

LAW SOCIETY SUBMISSION



CONSULTATION ON A TERRITORIAL SYSTEM OF TAXATION

DEPARTMENT OF FINANCE

MARCH 2022

1. Introduction

This submission is provided in response to questions raised in the [Public Consultation on a Territorial System of Taxation December 2021](#).

2. Questions and responses

1. **What is your opinion of Ireland's corporate tax potentially moving from the current worldwide system with credit relief for foreign tax to a territorial system of double taxation relief, including participation exemption and/or both exemption provisions?**

We are very much in favour of Ireland moving from the current worldwide system with credit relief for foreign tax to a territorial system of double taxation relief, including participation exemption. We consider that a territorial system would be simpler in its application and more in line with the taxation systems of other jurisdictions, making Ireland more competitive.

We think that the timing is right to move to an exemption method now that Ireland has implemented the Controlled Foreign Company ("CFC") rules in Part 35B of the Taxes Consolidation Act, 1997 (the "TCA"). Effectively, Ireland, together with the other Member States of the EU now has a list of non-cooperative jurisdictions. Defensive measures are applied to jurisdictions which are on the list.

Traditionally, the rationale for Ireland's credit based system may have been based on either a wish to preserve the tax base in Ireland on receipt of distributions but to offer relief for foreign tax or on a respect for the sovereignty of other jurisdictions in relation to their local tax affairs. Ireland did not concern itself with the tax rules of those jurisdictions. Rather, to ensure that there would not be double non-taxation, Ireland taxed all dividends fully under the credit based system. It meant that Ireland did not need to ascertain the tax position of its counterparty jurisdictions. Given that Ireland now needs to be aware of the tax position of other jurisdictions, because of the CFC rules, it is the perfect time to move to a territorial system of double taxation relief.

The timing is also right to move to an exemption system because of the changes in the global corporate tax systems. These include the proposed directive to ensure a minimum effective tax rate for the global activities of large multinational groups, which rate will be higher than the standard corporate tax rate currently in force in Ireland. Exemptions might not apply in non-cooperative jurisdictions so it is safe from tax avoidance.

Also, as the exemption system is effectively already in place for Irish and EU distributions, it would be more fair to extend it to all forms of double taxation.

We also consider that the participation exemption which we currently enjoy for capital gains under Section 626B TCA should be made easier to access by, for example, dropping the trading requirement and/or removing the limitation of the relief to where the investee company is by virtue of the laws of the 'relevant territory' resident for the purposes of tax in

a relevant territory. This latter requirement gives rise to significant compliance issues and unintended restrictions on relief in dealing with multi-national groups which can comprise of different types of entities, in different jurisdictions. Easier access to the participation exemption in this manner would align the Irish regime with other holding company regimes and would make Ireland more competitive as a holding company jurisdiction.

It would also be of benefit to use the opportunity presented by this consideration of moving to a new corporate tax system, to look at other simplifications in our tax code and to eliminate provisions which are no longer necessary. We believe it is also time for another consolidation of our tax code, given that 25 years have passed since the last consolidation.

2. What would the broad benefits be for multi-national enterprises if Ireland were to move to so such a system?

Multi-national enterprises (“MNEs”) would benefit from the more simple system of taxation in dealing with dividends from subsidiaries and foreign branch profits - it would give more certainty in planning and would encourage more repatriation of profits to Ireland. It would also reduce compliance complexities and costs.

In addition, the move would eliminate any concerns about the compatibility of Schedule 24 with EU law and the technical issues that can arise in its application.

3. Are there any particular drawbacks or concerns for multi-national enterprises which should be considered if Ireland were to move to such a territorial system of double tax relief, including any indirect consequences or risks?

We are not aware of any drawbacks or concerns for MNEs.

We consider that nothing arises *per se* from the move to a territorial system of double taxation relief (something that would not exist for MNEs otherwise). Essentially, we see the issues and risks facing MNEs as broadly the same whether there is a credit system or an exemption system.

Potentially, there may be an issue with existing financing arrangements and a loss of deductibility. A facility would be needed to identify those cases together with a means to facilitate them which recognises the interest on monies borrowed to finance overseas activities. When moving regimes, it might be preferable to run a period of duality or grandfathering provisions so that taxpayers can elect into one or other system in case a new territorial system would give rise a disadvantage over the existing regime.

In general, however, we expect that the changes should be either advantageous or neutral for taxpayers.

4. Are there particular examples of best practice associated with a change to territoriality in other jurisdictions which could be considered, with a view to reducing compliance burdens without increasing avoidance risks?

We are not privy to examples of best practice but expect that it may be beneficial to consider the way in which the tax rules in this area operate in Luxembourg and the Netherlands, without risk of tax avoidance.

5. Taking account of the above, what in your view would be the potential impacts of moving to a participation exemption regime as set out in the Coffey Report?

We consider that moving to a participation exemption regime (as set out in the Coffey Report) would make Ireland more attractive as a holding company location (including for publicly listed holding companies). Indirectly, it could raise more taxes for the Exchequer through VAT, Stamp Duty, PAYE and PRSI.

In relation to direct taxes, we expect that the move to a participation exemption regime would not have an adverse impact on taxation revenues and would, in fact, be more likely to increase taxation revenues from the improved corporate tax regime. To date, Ireland has enjoyed a very competitive tax rate relative to the rest of world and we have been able to give multilateral credit. Corporate tax on overseas distributions repatriated to Ireland do not appear to raise significant taxes for the Exchequer. As such, we expect that a move to a participation exemption regime will not have an adverse financial impact for Ireland. However, it does make Ireland more attractive for mobile capital.

6. Are there particular considerations or design features that should be considered in reviewing the basis of the Irish corporation tax system?

Our corporate tax system and calculation of taxable profits are aligned to historic legislation which is not always fit for purpose. The interest deductibility rules - the most complicated rules in any of the OECD jurisdictions - provide a clear example of this. It would be hugely advantageous to simplify these rules. The “wholly and exclusively” test is also quite old. Now that accounting standards are globalised and sophisticated, tax law should be designed to follow the adopted accounting treatment more closely. This would significantly reduce compliance costs and could allow for the calculation of corporation tax on a real-time basis, based on monthly management accounts. We also see no need to deal with capital allowances or tax depreciation and accounting depreciation differently.

The close company surcharge rules should also be reviewed with regard to dividends as the current rules can impose additional taxes on dividends from other jurisdictions where the participation exemption does not apply, or where the entity paying the dividend is Irish resident but not a ‘close company’ (this can place larger Irish dividend-paying entities at a disadvantage compared to foreign resident entities). It does not make good sense for professional service companies to suffer a surcharge on half of their trading income, particularly where reinvestment into business is encouraged. An active surcharge is a disincentive.

We would also question the necessity to have a passive rate of tax and an active rate of tax given global trends. A single rate of tax would simplify the corporation tax position for Irish resident companies and would tie in with other jurisdictions (e.g. the UK) which do not distinguish between trading and other activities in setting the applicable rate of tax.

7. Taking account of, but not limited to, the design elements above, what in your view would be the best regime for Ireland to transition to, should a change take place? Please elaborate with consideration of the impacts, benefits and potential drawbacks both of (a) your preferred approach and (b) any approaches which you do not think would be beneficial.

In our view, the best regime for Ireland to transition to would be a progressive tax system, simply based on the accounting profits of the taxpayer.

Whichever regime is chosen, the key to success will be simplification and certainty of outcome. Our new tax system should be easy to apply, and easy to understand. There should be certainty as regards variables outside the taxpayer's control. The exemption regime should achieve these objectives to a large extent.

We do not see a need for Section 247 TCA, or the recovery of capital rules, anymore given the new interest deductibility rules under the anti-hybrid legislation and the interest limitation rule (which caps deductibility at €3m or 30% of EBITDA, if higher). This makes interest deductibility planning obsolete so Section 247 TCA no longer serves a useful purpose. In any event, there should never be multiple layers of legislation covering the same topic. The benefits of this simplification include reduced compliance costs.

Pillar One will address base erosion and realign profits within the EU so the Irish base will be realigned regardless. Simplification is better. With a more simple tax system, we should not need software products to calculate a taxpayer's corporate tax rate. Rather, we should trust globally accepted accounting standards and tax should be calculated simply at a specified rate e.g. 15% of profit. To facilitate small businesses, the rate of tax applicable to accounting profits could be at a lower rate where those profits do not meet a specified threshold e.g. the applicable rate of tax could be 10% for profits under €1m, and 15% for profits over that.

There is no necessity for complicated rules about what is, and is not, taxable.

We should be able to analyse this in real-time with some simple rules e.g. entertainment costs are not deductible, which would be clear and easy to apply.

8. Please outline your view of whether Ireland's CFC rules would be adequately aligned with participation exemption and/or branch exemption regimes should these be introduced. What synergies or risks, if any, do you foresee arising?

We consider that Ireland's CFC rules will be adequately aligned with participation exemption and/or branch exemption regimes should these be introduced.

The aim of the CFC rules is to stop companies profit-shifting into low tax jurisdictions. Trade overseas is the main driving factor for profit shifting, rather than the rate of tax paid. Simplification of the corporate tax system in Ireland should not affect the CFC rules generally.

9. Please identify any particular design features of these exemption regimes that could have positive or negative impacts in this context? Please elaborate.

As stated above, we consider that simplicity would be achieved without any material adverse impacts.

10. Please identify any adaptations to Ireland's CFC rules that should be considered in conjunction with the introduction of such exemption regimes.

We suspect that no adaptations to Ireland's CFC rules should be required.

11. In your view, should tax relief for funding costs of investments be reviewed, with a view to restrictions, if foreign income from such investments were to be exempted? What EU law or tax treaty constraints, if any, might impede such restrictions?

We refer to our answer to Q7 in relation to interest relief and Section 247 TCA.

It is not possible to give a deduction for funding costs for an overseas operation in Ireland if the income is not being taxed in Ireland so tax relief for funding costs of investments will be fully in compliance with EU law. We consider that tax treaties should not constrain it either.

It would be useful to consider redressing the balance between equity and debt financing since excessive leveraging has been the cause of many corporate failures.

Further, it is a stated aim of the European Commission to treat equity and debt financing equally from a tax perspective.

12. Please outline what in your view the impacts, if any, of participation exemption and/or branch exemption regimes might be on Ireland's Exit Tax rules. Do you foresee any synergies or risks in this space?

Ireland's Exit Tax rules are designed to stop taxpayers moving profitable bases out of Ireland which would have been profitable if they had remained in Ireland. They are not designed to tax profits which would not be taxed in Ireland anyway i.e. they are not designed to constitute a penalty for not staying in Ireland.

Section 626B TCA (which currently denies relief for taxpayers where there is a deemed disposal under the exit tax provisions contained in Section 627 TCA) should be reviewed. This denial of relief only makes sense if Ireland also gives a step-up in base cost to companies moving to Ireland which have suffered an exit charge in their original jurisdiction of tax residence.

13. Please identify how particular design features of the exemption regimes could have positive or negative impacts in this context.

We consider that the exemption regimes can have positive impacts only.

14. Do you believe that a review and simplification of Schedule 24 could be feasible and sufficient, instead of changing to participation exemption and/or branch exemption regimes? How might this simplification be achieved?

We do not believe that a review and simplification of Schedule 24 could be a sufficient alternative to changing to participation exemption and/or branch exemption regimes.

It would be more difficult to reform the credit system than to implement an exemption system.

15. What in your view are the relevant considerations in terms of any simplification of Schedule 24?

We consider that simplification of Schedule 24 would not be the optimal choice. We would prefer a change to participation exemption and/or branch exemption regimes.

16. In the event of Ireland moving to participation exemption and/or branch exemption regimes, what simplifications, if any, could be considered for the remaining credit system of double taxation relief – including in respect of foreign-source interest and royalty income and out-of-scope dividend, branch income and capital gains?

Any such simplifications depend on the type of exemption system regime which is implemented and the extent of the carveouts which are incorporated.

17. Please outline how territorial participation exemption and/or branch exemption regimes could impact on Ireland's Anti-Hybrid rules. Do you foresee any synergies or risks arising from the change?

We do not anticipate that any adjustments to Ireland's Anti-Hybrid Rules would be required to facilitate a territorial participation exemption and/or branch exemption regime. These regimes relate to the repatriation of profits, whereas the Anti-Hybrid Rules were designed to prevent double non-taxation.

Also, the territorial participation exemption regime should only apply in circumstances where recipients are not resident in non-cooperative jurisdictions. The Anti-Hybrid Rules should be completely separate.

18. Please identify any specific design features of exemption regimes that could have positive or negative impacts in this context? Please elaborate.

We do not anticipate any impacts in this context – either positive or negative.

19. Please identify any adaptations to Ireland's Anti-Hybrid rules that should be considered in conjunction with a transition to such exemption regimes.

See above.

- 20. Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for the way in which the two pillar solution is implemented in Irish tax law? Are there any potential synergies or risks with the implementation of the two-pillar solution and such exemption regimes?**

As the two pillar solution has yet to be implemented in Irish tax law, any comment on this is merely speculative.

We do not anticipate any impact on the BEPS Rules as an exemption system should not be any different to a credit system in this context save that a credit system could be more complicated.

- 21. Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for Ireland's tax treaties?**

The question of access to tax treaties depends on whether the taxpayer is considered to be "liable to tax" or not. With an exemption system, is the taxpayer "liable to tax"?

We would argue that to be the case, as the exemption is only relevant on the basis of otherwise being liable to tax. However, there is an interpretation risk which could make it more difficult to meet the required threshold for a taxpayer in an exemption-based system (as against one in a credit-based system).

Our proposed solution to this potential impact on Ireland's tax treaties is that Member States agree multilaterally that the term "liable to tax" includes exempt tax.

- 22. Should the renegotiation of Ireland's tax treaties, as respects the Elimination of Double Taxation article, be considered in the event of the enactment of participation exemption and/or branch exemption regimes? Would this be necessary? If so, how might it be feasible to accomplish this in a targeted and efficient manner?**

Ireland's tax treaties can be easily amended through the Multi-Lateral Agreement. As mentioned above, we suggest that the Member States agree multilaterally that the term "liable to tax" includes exempt tax.

- 23. Would any amendment of Ireland's worldwide tax system to allow for exemption of foreign dividends, gains or branch income necessitate a review of specific tax treaties in Ireland's network, where previously Ireland's worldwide charge would have ensured taxation of such dividends, gains or branch income? Alternatively, could such taxation be ensured by limiting the scope of any exemptions enacted in domestic law?**

The double taxation treaty between Ireland and the USA may need to be renegotiated. However, we understand that it is due for renegotiation soon in any event. The current version was negotiated in 1997 and its Limitation of Benefits clause (the "LOB") is generous compared with other treaties. It is always risky to open tax treaties as renegotiation discussions may lead to a less favourable outcome to that which was originally held.

24. Do you foresee impacts in relation to the matters identified above or any other matters related to transitional arrangements?

We foresee impacts on interest relief. There may be a period of time in which it would make sense to run a dual system with an opt-in approach to the participation exemption so that unanticipated consequences can be dealt with more easily. The old system can be eliminated over a period of time.

The opt-in approach for a period of time might also be a good solution to treaty issues. If there is a question over whether an exempt taxpayer is “liable to tax” for the purposes of the treaty, that taxpayer could opt to remain in the credit-based system.

25. In your view, what other relevant considerations should be taken into account? You may wish to consider this question in the context of the recent OECD Inclusive Framework Two-Pillar agreement.

Simplification of the tax system in general makes sense, particularly if there is to be a global minimum effective tax rate of 15%.

One tax rate in Ireland would be easy to manage and should make Ireland more competitive. We suggest that tax is calculated by following the accounts with a few simple rules on deductions which should not be allowable.

We also suggest that the capital allowances regimes should come to an end in favour of following accounting depreciation instead.

We consider that there are better ways to incentivise investment in green energy (e.g. grants, costs etc.) rather than through the tax system.

We could make Ireland a simpler, and more attractive, place to do business with very few disallowable deductions. A simple exemption system for overseas participations would make Ireland much more competitive.

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