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Ireland's new CFC regime

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Under the Anti-Tax Avoidance Directive (ATAD), Ireland and other EU Member States will need to adopt Controlled Foreign Company (CFC) rules into domestic law by 1 January 2019. The Department of Finance have released this month the ATAD implementation CFC rules feedback statement as part of a consultation to end by 28 September 2018. The CFC regime is a significant change in the Irish corporate tax code and should be considered in the aviation finance and leasing sector.

CFC rules are an anti-abuse measure, designed to prevent the diversion of profits to offshore entities in low or no tax jurisdictions. Where CFC rules apply they have the effect of attributing the income of such an entity to its parent company.

In broad terms, an entity will be considered a CFC under ATAD rules where it is subject to more than 50% control by a parent company and its associated enterprises and the tax paid on its profits is less than half the tax that would have been paid had the income been subject to tax in the jurisdiction where the parent company is tax resident.

It is the Irish government's intention to implement legislation that attributes undistributed income arising from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage. This approach requires an analysis of the extent to which the CFC would own the assets or assume the risks it does if it were not for the parent company undertaking the significant people functions relevant to those assets and risks.

It is yet to be decided whether Irish tax legislation should implement a de-minimis derogation, apply the use of a black list of third countries in determining the application of CFC rules and whether a 'grace period' should be allowed.

Therefore, it is advisable to assess whether there are entities that might be affected by the CFC rules before 1 January 2019. Where the group is head quartered in Ireland it will be important to identify non-Irish based subsidiaries and affiliates with low effective tax rates or substantial accumulated reserves paying particular attention to treasury and leasing subsidiaries. Once those subsidiaries are identified, it is advisable to critically appraise the operations, capital, income and financing of the entity and ascertain where the significant people functions relevant to assets and risks which generate income of the subsidiaries are carried out. This should provide an understanding of the likely costs of classification as a CFC.

The CFC rules will be implemented by each EU Member State and consideration should be given to where an Irish entity is a subsidiary of a jurisdiction that is also implementing the change in law. An Irish subsidiary should consider the CFC rules in its parent jurisdiction, and whether additional substance in the Irish subsidiary could mitigate against CFC inclusion. For orphan structures, consideration should be given to whether under local CFC legislation would a PPN holder treat the Irish S110 as a CFC.

Furthermore, the proposed CFC rules should not be considered in isolation either and the forthcoming EU ATAD limitation on interest deductibility and anti-hybrid rules will also need to be analysed alongside the CFC changes.

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