions on ordinary shares from Irish resident companies should be retained.

In our view, it would not be appropriate to apply the dividend participation rules to Irish dividends as the logic is fundamentally different. Specifically, Irish source dividends are paid out of profits already in the Irish tax net whereas foreign dividends are not. Thus, the exemption under Section 129 exists to ensure that there is no double corporation taxation of profits that have already been subject to tax in Ireland.

The proposed dividend participation exemption is predicated on a general idea that it is not business friendly to tax dividends received by companies where those dividends are paid out of profits that have been subject to tax in another jurisdiction. However, most countries that make a policy decision to adopt this stance do not do so in an unqualified manner. Instead, they apply the exemption only where certain qualifying conditions are met. Nevertheless, most such countries do not tax local companies on domestic source dividends irrespective of whether those participations satisfy the criteria applied to foreign participations.

A corollary of the above is that Section 138, which taxes certain Irish source dividends on preference shares, should be repealed and the exemption under Section 129 should be applied.

[As we discuss in our response to question 10, we appreciate that it might be considered necessary to limit the application of the dividend participation exemption in a situation where a tax deduction is available to the paying company in respect of the relevant distribution. Given that an Irish company that pays a dividend to which Section 138 applies cannot, in any circumstances, claim a tax deduction for such a dividend, it follows that there is should be no basis to treat such dividends differently to dividends on ordinary shares.]

Insofar as introducing a participation exemption to foreign dividends is concerned, the benefits of the move to such a system would be as follows:

- Enhancement of Ireland's competitiveness as an investment jurisdiction: The move to a territorial regime would enhance Ireland's competitiveness as an investment and holding company jurisdiction. The introduction of a complete participation and branch exemption, the absence of which has been a long-standing criticism of international investors, will bring the Irish tax treatment in line with that of competitor jurisdictions. Furthermore it has the potential to further increase the level of substance (and therefore employment) in Ireland;

- Greater tax certainty: Moving to a territorial system, and the associated removal of complex double taxation relief via the credit system, will provide greater certainty to investors as to their annual Irish corporation tax liabilities.

- Reduced compliance burden: A move away from the double tax credit system would significantly reduce the corporation tax compliance burden for multi-national enterprises. This would be particularly impactful for entities which, for regulatory or other reasons, operate a number of foreign branches. This would bring their tax treatment in line with those of similar enterprises headquartered in other EU jurisdictions. There are currently varied mechanisms to obtain double taxation relief depending on the specific fact pattern resulting in layers of administration which is timely and costly for taxpayers. A move to a territorial regime should be less burdensome without adversely impacting the exchequer. This will create a benefit not just for taxpayers but also for the Revenue Commissioners who administer the system and audit the returns – a less complex system should help reduce pressure on Revenue's resources.

- Removal of adverse tax impact of inadequate information: The requirement to calculate double tax relief can present unique difficulties in the investment funds industry, as the information required to calculate relief may not be easily available in the case of joint ventures or non-controlling shareholdings. This can result in a requirement to pay Irish tax on profits which have already been taxed abroad, but in respect of which it is not possible to acquire the necessary information to compute the foreign tax credit available. A move to a territorial regime should effectively remedy this issue, and should enable investors to more easily avail of the relief to which they are entitled. As above, this should also benefit the Revenue Commissioners as a simpler system should be easier to administer and audit.

Q33. 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?

No; as discussed in our response to question 32, in our view it would not be appropriate to align the tax treatment of domestic and foreign dividend exemption regimes as the logic behind each is fundamentally different. Irish source dividends are paid out of profits which are already in the Irish tax net whereas foreign dividends are not. Moreover, Section 138, which taxes certain Irish source dividends on preference shares, should be repealed and the exemption under Section 129 should be applied.

Portfolio investors

Q34. 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 discussed in our response to question 2 in connection with the taxation treatment of franked investment income, the benefits of the portfolio exemption under section 21B include the enhancement of Ireland's competitiveness as an investment jurisdiction, the reduction of the compliance burden, and greater tax certainty.

We note that the exemption provided for in section 21B is limited and only applies to dividends which are within the charge to tax under Schedule D, Case I.

Q35. What are the arguments for or against retention of a portfolio exemption following the introduction of a participation exemption?

In our view the portfolio exemption in section 21B should be retained irrespective of whether or not a dividend participation exemption is introduced.

The exemption in section 21B is available in respect of dividends which are included in the trading income of the recipient company. However, for the most part the participation exemption will be applicable to dividends that are received by companies and are taxed otherwise than as part of their trading income (while there will be a number of circumstances where it is possible that the dividends would form part of the trading income of the recipient, we expect that these would be a minority of cases). Therefore, we see no policy reason to remove the exemption in section 21B, which is in respect of certain trading income, simply because the dividend participation exemption is introduced in respect of a broader class of dividends.

Q36. 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 see no reason why the introduction of a participation exemption should require the removal of the portfolio exemption. We believe they are not mutually exclusive and are predicated on different circumstances. Section 21B exemption only applies to dividends taxed as trading income whereas the proposed exemption is for non-trading income.

Q37. 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?

No modifications or anti-avoidance provisions should be introduced in relation to the tax treatment of portfolio investments in Ireland. In our view the existing protections are adequate.

Alignment with existing Irish reliefs for foreign subsidiaries

Q38. 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?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities.

As discussed in our response to question 28, in the event that a trading criteria were retained, we would recommend that the approach in section 21B whereby dividends may be deemed to come out of trading profits where certain conditions are met is adopted in the dividend participation exemption regime in order to simplify its application insofar as possible.

Q39. 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?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities.

Q40. 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?

As discussed in our response to question 2, we recommend that the conditions for the dividend participation exemption should be the same as the substantial shareholding exemption.

However, we also recommend that the conditions in section 626B should be modified so as to apply without regard to the paying company's jurisdiction of residence / establishment and the exemption should not be contingent on the nature of the paying company's business activities.

Deductibility of expenses related to exempt income

Q41. What are the considerations in support of or against allowing a deduction for expenses related to exempt foreign dividend income?

Irish tax legislation already includes significant protections from base erosion through the use of interest deductions, particularly following the introduction of interest limitation legislation (without any removal of pre-existing protections which were already provided for in legislation). The imposition of any further restrictions would add complexity to an already complex set of interacting measures concerning the deductibility of interest. In particular, there are already restrictions on the use of such deductions such that they are capable of being deducted against taxable interest and taxable dividends only. As a result, we do not recommend introducing any further restrictions. The interest limitation rules provide an adequate level of protection against base erosion.

By way of example, when the UK introduced a branch and dividend tax exemption, it also introduced interest limitation rules which are similar (albeit not identical) to those prescribed by the EU Anti-Tax Avoidance Directive No additional measures were necessary and accordingly no additional measures were introduced.

Close company surcharge

Q42. What are the considerations in relation to applying a close company surcharge in a regime incorporating a participation exemption for foreign dividend income?

The existing exclusion from the surcharge in respect of dividends on shares to which section 626B would apply should be appropriate where participation exemption criteria are aligned to be section 626B criteria.

Specific tax regimes

Q43. 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.

We have considered legislative provisions that could be affected by a change in how foreign dividends are taxed as well as other amendments which are required in modernising Ireland's approach to offer a successful domicile for private asset funds.

<u>Section 172A</u>

Section 172B imposes dividend withholding tax on distributions made by Irish tax resident companies and Section 172C provides for a number of exemptions from the imposition of this tax including with respect to distributions paid to a 'collective investment undertaking'. For these purposes the term 'collective investment undertaking' is defined in Section 172A.

At present, an ILP is not included in that definition while all other forms of regulated Irish collective investment undertaking are included.

We do not believe there is any policy reason for excluding ILPs from the existing exemption for collective investment undertakings. While an ILP is a tax transparent entity, we note that so are common contractual funds ("CCFs") to which the exemption applies. Consequently, there is no distinction (from a tax perspective) between ILPs and CCFs and ILPs should be afforded the same treatment as for other regulated investment funds.

The exemption is of particular importance for ILPs given the objective of better competing for global private equity investment. Private equity funds normally make their investments through wholly-owned subsidiaries, which are typically incorporated in the same jurisdiction as the fund. For Ireland to be competitive as a domicile for private equity funds, it is fundamentally important that there is no withholding tax on distributions to an ILP from its Irish subsidiaries. Otherwise, this withholding tax could negate the appeal of the other very welcome improvements to the ILP legal and regulatory regime.

Consequently, the definition of "collective investment undertaking" should be updated to include an ILP to align the withholding tax regime for regulated ILPs to the regime afforded to other regulated funds as follows (revisions shown in red font):

> *"collective investment undertaking" means—*
> - *(i) a collective investment undertaking within the meaning of section 734,*
> - *(ii) an undertaking for collective investment within the meaning of section 738,*
> - *(iii) an investment undertaking within the meaning of section 739B (inserted by the Finance Act, 2000), ~~or~~*
> - *(iv) a common contractual fund within the meaning of section 739I (inserted by the Finance Act 2005), or*
> - *(v) an investment limited partnership within the meaning of the Investment Limited Partnerships Act 1994.*

Outbound payments defensive measures

The definition of "excluded payment" in Section 817U applies to a payment, or a portion thereof, made by a company to the extent that it is reasonable to consider that an amount of income, profits or gains arising from the payment is within the charge to supplemental tax, foreign tax, or domestic tax. A clarification should be included in the legislation to confirm that a payment which qualifies for the dividend participation exemption or foreign branch exemption (or the equivalent thereof in another territory) is considered to be is within the charge to supplemental tax, foreign tax, or domestic tax (as the case may be).

Section 129A

Section 129A disapplies the exemption from corporation tax in respect of franked investment income for dividends of certain companies which have become tax resident in Ireland 10 years before the relevant distribution is made. In our view this provision should be disapplied where dividends would have qualified for the participation exemption had the relevant company not become Irish tax resident.

Part 28

In addition, Part 28 contains numerous provisions in relation to the taxation treatment applicable to certain holdings of shares and securities. We consider that it would be beneficial to clarify the non-application of these sections in a case where the participation exemption applies (and in certain cases, such as section 752, we consider that it would be helpful to clarify that where an exemption under section 129 or section 626B applies, these sections have no application).

Section 110

In our view all three exemptions (substantial shareholdings exemption, dividend participation exemption, and foreign branch exemption) should be made available to qualifying companies within the Section 110 regime. We can see no policy reason why dividends and gains in respect of shareholdings which satisfy the relevant conditions should be exempt outside the Section 110 regime but taxable within it. There is no good rationale for Section 110 companies to be treated differently to all other Irish companies on this issue. Moreover, in our view these proposals should significantly simplify the Irish taxation treatment for dividends and gains for companies generally and Section 110 companies in particular without materially adversely impacting the exchequer (as the existing foreign tax credit regime, while complex, will in most cases result in no net Irish arising).

Thus, the enacting provisions of the dividend participation exemption and branch profits legislation should have application to qualifying Section 110 companies and should also extend the application of section 626B to qualifying Section 110 companies.

In addition, Section 129 provides for an exemption from corporation tax in respect of distributions on ordinary shares from Irish resident companies. This is the case irrespective of whether the recipient is receiving the dividends in the course of a trading activity or as non-trading income. In a recent publication, the Revenue Commissioners stated that such Irish dividend income is subject to corporation tax in the hands of Section 110 companies, thereby applying a different treatment compared to all other Irish companies. We can see no policy reason why Section 110 companies should be treated differently to all other Irish companies on this issue; moreover, it is not clear that this interpretation of the law would be upheld by the Courts. Consequently, we do not think this more limited interpretation was intended and even if it was, it would be inconsistent with the application of a dividend participation exemption (*i.e.,* it would be inconsistent to tax domestic dividends while exempting foreign dividends). Thus we believe the uncertainty should be resolved through legislative amendments which could be implemented as part of the introduction of the dividend participation regime.

Q44. What amendments, if any, would be required to those provisions in order to ensure their continued operation in conjunction with a participation exemption?

Please see our response to question 43. In summary:

- The withholding tax regime for regulated ILPs should be aligned to the regime afforded to other regulated funds.

- Outbound payments legislation should be amended to ensure that the introduction of a dividend participation exemption does not inadvertently bring payments which would otherwise not be in scope of the rules into scope.

- Section 129A should be disapplied where dividends would have qualified for the participation exemption had the relevant company not become Irish tax resident.

- It would be beneficial to clarify the non-application of various sections of Part 28 where the participation exemption applies (and in certain cases, such as section 752, we consider that it would be helpful to clarify that where an exemption under section 129 or section 626B applies, these sections have no application).

- All three exemptions (substantial shareholdings exemption, dividend participation exemption, and foreign branch exemption) should be made available to qualifying companies within the Section 110 regime.

Anti-avoidance rules

Q45. What type of anti-avoidance provisions should be incorporated into a participation exemption in order to eliminate opportunities for tax avoidance?

As set out in our response to question 2, in our view the criteria for the application of the dividend participation exemption should mirror a modified form of Section 626B. In this regard, we believe that the anti-avoidance provisions in that section should be adequate.

Q46. Are there features of existing anti-avoidance provisions that could be enhanced in order to support this aim?

We have not identified any additional anti-avoidance provisions which we think need to be enacted.

Controlled Foreign Companies

Q47. Are there other legislative amendments required to CFC rules in order to ensure they are robust enough in the context of a participation exemption?

The consultation notes that CFC rules are commonly used in territorial systems to prevent the artificial diversion of profits offshore. Accordingly, CFC rules are not an uncommon feature of a territorial/part-territorial tax regime which would include a regime that provides for a participation exemption and/or a foreign branch exemption.

We believe that Ireland's CFC rules would not require amendments to cater for the introduction of a participation exemption on dividends.

Anti-hybrids / Non deductibility in payor jurisdiction rule

Q48. 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?

In our view if the participation exemption is implemented in line with our recommendations set out in our response to question 8, no such adjustments should be required. In summary:

- While an exemption is slightly simpler, the deduction method helps to eliminate uncertainty about such income being 'subject to tax'.

- More particularly, access to treaty based reliefs is often predicated on the company concerned (here an Irish tax resident company) being 'subject to tax' in Ireland. To avoid this confusion, a system of inclusion with deduction may be helpful.

Q49. 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?

We have not identified any such provisions which we consider should be implemented as part of the dividend participation exemption.

Interaction with Pillar II of the OECD Inclusive Framework

Q50. Are there features of the Pillar II regime that should be considered and taken into account when designing a dividend participation exemption?

A dividend exemption regime and a branch exemption are both aligned with Pillar Two, so we expect there should be overlap in implementing the respective rule sets. From the perspective of the asset management industry, it will be important that there is sufficient stakeholder consultation as part of the legislative drafting process, to ensure that the exemptions provided in relation to investment funds take into account the complexities which can be involved in certain fund structures, whilst also satisfying the requirements of the relevant EU Directive.

In terms of potential Pillar Two considerations, it is proposed under Article 15 of the current draft Directive (on ensuring a global minimum level of taxation for multinational groups in the Union) that dividends received and gains arising on the disposal of shares (except dividends/gains arising in relation to shareholdings of less than 10%) are excluded from the calculation of an enterprise's qualifying income when determining whether the minimum tax rate has been paid.

The exclusion of these items would be aligned with their treatment under a full participation exemption, and it is therefore unlikely that the introduction of a participation exemption should have any adverse interaction with Ireland's introduction of the Pillar Two rules in accordance with the Directive. For completeness, we recommend that the 5% ownership threshold in the current exemption for gains on substantial shareholdings is retained generally notwithstanding that this might mean that the exclusion does apply to in-scope tax payers if their participation is between 5% and 10% (or, if that is not seen as desirable, that a 10% threshold apply only to in-scope taxpayers).

Similarly, it is proposed under Article 17 that the financial results of any permanent establishment abroad (*i.e.,* a branch) shall not be taken into account in determining the qualifying income of the main entity. This treatment would be aligned with the treatment of a branch's financial results under a branch exemption, and it is therefore also unlikely that the introduction of a branch exemption should have any adverse interaction with the Irish Pillar Two rules.

Transfer Pricing

Q51. Do you foresee potential impacts arising from moving to a participation exemption for Ireland's transfer pricing regime?

We do not believe that there should be any material impacts from a transfer pricing perspective. In general, transfer pricing is not relevant to dividends and other distributions on shares and, therefore, we do not envisage that there should be a need for any material modification to the Irish transfer pricing regime.

Multilateral Instrument provisions

Q52. Do you foresee a need to adopt any provisions of the Multilateral Instrument in conjunction with a participation exemption?

[We have not identified any MLI provisions which we think need to be adopted.]

Any other issues

Q53. 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?

Treaties

Many international tax treaties were negotiated on the basis of the credit method for relieving double taxation and, later, one or both of the contracting States moved to a territorial or part-territorial system of tax. To our knowledge those treaties were not amended as a direct consequence. We do not foresee a negative impact in terms of how our tax treaties would operate going forward if Ireland were to move to a participation exemption and/or branch exemption regime. Indeed, because we expect that the regimes would be criteria based, it does not entirely change Ireland's tax regime from a worldwide system to a territorial system. Where the criteria for a participation exemption are not met, the current regime would apply and foreign tax credits should be available in line with the current regime. A move towards a participation/branch exemption would bring Ireland's regime in line with similar international regimes, such as those operated in the UK and Luxembourg (two treaty-partner territories).

Foreign tax credit regime

As set out in the introduction to the consultation, the legislation governing double tax relief, contained in Schedule 24, has become more complex over many years in response to changes in policy and to accommodate principles established by European case law. The Coffey Review considered that, instead of moving to a territorial corporation tax base, Schedule 24 could be simplified on a policy and tax neutral basis.

We believe that a review and simplification of schedule 24 is desirable for those dividends that do not qualify for exemption. However, our view is that the introduction of a participation exemption in addition to those reforms and branch exemption is preferable to the reform of Schedule 24 only.

CFC regime

The introduction of CFC legislation in Ireland from 1 January 2019 effectively prevents Irish companies from profit shifting to low tax jurisdictions and paved the way for moving to a territorial system, in line with the BEPS Model and other global tax systems. As mentioned below, the introduction of a participation exemption should not result in any net cost to the exchequer but there will be a real gain to taxpayers in reducing the compliance burden and eliminating unnecessary complexity and uncertainty.

Part II – Foreign branch exemption

General

Q54. 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?

Yes, some Irish companies have foreign branches. This is not uncommon in regulated financial services industries where passporting of authorisations is needed.

The use of a foreign branch is also common in the start-up phase of foreign operations where a full subsidiary is not yet justified.

The jurisdictions involved are global though EU and UK branches are perhaps more prevalent amongst companies carrying on regulated financial services.

Q55. What activity is carried out in the foreign branch structures? Responses should include, for example, sectoral information, whether activity is trading or passive, etc.

This varies considerably. As a general comment many such branches will be carrying on trading activities of a service character.

Examples of regulated financial services companies operating through a foreign branch structure include:

- An investment fund manager with operations in multiple EU Member States under a 'management company passport' issued by a regulator of a single Member State;
- A bank operating through a branch network across multiple EU Member States, using a Fourth Capital Requirements Directive passport issued by a regulator in a single member state
- An investment firm holding a Markets in Financial Instruments Directive passport issued by a regulator of a single Member State;
- A payment services institutions holding a Payment Services Directive passport issued by a regulator of a single Member State;
- An insurance or reinsurance firm providing services in multiple EU Member States under a Solvency II passport issued by a regulator in a single EU Member State.

Although regulatory passporting allows financial services companies to provide cross-border services, they may nevertheless require a physical presence for commercial and operational reasons (e.g. to interface with customers).

Q56. 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.

Ireland currently offers full credit relief to Irish companies for foreign corporation tax paid on foreign branch profits (Schedule 24). This means that in practice Irish companies with foreign branches often pay no incremental Irish tax on foreign branch profits. Therefore, Ireland should be an attractive location for companies that operate globally through a branch structure (such as banks and other institutions carrying on regulated financial services).

However, the complexity surrounding the taxation of foreign branches and the utilisation of foreign tax credits in particular can pose a significant administrative and compliance burden and act as a disincentive to using a branch structure. Companies operating through a branch structure generally prefer to establish their headquarters in jurisdictions that exempt foreign branch profits from corporation tax, such as the UK.

Q57. 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?

One of the reasons Irish companies transfer foreign branches into subsidiaries is to simplify their Irish tax filing position by taking the profits of foreign operations off their balance sheet. However, incorporation can also introduce inefficiencies from a commercial, business operations and regulatory standpoint. Therefore, we think that this change will be attractive to some groups with existing operations in Ireland as it will offer them the possibility to reorganise foreign subsidiaries into foreign branches where doing so simplifies their business operations and / or regulatory position. Equally, this change should reduce the pressure on Irish SMEs to transfer foreign branches into subsidiaries.

We also believe that such an exemption will make Ireland more attractive to foreign groups which already operate through branch structures (*e.g.,* regulated financial services).

Q58. 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 noted at our response to question 54, this will be of relevance to companies carrying on regulated financial services and SMEs.

Q59. 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.

In our view, the framework adopted by the UK is a good starting point for an Irish branch exemption. This would result in the following principles applying:

- It is enacted as an elective regime.
- Applicable to all profits and gains attributable to the branch.
- Profits would be allocated using OECD principles and assuming that a branch of a company is a separate company from that company.
- The branch is deemed to be connected with the head-office and any other branches.
- Transactions with the head-office or other branches are considered to be transactions between connected parties and subject to rules applicable to such.
- The branch is treated as a CFC resident in the territory where it is established.
- Payments by the branch are outside the scope of Irish withholding taxes.
- Distributions from the branch are exempt from tax under the dividend participation exemption.
- Rules are put in place to deal with the initial transition to an exempt branch and any subsequent dissolution of an exempt branch.

Q60. 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.

Exit tax

Article 5(1) ATAD1 provides for an exit tax charge in certain circumstances and section 627 imposes an exit tax charge pursuant to ATAD1.

However, the existing Irish exit tax provisions have not transposed article 5(1)(a) which imposes an exit tax charge where:

> *A taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third country insofar as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer*.

This is potentially because of the worldwide regime of taxation currently operated in Ireland. In the event that an Irish resident company were to transfer assets to its foreign permanent establishment, the company would retain taxing rights over assets transferred. If a foreign branch exemption were to be introduced, such assets would likely be removed from the Irish tax net and as such, some amendments may be required to existing legislation to take this into account.

In addition, consideration should be given to instances where an exit tax charge may arise on the migration of tax residence from Ireland to another Member State or third country pursuant to section 627(2)(c). Such considerations arise in the context of a potential foreign branch exemption and the manner in which assets in use by the foreign branch are to be taken into account in the computation of any Irish exit tax charge.

Section 26(1) provides for the application of the worldwide regime currently in force in Irish law and provides that "*Subject to any exceptions provided for by the Corporation Tax Acts, a company shall be chargeable to corporation tax on all its profits wherever arising"* (profits in this context being read in conjunction with section 4 as meaning "*income and chargeable gains"*). Therefore, for an Irish tax resident company, the Irish tax net extends to include gains made on assets held in Ireland and those held by/attributable to a foreign branch. We would therefore recommend that if a foreign branch exemption is adopted, it should exempt not only income of the foreign branch, but also gains made on a disposal of assets used or attributed to a foreign branch including a deemed disposal under section 627. Finally, any exit tax charge should continue to be subject to the provisions of section 627(3) to allow for an exclusion where Ireland retains taxing rights on a subsequent disposal of assets.

CFC regime

The consultation notes that CFC rules are commonly used in territorial systems to prevent the artificial diversion of profits offshore. Accordingly, CFC rules are not an uncommon feature of a territorial/part-territorial tax regime which would include a regime that provides for a participation exemption and/or a foreign branch exemption.

The existing CFC rules should combat non-genuine arrangements arising with foreign branches. Amendments to those rules may be needed for their application to a foreign branch in relation to the operation of the concepts of 'undistributed income' and 'relevant distributions'.

Anti-hybrid rules

The introduction of a branch exemption could result in certain arrangements which are not currently within the scope of Ireland's anti-hybrid legislation (due to the provisions of Section 835AB) falling within scope of the rules. For example, to the extent a foreign branch of an Irish company makes a tax-deductible payment to its head-office, the payment would be regarded as a 'disregarded payment' in the context of Section 835AB. A hybridity issue could arise in relation to such a scenario (and others involving branches) where there is a full branch exemption in place if that exemption does not treat tax-deductible payments from the branch to its head-office as taxable income of the head-office (in which case a deduction-without-inclusion mismatch could occur).

Although we do not see any specific risks or synergies in the context of anti-hybrid legislation, it would be crucial that the interaction with anti-hybrid legislation is closely considered, to ensure any necessary amendments are made to deal with examples such as that outlined. Such amendments should seek to maintain the balance between preventing tax regime arbitrage and ensuring that there is certainty in relation to the taxation of cross-border arrangements.

One possible design feature of the regime which could be applied would be to allow optionality regarding whether / when branch profits or foreign source dividends are taxable.

In addition, while chapter 3 of Part 35C has a framework for dealing with hybrid mismatches involving disregarded permanent establishments, this legislation may need some further modification to address situations where profits are neither taxed in Ireland (due to the branch exemption) nor the jurisdiction where the branch is established due to differences in profit allocations.

Foreign tax credit regime

As set out in the introduction to the consultation, the legislation governing double tax relief, contained in Schedule 24, has become more complex over many years in response to changes in policy and to accommodate principles established by European case law. The Coffey Review considered that, instead of moving to a territorial corporation tax base, Schedule 24 could be simplified on a policy and tax neutral basis.

We believe that a review and simplification of schedule 24 is desirable for those dividends that do not qualify for exemption. However, our view is that reform of Schedule 24 should complement the introduction of the foreign branch profit exemption.

Section 110

As discussed in our response to question 43, in our view all three exemptions (substantial shareholdings exemption, dividend participation exemption, and foreign branch exemption) should be made available to qualifying companies within the Section 110 regime. In our view these proposals should significantly simplify the Irish taxation treatment for dividends and gains for companies generally and Section 110 companies in particular without materially adversely impacting the exchequer (as the existing foreign tax credit regime, while complex, will in most cases result in no net Irish arising).

Thus, the enacting provisions of the dividend participation exemption and branch profits legislation should have application to qualifying Section 110 companies and should also extend the application of section 626B to qualifying Section 110 companies.

Q61. 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?

As set out in our initial comments, given the changing international tax and business landscape, and specifically taking into account the introduction of the global minimum effective tax rate under Pillar Two, Brexit, US tax reform and the global implementation of the OECD BEPS agenda, international asset managers are now considering appropriate locations for their operations, with a preference for onshore jurisdictions where they can match their regulated management substance with their asset owning entities.

When compared to other European asset management centres, Ireland is considered an outlier by its lack of a foreign branch exemption. In the quest to attract foreign direct investment into Ireland, this mismatch against the international standard puts Ireland at a considerable competitive disadvantage.

From a timing perspective, Brexit has presented a substantial opportunity to Ireland and specifically the Irish funds industry to encourage relocation of regulated business to Ireland. Accordingly, a point that is raised consistently by international businesses looking at relocating out of the UK, is that it is important that Ireland’s tax regime is competitive and fit for purpose when compared to the other major European locations such as Luxembourg and France.

It is anticipated that private assets as an asset class will continue to grow significantly over the next 5 years. Private assets in a funds context is an area where Ireland has traditionally not been successful in attracting foreign investment, with private assets fund managers generally favouring the UK or Luxembourg. Establishing Ireland as a hub for private assets is particularly relevant at this moment in time, given the role that private assets played in the support of SMEs post the COVID 19 crisis. Putting Ireland, and domestic Irish enterprises in the spotlight for private assets firms is an important opportunity for the wider Irish economy with respect to the need for liquidity in the Irish market, along with the funds industry specifically, as discussed in more detail below.

Finally, the public consultation on a Territorial System of Taxation was released by the Department of Finance in December 2021. A number of industry bodies, including Irish Funds and other stakeholders provided responses to the queries raised as part of the Feedback process. A number of respondents addressed the policy benefits that could be achieved by the introduction of a participation exemption and branch exemption, including a simplified tax compliance process, greater certainty for businesses and enhancing Ireland's attractiveness as an investment location. In light of the above, it is our view that now is the right time for the introduction of the participation exemption in Ireland.