Territorial System of Taxation

Public Consultation Response

Deloitte.

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Consultation on Territoriality
Tax Division
Department of Finance
Government Buildings
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VIA EMAIL: intltax@finance.gov.ie

Dear Sirs/Mesdames:

We are pleased to submit comments on behalf of Deloitte in response to your Consultation document of 22 December 2021. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives, and are available to discuss anything in this document, as needed. In the meantime, if you have any queries, please do not hesitate to contact us at 01-417-2200.

Yours sincerely,

Lorraine Griffin　　Tom Maguire

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Executive Summary

As an overarching comment, Ireland's current double tax regime is complex and has experienced significant change over the years to address EU law concerns. This has resulted in a double tax regime which does not lend itself either to taxpayer certainty or user-friendly compliance obligations. Accordingly, we would make the following key observations and recommendations, expanded on further throughout this document:

- Ireland should adopt a "two-pronged approach" in introducing a foreign branch profit exemption and a foreign source dividend exemption (participation exemption) on an elective basis while simultaneously providing for a broad simplification of the existing double tax relief rules in Schedule 24 TCA97.
- The broad benefits associated with an elective foreign branch profit and dividend exemption would be a reduction in compliance workload and complexity with respect to the tax treatment of such income streams. Detailed double tax relief provisions, while providing for a de facto participation exemption, require a series of complex steps to be undertaken as part of the tax compliance process. Accordingly, an elective exemption for foreign branch income and/or foreign dividend income would be welcome.
- A broad simplification of existing double tax relief mechanisms would bring greater clarity for companies operating internationally. In the context of multinationals (both inward investment and indigenous companies expanding internationally), simplification of the existing double tax relief rules for royalties would bring significant benefit in a variety of industries but particularly in the Intellectual property licensing space.
- In considering the potential simplification of Schedule 24 TCA97, we would point to a number of key areas including broadening the categories of income on which relief may be obtained and simplification measures for the pooling and carry forward of unrelieved foreign tax.
- Companies should be provided with the option of an exemption from corporation tax for foreign branch profits, irrespective of the branch territory. To allow for taxpayer flexibility and to avoid additional compliance or filing obligations, such an election should be made at the filing of the corporation tax return for the Irish company (the Form CT1) and should be made on a year-by-year basis.
- Existing controlled foreign company (CFC) rules currently contained in law could, in theory, be used to combat non genuine arrangements arising from the use of an exempt foreign branch; such an approach would negate the need for complex anti avoidance arrangements within the branch exemption rules themselves. However, potential legislative amendments maybe required to appropriately bring exempt foreign branches within the scope of CFC rules as outlined below.
- We would therefore suggest that where a foreign branch exemption is introduced, it should exempt not only income of the foreign branch, but gains made on a disposal of assets used or attributed to a foreign branch.
- In the event of Ireland moving to a participation exemption and/or branch exemption, provision would need to be made to allow for the timely use of unrelieved foreign tax carried forward from prior years whether in respect of dividends or foreign branches.
- The calculation of GloBE Income and Loss and Adjusted covered taxes for Pillar Two purposes require (in general) adjustments to be made to remove dividend income and tax expenses associated with such income. Such an outcome would likely arise irrespective of whether Ireland adopts a participation exemption for dividends or maintains the current worldwide regime in force. Accordingly, we would not be of the view that a dividend participation exemption would overly interact with the GloBE rules currently contained within either the Pillar Two model rules or the draft EU Directive.
- The proposed EU Directive on Pillar Two would indicate that a "constituent entity" for the purpose of the Global anti- Base Erosion (GloBE) rule refers to an entity or permanent establishment that is a part of an MNE group or a large-scale domestic group. Accordingly, top up tax levied with respect to a foreign PE would likely be collected in that other Member State, with foreign PEs being treated as constituent

entities for the purpose of the Pillar Two rules. Such an outcome is likely to be irrespective of whether Ireland adopts a foreign branch exemption or retains a purely worldwide regime.

- We would not therefore envisage significant difficulties associated with the Subject to Tax Rule (STTR) if Ireland was to adopt a participation exemption on dividends.
- The interaction between the STTR and any potential exemption for foreign branch profit could in theory result in the levying of source taxation by virtue of such an exemption, irrespective of the tax actually levied in the country in which the branch carries on its activities. While not specifically an Irish tax concern, it raises a potential disparity in treatment between foreign branches versus foreign subsidiaries of an Irish company and introduces complexity for such companies who may look to expand internationally. Such an outcome would not appear to be in line with the objectives of the STTR where the income in question is in fact subject to an acceptable nominal rate at the level of the branch.
- Without prejudice to our comments on the STTR, we are not aware of any challenges which may be faced with respect to the interaction between any proposed participation or branch exemption and Ireland's existing tax treaties in force.

Consultation Questions

Policy Benefits of Participation Exemption and/or Branch Exemption Regimes

Q1.	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 branch exemption provisions?
Q2.	What would the broad benefits be for multi-national enterprises if Ireland were to move to such a system?
Q3.	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?
Q4.	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?

As an overarching comment, we recognise that the recent developments on international tax reform and the BEPS process have resulted in significant changes to the global tax landscape. While such changes create a level of uncertainty for taxpayers, we would be of the view that they also represent an opportunity for Irish fiscal policy to take stock of our current offering both in terms of Ireland's tax and broader competitiveness. Going forward, the challenge faced is likely to focus not only on attracting inward investment and domestic growth but by ensuring the continued presence and success of such businesses. Such a challenge should be addressed through continued investment in other areas such as improving our tax competitiveness in key areas. One such area is that of double tax relief contained in Schedule 24 TCA97. Ireland's current double tax regime is complex and has experienced significant change over the years to address EU law concerns. This has resulted in a double tax regime which does not lend itself either to taxpayer certainty or user-friendly compliance obligations.

Accordingly, we would recommend the following:

i. Ireland should adopt a foreign branch profit exemption and a foreign source dividend exemption. a territorial regime on an elective basis.
ii. A broad simplification of the existing double tax relief rules in Schedule 24 TCA97.

The broad benefits associated with (i) (i.e., an elective territorial system) would be a reduction in compliance burden and complexity with respect to the tax treatment of dividends and foreign branch income. In the case of dividend income, the operation of double tax relief per Schedule 24 TCA97 would, in general, result in no incremental Irish tax arising on such income streams and provides a de facto participation exemption. Such a regime compares unfavourably to the territorial exemption regimes for dividends and branch income of other EU countries. For example, competitor jurisdictions such as the Netherlands, Switzerland and the UK offer participation exemptions on dividends. Detailed double tax relief provisions, while providing for a de facto participation exemption, require a series of complex steps to be undertaken as part of the tax compliance process. It would be preferable to eliminate such steps and to provide international investors with simplicity and clarity.

One particular draw back we would note with respect to not only multinationals would be the potential interaction between the newly introduced Interest Limitation Rules and any potential exemption for either dividend or branch income. Please refer to our responses to Questions 5, 6 and 7 where this is expanded further.

With respect to the operation of a foreign branch exemption, the expectation is that an elective territorial regime should not overly impact on tax revenues from Irish resident companies with such branches. The existing operation of double tax relief under Schedule 24 TCA97 would, in general, provide for relief either by way of a double tax credit or a partial credit with the remaining foreign tax relieved by way of a deduction in the computation of taxable profit for the Irish company. Accordingly, a move to an optional exemption for foreign branch income would likely result in a similar level of tax take from such companies but with reduced time and complexity associated with the preparation of the company's corporation tax computation and return. A move to an elective branch exemption would also bring Irish law in line with that of competitor jurisdictions including the UK.

With respect to point (ii), a broad simplification of existing double tax relief mechanisms would bring greater clarity for companies operating internationally. In the context of multinationals (both inward investment and indigenous companies expanding internationally), simplification of the existing double tax relief rules for royalties would bring significant benefit in a variety of industries but particularly in the Intellectual property licensing space. Irish multinationals are well placed to derive significant benefit from centralising valuable intellectual property in Ireland in the coming years. This is supported by evidence to suggest that revenue from IP licensing and leasing is expected to expand[1]. As a result of limited direct competition and low operating costs, industry profitability is high, estimated at 30.8% in 2021. High profitability and efforts by the Patents Office have attracted more operators over the period.

The pool of intellectual property is expected to increase as small and medium-size companies increasingly register their inventions and commercialise their assets. Companies from a range of sectors are expected to continue licencing intangible assets because developing a new asset can be difficult and expensive. Revenue is forecast to increase at a compound annual rate of 8.4% to reach €2.4 billion over the five years through 2026[2]. Against a background of expected growth in this sector, simplification of existing rules relating to double tax relief on royalties would likely bring greater clarity to the industry and would make a meaningful contribution to creating a favourable investment landscape.

We would refer to our responses to Questions 14, 15 and 16 where we address some of the clarification measures that should be considered in this regard.

With respect to the calculation of double tax relief on foreign sourced interest income, we would recommend a simplification of such measures in light of the ever-increasing complexity associated with the treatment of borrowing costs and the tax relief available on same. The introduction of the Interest Limitation Rules (ILR) in Part 35D TCA97 has introduced significant complexity to the tax treatment of interest and is likely to result in an increased compliance burden. A simplification in terms of the calculation of double tax relief on interest income could, in our view, mitigate some of the compliance burden imposed by the ILR for companies engaged in financing type arrangements.

[1] IBISWorld Industry Report N77.400IE "Intellectual Property Leasing in Ireland", Yusuf Allinson, May 2021.
[2] See footnote 1.

Scope of Exemption Regimes

Q5.	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?
Q6.	Are there particular considerations or design features that should be considered in reviewing the basis of the Irish corporation tax system?
Q7.	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.

The adoption of an exemption for foreign source dividends would be positive for Ireland and would replace what in practice is an effective exemption (due to extensive unilateral credit relief as well as bilateral measures) with an actual exemption as evidenced by the Coffey reports. A participation exemption would be a welcome simplification of our system and would reduce needless complexity.

The principal motivation behind any move towards such a 'territorial' system should be to enhance the competitiveness of Ireland's tax regime. However, if the reforms ultimately unveiled involve unnecessary complexity that would probably dilute these potential gains. The proposed exemption system would be simplest if the exemption for foreign dividend and branch profits included as few exceptions as possible.

Branch exemption

In line with our comments previously submitted to the Commission on Taxation, companies should be provided with the option of an exemption from corporation tax for foreign branch profits, irrespective of the branch territory. Where an Irish resident company makes an election for its foreign branches to be exempt from foreign tax, the profit or loss arising in each branch[3] would be deducted from the Irish company's taxable profit calculation to give a net amount subject to corporation tax. To allow for taxpayer flexibility and to avoid additional compliance or filing obligations, such an election should be made at the filing of the corporation tax return for the Irish company (the Form CT1). Such an approach would avoid the need for overly complex mechanisms for making an election and would be clear and unambiguous with respect to the accounting periods for which it relates.

The operation of the branch exemption could, in certain instances, prevent relief from being given for branch losses. Equally, the removal of branch profits from the Irish tax net reduces the amount of relevant profits arising to the company in the calculation of EBITDA for the purposes of identifying any restriction on interest relief under the ILR. As the operation of a branch exemption could therefore result in an increased interest restriction on the Irish company, such an exemption should remain at the discretion of the company. Where a company does not opt-in to such measures, the existing (albeit in our view they should be simplified) provisions for branch taxation should remain in place as well as appropriate relief for double tax.

[3] To be attributed based on the separate entity fiction.

Dividend exemption

We would recommend that taxpayers be allowed the option of an exemption given that it could reduce the level of interest deductibility (due to the Interest Limitation Rules introduced by Finance Act 2021); therefore, the regime should be optional.

Interaction with CFC Rules

Q8.	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?
Q9.	Please identify any particular design features of these exemption regimes that could have positive or negative impacts in this context? Please elaborate.
Q10.	Please identify any adaptations to Ireland's CFC rules that should be considered in conjunction with the introduction of such exemption regimes.

Branch participation exemption

Article 7 of the Anti-Tax Avoidance Directive[4] ("ATAD1") provides (inter alia) that:

"The Member State of a taxpayer shall treat an entity, or a permanent establishment of which the profits are not subject to tax or are exempt from tax in that Member State, as a controlled foreign company …."

ATAD1 accordingly recognises that a permanent establishment may be treated as a controlled foreign company in instances where the profits of such a PE are exempt from or are not subject to tax. We are aware of the policy objective and purpose of the existing CFC rules, being to prevent the artificial diversion of profits to low tax jurisdictions. The CFC rules currently contained in law could, in theory, be used to combat non genuine arrangements arising from the use of an exempt foreign branch; such an approach would negate the need for complex anti avoidance arrangements within the branch exemption rules themselves.

However, further potential legislative amendment would be required to appropriately bring exempt foreign branches within the scope of CFC rules as outlined below.

From an Irish perspective, a "controlled foreign company" is defined as a company which is:

(a) Not resident in the State; and
(b) Controlled by a company or companies' resident in the State.

The CFC provisions as currently enacted in Irish law are therefore limited solely to a company[5]. Where a foreign branch exemption is opted for in line with the recommendations in the Coffey report, we would struggle to see how a PE, or a branch could be brought within the scope of Irish CFC rules as they currently operate in Part 35B. The rules operate by attributing the *undistributed* income of a CFC, arising from non-genuine arrangements put in place for the essential purpose of avoiding tax, to the controlling company. Article 7(2)(b) ATAD1 provides that

[4] Council Directive (EU) 2016/1164 of 12 July 2016.
[5] Such narrower drafting in Part 35B TCA97 should be seen as in line with the objectives of ATAD1, as under the existing worldwide regime operated in Irish law any profits of a foreign PE or branch are subject to tax in Ireland under normal rules. Accordingly, it would not have been possible under a worldwide regime for an Irish company to artificially divert profits to a low tax jurisdiction through the use of a foreign PE or branch.

"Where an entity or permanent establishment is treated as a controlled foreign company under paragraph 1, the Member State of the taxpayer shall include in the tax base…. the non-distributed income of the entity or permanent establishment arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage."

Clarity would be required as to what constitutes "undistributed income" in the context of a branch. Furthermore, S835Q TCA97 allows for the undistributed income of a CFC to be reduced by the amount of any "relevant distributions" made in the accounting period and similar clarity would be required here. Technical amendments may be required to Part 35B to address these challenges. Equally, such amendments should be drafted to only apply to those branches exempted from Irish corporation tax and should not capture instances where the Irish company continues to operate under a worldwide regime.

Participation exemption on dividends

Where the CFC provisions apply, corporation tax under Part 35B is charged on the undistributed income of a CFC that is reasonably attributable to the Irish activities[6]. Where a CFC charge arises, S835R(6) TCA97 provides that the CFC charge shall be subject to corporation tax:

A. At 12.5% if the income would have been charged to tax under Schedule D, Case I (had it been accruing to the chargeable company); or
B. At 25% if the income would have been charged to tax under Schedule D, Case III, IV or V.

Accordingly, the undistributed income attributed to the chargeable company would therefore retain its character and would be taxed as if it had accrued to or was received by the chargeable company.

Therefore, the introduction of a participation exemption on dividends should not impact on the attribution of undistributed income of a CFC to a chargeable company as amounts so attributed would continue to be subject to corporation tax in the normal manner. It must be recalled that a "tax and credit" regime has been likened to a defacto exemption and therefore the treatment of exempt dividends should not affect the CFC rules.

Interest Charges associated with Exempt Income

Q11.	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?

Companies may avail of tax relief for borrowing costs under S247 TCA97 where specific conditions are met, including where an investor uses funds borrowed to acquire shares in certain companies[7].

Critically, one of the long standing and well understood conditions attaching to S247 TCA97 would look to the *use* of the borrowed money in the loan and would ask whether the funding was for a qualifying purpose (acquiring shares in a trading/rental company/intermediate holding company or in lending money to a trading/rental/intermediate holding company). The general conditions which underpin S247 TCA97 relief do not currently require the investor company to consider whether the income derived from such investments is

[6] Meaning relevant functions performed in the State on behalf of a controlled foreign company group where such relevant functions are relevant to the legal or beneficial ownership of the assets, or the assumption and management of risks included in the relevant assets.
[7] Refer to S247(2) TCA97 in this regard.

chargeable to tax. We would note one exception to this, contained in S247(4A)(a) TCA97 which operates to deny interest relief in respect of a loan made to an investing company by a person that is connected with it, if the loan is used by the investing company to acquire the ordinary share capital of a company from a connected company. Such a restriction is disapplied in the case of matching dividend income arising directly or indirectly from the use of the loan (per S247(4A)(d) TCA97) which is chargeable to corporation tax at the level of the investing company. Where a participation exemption is introduced for dividends, certain loans availing of the exemption from S247(4A)(d) TCA97 could find their interest relief restricted accordingly. While we are conscious that such anti avoidance provisions have been introduced into S247 TCA97 to address specific concerns, we would suggest that with the introduction of the Interest limitation Rules in Finance Act 2021, the underlying policy rationale behind such specific anti avoidance should now be re-examined. We would also point to the ongoing need to simplify S247 TCA97 in light of the additional complexity now associated with tax relief for borrowing costs.

Furthermore, any restriction to remove or restrict relief on borrowing costs in the case of dividends subject to a participation exemption would arguably undermine the operation of the relief itself as a *charge on income.* Under S243 TCA97, charges on income are allowed as deductions against the profits of the accounting period in which they are paid. The deduction is a "deduction against total profits". It is not, therefore, a deduction made in computing any particular component of the company's income. In addition, Revenue have acknowledged that reliefs reducing "total profits" may be "pointed" to certain income streams within those profits and as such may relieve income other than foreign income (this has been recognised by the courts, see, inter alia, Sterling Trust v IRC 12 TC 868. We cannot therefore see a policy rationale for limiting interest relief where foreign dividend income is exempt as to do so would contradict the established and well understood mechanism by which a charge on income is used. This is particularly evident when we consider that pursuant to Finance Act 2017, S247 relief may be available on a loan used to acquire or lend to a holding company that indirectly holds ordinary shares in a trading company through one or more intermediate holding companies. Where the companies in such an arrangement are all Irish resident (including the investor), any dividend income receivable by the Investor would be treated as Franked investment income and thus exempt from tax[8]. Notwithstanding this, tax relief may still be available in such cases[9] and has been available for a number of years; we would therefore question why an amendment would now be required in the case of exempt *foreign* dividend income.

A further point may be made with respect to the manner in which interest relief is predominantly used in the context of an investor company and their participations in foreign investee companies. Investment in such foreign companies would, most likely, be obtained either through a share acquisition or through the issue of shares in an investee company for consideration. As such, any return on such investment to the investor would be in the form of dividends payable by the investee. With respect to the existing treatment of foreign dividends, double tax relief may be available in respect of both foreign withholding tax suffered at source in addition to the underlying tax suffered on profits out of which the dividend is paid. Accordingly, the effect of the double tax relief available under Schedule 24 TCA97 would, in general, provide for no incremental Irish tax on the receipt of such dividends. Accordingly, while tax relief may be obtained for funding costs (under Section 247 TCA97), such relief would arguably never be used against foreign dividend income to reduce Irish profits and Irish tax payable. Where interest relief is used to reduce Irish profits and Irish tax payable, it is more likely that this takes the form of reducing *other* profits of the investor company or are surrendered to members of a loss relief group, as allowed for in existing law. Amendments to existing tax relief on interest would therefore be neither required nor practical.

Lastly, existing provisions providing tax relief for borrowing costs in Ireland are complex both with respect to pre–Finance Act 2021 rules but also with the recent introduction of the Interest Limitation Rules in Part 35D TCA97. Accordingly, we would not recommend adding any further conditions to existing interest relief provisions

[8] S129 TCA97.
[9] Part 3.2.1 of Revenue's Tax and Duty Manual Part 08-02-01.

at this time, as such changes would likely increase or introduce further complexity into the law. We would recommend that a review of section 247 TCA97 be done with a view to its simplification as soon as is possible in the light of the introduction of the abovementioned Interest Limitation Rules in Part 35D TCA97.

Exit Tax

Q12.	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?
Q13.	Please identify how particular design features of the exemption regimes could have positive or negative impacts in this context.

Article 5(1) ATAD1 provides for an exit tax charge which arises on the occurrence of any of the following:

(a) 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;

(b) A taxpayer transfers assets from its permanent establishment in a Member State to its head office or another permanent establishment in another Member State or in a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer;

(c) A taxpayer transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a permanent establishment in the first Member State;

(d) A taxpayer transfers the business carried on by its permanent establishment from a Member State to another Member State or to a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer.

S627 TCA97 imposes an exit tax charge pursuant to ATAD1, applicable where:

i. The company transfers assets from a permanent establishment in the State to its head office or to a permanent establishment in another Member State or third country (transposing Article 5(1)(b));

ii. The company transfers a business (including the assets of the business) carried on by a permanent establishment of that company in the State to another Member State or to a third country (transposing Article 5(1)(d));

iii. The company ceases to be resident in the State and becomes resident in another Member State or a third country (transposing Article 5(1)(c)).

With respect to (i) and (ii) above, such events refer to the movement of either assets or a business from an *Irish* branch of a foreign company as opposed to a foreign branch of an Irish company; as such we would not expect the introduction of a foreign branch exemption to interfere with such pre-existing exit tax charge provisions.

The existing Irish exit tax provisions have not, however, transposed article 5(1)(a) into law. The rationale for such an omission would likely stem from 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 nevertheless 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; amendment may be required to existing legislation to take this into account.

In addition to the above comments, 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

S627(2)(c) TCA97. 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.

S26(1) TCA97 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 is to be read in conjunction with S4 TCA97 as meaning "income and chargeable gains". Accordingly, it follows that in the context of an Irish tax resident company, the Irish tax net extends to include gains made on assets held not only in Ireland but also assets held by or attributable to a foreign branch. We would therefore suggest that where a foreign branch exemption is introduced, it should exempt not only income of the foreign branch.

Existing legislation may be referred to as precedent for such an exclusion in the form of S847 TCA97. S847 TCA97 provides for an exemption from corporation tax in respect of foreign branch income and from capital gains tax for foreign branch gains subject to specified conditions. S847(6)(a) TCA97 provides that "profits, gains or losses arising from the carrying on of qualified foreign trading activities shall be disregarded for corporation tax purposes". In addition, S847(7) TCA97 provides that a gain on the disposal of an asset used wholly and exclusively for the purposes of qualified foreign trading activities is not to be a chargeable gain.

The relief afforded by S847 TCA97 ceased to apply after 31 December 2010. Notwithstanding this, we are of the view that it represents a logical precedent which should be followed with respect to the potential interaction between any future foreign branch exemption and S627 TCA97.

As a final overarching comment, any exit tax charge should continue to be subject to the provisions of S627(3) TCA97 to allow for an exclusion where Ireland retains taxing rights on a subsequent disposal of assets[10].

Schedule 24

Q14. 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?

Q15. What in your view are the relevant considerations in terms of any simplification of Schedule 24?

Q16. 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?

Irrespective of whether a foreign branch profit exemption and/or a foreign source dividend exemption were to be introduced into Irish law, we would be of the view that a broad simplification of the existing tax credit rules in Schedule 24 TCA97 would be welcome. It is generally accepted that relief for foreign taxation, and hence potential double taxation is complex under Irish law. While the general effect of the double tax relief provisions

[10] Relevant assets or shares deriving their value or the greater part of their value directly or indirectly from relevant assets (other than shares quoted on a stock exchange), or assets referred to in S29(3)(d) TCA97.

in Schedule 24 TCA97 would allow for a reduction in the taxable income and ultimately the tax payable on foreign sourced income, the mechanism by which relief is calculated is complex and gives rise to a significant compliance burden on taxpayers.

In considering the potential simplification of Schedule 24 TCA97, we would point to a number of key areas:

i. Broadening the categories of income under Schedule 24 TCA97

At present, relief under Schedule 24 is only afforded with respect to specific income streams (interest, royalties etc). In line with our previous recommendations to the Commission on Taxation, we would welcome a simplification of Schedule 24 TCA97 which would distinguish between income sources:

A. Income subject to tax at the rate of 12.5%; and
B. Income subject to tax at the rate of 25%.

The broadening of Schedule 24 TCA97 beyond the set categories of income is likely to be important in the context of our previous comments to the Department in our response to the consultation on Ireland's tax treaty network. In particular, we would reiterate our previous comments that we are aware of a number of Asian countries and developing economies who seek to impose withholding tax on payments for services referred to commonly as "technical services". This is a consequence of the wording of the UN Model Treaty which, unlike the OECD Model Tax Convention, has since 2017 included a special clause granting the right to tax fees for technical services (see Article 12A of the UN Model Treaty).

The treatment of such payments, and in particular whether they are to be assessed as royalties or business profits typically varies depending on jurisdiction. The analysis may also vary depending in the facts at issue. For example, where in the course of providing a service the supplier uses technology but does not grant or sell the technology then such payments may not fall to be classed as "royalties".

The question then arises as to how such payments and the corresponding withholding tax are to be classified by an Irish recipient in order to assess firstly whether the treaty allows for a reduced rate of tax, and secondly whether double tax relief may be availed of under Schedule 24 TCA 1997. In cases where these payments are assessed as "royalties", then relief under Schedule 24 may be availed of – however complications arise where the payments are not classified as royalties and are not viewed as arising from a Permanent Establishment in the source country and therefore cannot be relieved in the same way as tax on foreign branch profits. While a review of such treaties may be warranted to identify whether a Protocol may be appropriate in order to provide greater clarity, the issue may be more clearly addressed through a broad simplification of Schedule 24 TCA97.

Relieving provisions for tax suffered on income from non-EU or non DTA sources should not be less favourable than those for EU/DTA source income. To the extent that a policy decision is to be made with respect to certain non-cooperative jurisdictions, double tax relief and its availability could in theory be linked to the EU's published listing of such jurisdictions.

ii. Simplification of pooling and carry forward provisions

The provisions governing the pooling and carry forward of excess double tax credits are complex and not universally applied to all sources of income on which double tax relief may be available. While current provisions allow for the pooling of excess credits arising on relevant interest, there is no provision for the carry forward of excess credits arising on such interest to later periods. In addition, the conditions attaching to whether interest is "relevant interest" for pooling purposes can be onerous. In contrast, it may be possible to rely on pooling provisions with respect to branch profits and dividends and to carry forward any unrelieved foreign tax to later accounting periods. The differing requirements imposed depending on the type of income create unnecessary complexity and should be simplified.

iii. Transitional provisions

In the event of Ireland moving to a participation exemption and/or branch exemption, provision would need to be made to allow for the timely use of unrelieved foreign tax carried forward from prior years whether in respect of dividends or foreign branches.

Anti-Hybrid rules

Q17.	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?
Q18.	Please identify any specific design features of exemption regimes that could have positive or negative impacts in this context? Please elaborate.
Q19.	Please identify any adaptations to Ireland's Anti-Hybrid rules that should be considered in conjunction with a transition to such exemption regimes.

S835AB TCA97 is designed to provide to the effective interaction between the anti-hybrid rules and Ireland's existing worldwide system of taxation. In particular, the provisions allow for certain "disregarded payments" to be treated as included for the purpose of the anti-hybrid rules with the objective of only neutralising actual economic hybrid mismatches and not juridical mismatches which arise because of a worldwide system of taxation. In particular, S835AB TCA97 refers to payments between the head office of an entity and a permanent establishment of that entity or between two or more permanent establishments of the entity. Where a foreign branch exemption is introduced, we would be of the view that S835AB TCA97 as it currently operates in the context of branches/permanent establishments may cease to be beneficial and therefore may warrant amendment. We would not, however, recommend a removal of S835AB TCA97 as this section remains necessary to ensure that purely hybrid mismatches are neutralised in other instances (for example in the interaction of the worldwide system of taxation and US check the box elections[11]). We would also suggest that where amendment is made to S835AB TCA97, such amendment should continue to be applicable in instances where an Irish company does *not* operate a branch exemption and continues to operate on the basis of a worldwide regime.

In the event that a foreign branch exemption is introduced, we would note that foreign payors making payments to a foreign branch of an Irish resident company may be required to reassess the treatment of such payments from a foreign anti hybrid perspective to confirm whether inclusion in fact does arise in in Ireland in respect of the payment made. However, we would expect this to require an assessment of foreign tax law and not Irish tax law.

Interaction with the Two Pillar Solution

Q20.	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?

Pillar One

[11] Referred to in part 5.2 of the Revenue Tax and Duty Manual Part 35-00-01.

The detailed blueprint on Pillar One[12], published in October 2020 address potential rules for addressing nexus and profit allocation challenges associated with increased globalisation. Amount A of Pillar One proposes to reallocate taxing rights in favour of market jurisdictions through the creation of a new taxing right. In addition, Amount B will focus on the application of the arm's length principal to standardise the remuneration of related party distributors that perform "baseline marketing and distribution activities". While we would expect that further consideration may be given as to how the outcomes of Pillar One are to be reflected in Pillar Two, we would not expect such considerations to interact with the operation of either a participation on foreign sourced dividends and/or a foreign branch participation.

Pillar Two

Participation exemption

Per Article 3.1 of the Pillar Two Model rules, the GloBE income or loss of each constituent entity is the Financial Accounting Net Income or Loss determined for the Constituent entity for the fiscal year, subject to number of specified adjustments. The definition adopted in the proposed EU Directive refers to "qualifying income or loss", to be computed by making specified adjustments to the financial accounting net income or loss of the constituent entity for the fiscal year before any consolidation adjustments[13], as determined under the accounting standard used in the preparation of the consolidated financial statements of the ultimate parent entity. The adjustments referred to include an adjustment for "excluded dividends[14]", meaning a dividend or another distribution received or accrued in respect of an ownership interest[15]. Therefore, to the extent that the accounting standards employed by the ultimate parent entity recognise the dividend income received by the Irish constituent entity in the calculation of Financial Accounting Net Income or Loss, the provisions of the GloBE rules would require such income to be carved out.

Per Article 4.1 of the Pillar Two model rules, the Adjusted Covered Taxes of a Constituent Entity for the Fiscal Year shall be equal to the current tax expense accrued in its Financial Accounting Net Income or Loss with respect to Covered Taxes. Such covered taxes must be turn be subject to specific reductions for the amount of current tax expense with respect to income excluded from the computation of the GloBE income or loss. This is mirrored in Article 20 of the draft Directive. Accordingly, any current tax expense (which may include foreign withholding tax suffered on the dividend) reflected in the accounts for an Irish constituent entity would be reduced by the amount of such tax expense referable to the dividend in question.

The net result of the above adjustments would be to remove both dividend income and tax expenses associated with such income from the calculation of the jurisdictional effective tax rate for Ireland. Such an outcome would likely arise irrespective of whether Ireland adopts a participation exemption for dividends or maintains the current worldwide regime in force. Accordingly, we would not be of the view that a participation exemption would overly interact with the GloBE rules currently contained within either the Pillar Two model rules or the draft EU Directive.

Branch exemption

The proposed EU Directive on Pillar Two would indicate that a "constituent entity" for the purpose of the Global anti- Base Erosion (GloBE) rule refers to an entity or permanent establishment that is a part of an MNE group or a large-scale domestic group. A permanent establishment[16] in turn is defined in several ways with accompanying

[12] Accessible here.
[13] Article 14(1) of the Directive refers.
[14] Article 15(2)(b) of the Directive refers.
[15] Subject to an exception for dividends in respect of portfolio shareholdings, and dividends in respect of an ownership interest in an investment entity.
[16] Defined in Article 3.10.

rules to identify the jurisdiction in which it is located. In general, for Pillar Two purposes a PE is deemed to be located in the jurisdiction where it is treated as a PE and liable to tax under the applicable tax treaty in force. Where no such treaty is in force, the PE is deemed to be located in the jurisdiction where it is subject to income taxation based on its business presence, or where it is situated (where the jurisdiction has no corporate tax system but where the jurisdiction would have had the right to tax the income if such a system were in place). The effect of such provisions means that for the purposes of calculating GloBE income for an Irish resident company with a foreign branch, the income of the branch would need to be identified and carved out. Equally, the Directive provides for specific rules assigning covered taxes between jurisdictions; accordingly, taxes paid/payable by the Irish head office should be carved out in the calculation of the Irish Covered taxes when calculating the Irish jurisdictional effective tax rate.

The Directive recognises that in order to allow Member States to benefit from top up tax revenues collected on low taxed constituent entities located in their territory, Member States should be able to elect to apply a domestic top up system. Accordingly, top up tax levied with respect to a foreign PE would likely be collected in that other Member State, with foreign PEs being treated as constituent entities for the purpose of the Pillar Two rules. Such an outcome is likely to arise irrespective of whether Ireland adopts a foreign branch exemption or retains a purely worldwide regime.

Subject to Tax Rule

While not addressed in the current Pillar Two model rules or the draft EU Directive, model treaty provisions dealing with the STTR are expected to be issued early in 2022. The STTR is a treaty-based rule that allows source jurisdictions to impose source taxation on certain related party payments that are subject to tax a nominal rate of less than 9% in the other contracting jurisdiction (that is, the jurisdiction of the payee). As outlined in the Pillar Two blueprints issued in October 2020, the STTR will apply to certain categories of payments that present a greater risk of base erosion, with technical work to date focussing on the payment of interest, royalties and a defined set of other payments that present base erosion risks because they relate to mobile capital, assets, or risk. Based on the blueprints issued to date, dividend payments are not regarded as a covered payment for the purposes of the STTR[17]; as such we would not therefore envisage significant difficulties if Ireland was to adopt a participation exemption on dividends.

With respect to the interaction between the STTR and any potential foreign branch exemption, Part 9.2 of the Pillar Two blueprint refers to STTR applying at the entity (person *resident in a contracting jurisdiction*) level. The question arises as to whether covered payments made to an Irish resident company which are in fact attributable to a foreign branch and thus not subject to a nominal rate of at least 9% (by virtue of a branch exemption in Ireland) could be subject to the STTR. A permanent establishment, by its nature, cannot be tax resident in a contracting jurisdiction for treaty purposes but instead would be subject to tax by virtue of its business activities/trade carried on in country. The conclusion which may be inferred is that the STTR could attach to payments between contracting jurisdictions, and therefore could unnecessarily result in source taxation on payments made to foreign branches of Irish companies notwithstanding the fact that the foreign branch income may in fact be subject to a nominal rate above 9% albeit not in Ireland.

We would note the below in paragraph 593 of the Pillar Two blueprint specifies as follows:

593. None of these categories apply to payments forming part of the income of a permanent establishment in the source state or for the use of an asset that forms part of the business property of a permanent establishment in the source state. This is because the source state has an existing and prior taxing right over the profits of the permanent establishment under Article 7. This would be codified in the text of the STTR.

The blueprint is, however, silent as to the treatment of payments to a PE *not* in the source state. For example, a payment may be made from Company A (resident in Country A) to a foreign branch of IrishCo. Strictly speaking,

[17] Refer to Part 9.2.3 of the OECD Pillar Two blueprint of October 2020, accessible here.

the contracting States are Country A and Ireland as only Company A and Irish Co are capable of being entities resident in such states (as the branch is not capable of having a tax residence, per se). Where a covered payment of €100 is to be made by Company A, it is subject to source taxation under STTR at a rate of 5%[18] , resulting in a net payment of €95. Under the relevant treaty between Ireland and the branch State, the net income of €95 is allocated to the branch albeit the gross amount of €100 being payable prior to the application of WHT. While the operation of a branch exemption removes the amounts from the Irish tax net and therefore removes the issue for the Irish company, it does little to alleviate double taxation concerns at the level of the foreign branch. Such concerns rest on whether the foreign branch can in fact claim double tax relief on the source taxation levied by Country A; assuming that the foreign branch operates a similar regime to Ireland in terms of double tax relief, the question which arises is whether the branch can obtain relief for the source taxation already applied on the payment received. While not specifically an Irish tax concern, it raises a potential disparity in treatment between foreign branches versus foreign subsidiaries of an Irish company and introduces complexity for such companies who may look to expand internationally. Such an outcome would not appear to be in line with the objectives of the STTR where the income in question is in fact subject to an acceptable nominal rate at the level of the branch:

661. The STTR is intended to address remaining BEPS risks by restoring to source jurisdictions a limited right to apply a top up tax to a defined set of connected person payments resulting in low tax outcomes in the other contracting jurisdiction, in order to bring the tax on those payments up to an agreed minimum rate.

Ireland’s Double Taxation Treaty Network

Q21. Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for Ireland’s tax treaties?

Q22. 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?

Q23. 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?

As an initial comment, we would reiterate our view expressed in our responses to Questions 14, 15 and 16 with respect to the treatment of “fees for technical services” under existing double tax treaties. We would recommend a review of such tax treaties to determine whether a Protocol may be appropriate in order to provide parties with greater clarity on the types of payments for service fees that may be treated as royalties, and whether double tax relief may be afforded to withholding tax that does not fall squarely on either royalties or business profits.

With respect to existing double tax treaties in force, we would note that treaties entered into by Ireland would adhere (in general) to the OECD Model Tax Convention. Accordingly, in the context of any potential participation exemption and/or foreign branch exemption, the relevant treaty articles to be reviewed are as follows:

- Article 7 (Business Profits);
- Article 10 (Dividends); and

[18] For illustrative purposes only.

- Articles 23A and 23B (Exemption Method and Credit Method, respectively)

With respect to the attribution of taxing rights in the context of a permanent establishment, Article 7(1) and 7(2) are of relevance, reproduced below:

1. *Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.*
2. *For the purposes of this Article and Article [23A] [23B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits that it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through other parts of the enterprise.*

The effect of Articles 7(1) and (2) attribute taxing rights with respect to foreign permanent establishments not only to the Contracting State but to the other Contacting State in which business is carried on through a permanent establishment. The provisions of the tax treaty therefore address the attribution of taxing rights as between Contracting States and to allow for foreign tax to be levied on a foreign branch, as opposed to the specific levying of any tax charge (the latter to be solely within the remit of domestic tax provisions). Where an optional branch exemption is introduced, we would not expect such domestic provisions to run contrary to the aforementioned Articles 7(1) and (2) above. Therefore, we would not expect any modification to existing treaties to be required. An example of same may be found in the Ireland – UK Double tax treaty. Notwithstanding the optional branch election which may be applied by UK resident companies to exempt foreign (including Irish) branch income, the business profits article of the relevant treaty nevertheless provides for the allocation of taxing rights irrespective of any domestic exemption.

Equally, with respect to a potential participation exemption on dividends, Article 10 of the OECD Model Treaty is of relevance and in particular Articles 10(1) and (2), reproduced below:

1. *Dividends paid by a company which is resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.*
2. *However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the Other State, the tax so charged shall not exceed:*
   a. *5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of that payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);*
   b. *15 per cent of the gross amount of the dividends in all other cases.*

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

The effect of Articles 10(1) and (2) of the Model Treaty is to allocate taxing rights and to specify that while dividends are primarily to be taxed where the recipient is resident (per paragraph 1), it is open to the paying Contracting State to nevertheless levy tax at source to be relieved by way of credit. e.g., Notwithstanding the domestic participation exemption available on dividends under Dutch law, the dividends article of the relevant treaty nevertheless provides for the allocation of taxing rights in a manner consistent with the OECD Model Treaty.

With respect to the elimination of double taxation (Articles 23A or 23B), all double taxation treaties adopted by Ireland apply the credit method of granting double taxation relief to Irish resident persons who have paid tax in the other treaty country. In particular, the Model treaty provides as follows:

1. *Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allows taxation by that other State solely because the income is also income derived by a resident of that State or because capital is also capital owned by a resident of that State), the first mentioned State shall allow:*
   a. *as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;*
   b. *as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.*

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

In the case of either a participation exemption on dividends and/or a foreign branch exemption, our expectation is that there would be no "income tax or capital tax" attributable to the income or capital taxed in the other State as such amounts would be, from an Irish perspective, exempt from tax.

To take a practical example of an article currently in force, the Ireland – France Double tax treaty provides as follows in Article 21b:

b. *In the case of Ireland:*

Subject to the provisions of the law of Ireland regarding the allowance as a credit against Irish tax of tax payable in a territory outside Ireland, French tax payable directly on or by deduction in respect of income from sources within France shall be allowed as a credit against any Irish tax payable in respect of that income. Where such income is a dividend paid by a company which is a resident of France the credit shall take into account (independently of the withholding tax) the French tax payable by the company in respect of its profits.

Where domestic law provides for an exemption in respect of foreign dividends and/or foreign branch income, there should be no "Irish tax payable in respect of that income". Accordingly, a participation exemption and/or branch exemption should not, in our opinion, interfere with existing double tax relief provisions.

Transitional Arrangements

Q24.	Do you foresee impacts in relation to the matters identified above or any other matters related to transitional arrangements?

We would reiterate our comments previously outlined in response to Questions 14, 15 and 16 that in the event of Ireland moving to branch exemption and/or participation exemption, provision should be made as a transitional arrangement to allow for the timely use of foreign tax credits carried forward from prior years.

Other Issues

Q25.	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.

We have no further comments to make at this time.