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Deloitte submission on New Taxation Measures to apply to Outbound Payments – Feedback Statement July 2023

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Feedback Statement on New Taxation Measures to apply to Outbound Payments
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
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VIA EMAIL: intltax@finance.gov.ie

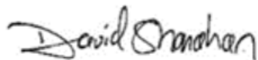
Dear Sirs/Mesdames

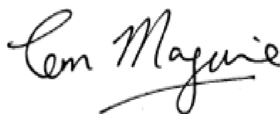
We are pleased to submit comments on behalf of Deloitte in response to your New Taxation Measures to apply to Outbound Payments - Feedback Statement July 2023.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives. We are available to discuss anything in this submission, as needed.

If you have any queries or wish to discuss this submission, please contact the undersigned at 01-417 2200.

Yours sincerely,





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1. Executive Summary

In this document we set out our comments on the draft legislative approaches which aim to prevent double non-taxation applying to outbound payments of interest, royalties, and dividends to jurisdictions on the EU list of non-cooperative jurisdictions, no-tax and zero-tax jurisdictions. Further details are provided in response to the consultation questions; however, we would like to emphasise the following:

- In our view the scope of the proposed legislation is unnecessarily broad and goes beyond what is proportionate to satisfy Ireland's commitment under the National Recovery and Resilience Plan[1].
- Ireland's competitiveness with respect to inward investment must be a key consideration to ensure the significant role of the Financial Services Industry in Ireland and Ireland's position as a key hub for inward investment is maintained.
- Bona fide commercial arrangements of which the main purpose or one of the main purposes is not the avoidance of tax, should not be within scope of the new measures.
- We recommend that a grandfathering provision be included in the legislation so that the new measures only apply to arrangements the terms of which are agreed on or after 1 January 2024.
- Consideration should be given to bringing the rate of withholding tax in line with the 12.5%/ 15% rate of tax.
- In the case of interest and royalties, regard should be given to introducing provisions which will allow the payor to elect to withhold tax on the payment or to deny a deduction for the payment.
- The withholding tax exemption for interest payments in respect of Quoted Eurobonds and wholesale debt instruments should not be restricted nor within scope of the new measures.
- The legislation should consider including a form of "main purpose test" or "Principal Purpose Test" (PPT) such that the existing withholding tax exemptions should only be denied where such a PPT test is not satisfied.
- Any amendment to the existing Dividend Withholding Tax (DWT) provisions contained in Irish tax law would arguably not achieve the stated aim in Ireland National Recovery and Resilience Plan[1] to tackle aggressive tax planning.
- In our view the proposed measures should not go beyond what is necessary to prevent double non taxation.

[1] Ireland's National Recovery and Resilience Plan 2021 (www.gov.ie)

2. General comments

We reiterate our comments made in our response to the consultation on Measures to apply to Outbound Payments, December 2021[2], on the need for specific consideration to be given to the effect of the OECD Pillar Two agreement and the EU Minimum Tax Directive. It would be preferable to work through the impact of transposition of the Directive into Irish tax law fully over time before seeking to introduce new measures in respect of outbound payments.

However, we acknowledge the commitments agreed under Ireland's National Recovery and Resilience Plan to complete the introduction of legislation applying to outbound payments to prevent double non-taxation, by 31 March 2024 and the intention to provide the necessary legislation in Finance (No.2) Bill 2023.

We recommend that a grandfathering provision be included in the legislation, along the lines of the grandfathering provisions that applied when the transfer pricing legislation was introduced[3] so that the new measures only apply to arrangements the terms of which are agreed on or after 1 January 2024. This will go some way to providing tax certainty for in scope outbound payments under existing commercial arrangements, but this comment is without prejudice to our earlier comments regarding timing of introduction.

Ireland's competitiveness with respect to inward investment must be a key consideration to ensure the significant role of the Financial Services Industry in Ireland and Ireland's position as a key hub for inward investment is maintained. Equally, the Irish domestic market relies on inward investment in many ways, such as investment in research and innovation, employment, and general commercial activity across the Irish economy. Further, and as we noted in our response to the previous consultation, consideration should be given to the effect of any legislative amendment on the competitiveness of Ireland's tax regime with respect to inward investment compared to competitor jurisdictions.

Bona fide commercial arrangements of which the main purpose or one of the main purposes is not the avoidance of tax, should not be within scope of the new measures. The proposed new measures should not go beyond what is necessary to prevent double non taxation.

The current rate of withholding tax on interest and royalties is 20%. This contrasts with the tax effect which would arise on the denial of a deduction at either 12.5% or 15%. Consideration should be given to bringing the rate of withholding tax in line with the 12.5%/15% rate of tax.

It is noted in para 1.1. of the Feedback Statement that "in order to ensure the effectiveness of the measures anti-avoidance provisions will also be introduced." It is presumed that this refers to those provisions already in the feedback statement regarding the position where the main purpose of an arrangement is to avoid the application of the provisions. If other matters are being considered, then regard should be made to the competitiveness issue highlighted above.

We question the need for such anti-avoidance provisions within what can be assumed to be overall an anti-avoidance measure. We have provided further comments on this point in response to question 2 below. One interpretation of the overall aim of the measures is to incite change in the tax policies of a 'specified territory' and/or to influence taxpayer behaviour.

In the case of interest and royalties, in our view consideration should be given to introducing provisions which will allow the payor to elect to withhold tax on the payment or to deny a deduction for the

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[2] Measures to apply to Outbound Payments, December 2021

[3] Part 35A TCA 1997 as inserted by section 42 Finance 2010

payment that is applied consistently on an accounting period by period basis unless some required notice is given by the payor.

For the reasons outlined above, in our view the scope of the proposed legislation is too broad and goes beyond what is proportionate to satisfy Ireland's commitment under the National Recovery and Resilience Plan, specifically the commitment per Reform: 3.6 Aggressive Tax Planning to "*the entry into force of legislation to prevent double non-taxation applying to outbound payments towards jurisdictions on the EU list of non-cooperative jurisdictions, no-tax, and zero-tax jurisdictions. These legislative measures shall include withholding taxes or non-deductibility of outbound payments. In the case of dividends, measures shall include withholding taxes since dividends cannot be deducted. The reform shall be completed by 31 March 2024.*"[4] It is our understanding of this commitment that not all payments of interest, royalties and dividends should be in scope of the proposed legislative measures.

3. Feedback questions

We provide our comments in response to the proposed legislative provisions and the specific questions set out in the Feedback Statement.

Question 1 Comments are invited on these possible definitions, and in particular on the definitions of specified zero-tax territory and the meaning of 'definite influence'

Entity

We welcome consideration of corporate entities that are treated as a Disregarded Entity or a Partnership for US federal tax purposes. Disregarded entities are fiscally transparent; therefore, the residence of the disregarded entity is not considered for US federal tax; rather, tax is imposed on the disregarded entity's investors in the state(s) where the investors are resident.

Also, consideration should be given to make it explicit in the legislation that transparent entities are not in scope of these measures because in our view including such entities is not required to meet the aim of preventing double non taxation.

The rules to determine if two entities "shall be associated entities" introduces a new concept of "definite influence." Rather than introducing such new concept we are of the view that existing, well-practised control and shareholding tests only should be applied.

Foreign company charge

The proposed definition of 'foreign company charge', which has the same meaning as it has in Part 35B TCA 1997 - *"a charge under the law of a territory, other than the State, which is similar to the controlled foreign company charge",* and the meaning taken therefrom is crucial to determining the scope of the proposed legislation on payments on interest, royalties, and dividends. It is not apparent if regimes in other jurisdictions like a Controlled Foreign Company charge, such as the US regimes which include

[4] ANNEX to the Council Implementing Decision on the approval of the assessment of the recovery and resilience plan for Ireland Reform 3.6 .

Subpart F income, GILTI (Global Intangible Low-Taxed Income) and PFIC (Passive Foreign Investment Company) regimes, will fall within 'foreign company charge' for the purpose of 'supplemental tax.'

Taxpayers need certainty on the equivalent regimes that fall within 'foreign company charge'; while this could be dealt with under Revenue guidance, like for Part 35C TCA 1997[5], the preference would be that the position is legislated for at the outset of these new measures applying. In addition, the types of cases that satisfy the "subject to tax" meaning for the purposes of section 110 TCA 1997 as per Revenue Guidance[6] should equally fall within the meaning of 'foreign company charge' for the purpose of 'supplemental tax' under the new measures.

Supplemental tax

We acknowledge that the definition covers a foreign company charge and a top up tax under the OECD Pillar Two Global Anti-Base Erosion Rules. It is our view that there are circumstances where payments of interest, royalties or dividends will have been considered for tax purposes not covered by this definition.

We refer to our comments above regarding the proposed definitions of 'entity', 'foreign company charge' and the US regimes, specifically the need for the legislation to consider all taxes on the in-scope payments that are ultimately subject to tax, irrespective of the jurisdiction of the entity the payments are paid to.

Specified Territory

There is no reference to, or provision in the proposed legislation to consider the economic substance rules that certain territories have introduced into their domestic tax law in response to the OECD BEPS Action 5 minimum standard on harmful tax practices and to the EU Code of Conduct Group's 'economic substance' criterion. The results of the most recent BEPS Action 5 review by the OECD show from the perspective of part of the international standard under BEPS Action 5 to address harmful tax practices, that "No issues were identified for Guernsey, Jersey, the Isle of Man and the United Arab Emirates".[7] In our view, consideration should be given to those rules as part of any legislation to deal with outbound payments.

For the purpose of the measures, the recipient entity must be resident in a specified territory (as defined) or created under the laws of a specified territory. It may be the case that the entity concerned may be hybrid in nature such that its profits are chargeable to tax in another jurisdiction due to the latter seeing that entity as transparent. Therefore, in our view, it would be more appropriate for any proposed legislation for outbound payments to adopt a form of inclusion rules brought about for the treatment of hybrid entities in Part 35C TCA 1997. See our earlier comments.

Zero-tax territory

It is noted in the Feedback Statement that the measures are not intended to apply to no-tax and zero-tax jurisdictions that provide a participation exemption, where the relevant conditions for that exemption are met in that jurisdiction. The proposed legislative basis should deal with this issue,

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[5] Part 35C-00-01 - Hybrid Mismatches (revenue.ie), section 4.2.2.
[6] Part 04-09-01 - Section 110 companies (revenue.ie), Appendix 1.
[7] OECD releases results that show further progress in countering harmful tax practices - OECD.

possibly by way of amendment to the proposed definition of 'zero-tax territory'. This could be combined with the point made earlier regarding hybrid entities.

Question 2 Comments are invited on this possible approach with regard to outbound payments of interest

The Quoted Eurobond exemption from withholding tax on interest payments (section 64 TCA 1997) and similarly the wholesale debt instruments exemption (section 246A TCA 997) are relied on extensively in the Financial Services Industry to ensure efficient functioning of the capital markets. In addition, listed debt and payment of interest is made through custodial and settlement systems whereby the payor may not know the identity of the ultimate recipient of the payment. Removal of these well-established exemptions could have significant reputational impact on Ireland's Financial Services Industry. For these reasons Quoted Eurobonds[8] and wholesale debt instruments[8] should be removed from the scope of the proposed legislation.

The proposed legislation does not take account of situations where interest is not deductible for Irish tax purposes. There are several existing domestic provisions which deny relief for interest expenses, such examples are the interest limitation rules and anti-hybrid rules. Additionally, under section 130(2)(d)(iv) TCA 1997 interest could be treated as a distribution, absent any election under section 452 TCA 1997, and, therefore, would not be deductible as a trading expense. Imposing withholding tax in those situations would lead to double taxation.

The application of withholding tax provisions to interest that is not yearly interest under the new measures is very broad and we question the need to extend withholding tax beyond yearly interest payments.

The proposed legislation should consider including a form of "main purpose test" or "Principal Purpose Test" (PPT) such that the provisions to deny a withholding tax exemption should only apply where the test is not satisfied. This is to ensure that bona fide commercial transactions are not interfered with by virtue of the proposed legislation. In addition, the PPT in the OECD's Multilateral Instrument (MLI)[9] will deny treaty benefits, such as the reduction of withholding tax on interest, royalties and dividends, where it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that treaty benefit is one of the principal purposes of the party seeking to rely on the relevant double tax treaty.[10]

On the matter of treaties, the Feedback statement explains that *"existing administrative practices with regard to the requirement to withhold tax may be altered such that where the proposed measures apply to a payment, the practice prospectively would be to require tax to be withheld and a refund claim be made under the relevant treaty*." This would place an additional burden on the taxpayer concerned and therefore would be a matter which would interfere with our tax competitiveness. Therefore, we would recommend that such matter be reconsidered.

In addition to our earlier comments, the proposed new measures are themselves anti-avoidance defensive measures aimed to prevent double non-taxation. We question the need for further anti-avoidance provisions, such as the proposed subsection 5 of the payment of interest provisions. Consideration should be given to the possible unintended reach to bona fide commercial arrangements and/or arrangements agreed prior to the enactment of the legislation.

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[8] Proposed legislation – Payment of Interest, section 2, subsection 2 inclusion of section 64(2) TCA 1997, section 246A(3) TCA 1997.

[9] The PPT is one of the key provisions included in the OECD's Multilateral Instrument (MLI), to assist tax authorities to prevent any "treaty abuse" pursuant to Action 6 of the Base Erosion and Profit Shifting (BEPS) project.

[10] OECD BEPS - Multilateral Instrument: Treaty Abuse Principal Purpose Test, Deloitte.com.

Question 3 Comments are invited on this possible approach with regard to outbound payments of royalties

The above-mentioned comments in response to question 2, except the specific comments on Quoted Eurobonds and wholesale debt instruments, apply.

In addition, we welcome a discussion in relation to the proposed subsection 4 and the denial of section 757(2) TCA 1997 to a payment of a relevant royalty to which the measures apply.

The reach of "relevant royalty" is quite broad when compared to the position that exists for the purposes of section 238 TCA 1997 and the withholding tax rules across many EU Member States. We would question the need for such wide-ranging application. Rather in our view the measures should consider denying current withholding tax exemptions on royalty payments between in scope entities.

Question 4 Comments are invited on this possible approach with regard to outbound distributions

We reiterate our comments made in our response to the consultation on Measures to apply to Outbound Payments, December 2021, that any amendment to the existing Dividend Withholding Tax (DWT) provisions contained in Irish tax law would arguably not achieve the stated aim in Ireland National Recovery and Resilience Plan to tackle aggressive tax planning.

In the context of dividend payments (for which no tax relief is available to the payer) to a 'specified territory' it is difficult to identify instances where such payments would facilitate base erosion. Further, there is a risk of double taxation given that the distributed profits which are the subject of the dividend or distribution have themselves suffered tax such that a withholding tax charge would bring about a second domestic charge where a treaty may not allow credit for either withholding or underlying tax.

We are of the view that where a DWT exemption applies to a payment of a dividend to a parent company of the recipient and that parent company is not resident in 'specified territory' but resident in another EU Member State or Tax Treaty country, then the proposed new measures should not apply. The existing conditions for withholding exemptions should be sufficient to ensure that where the ultimate/final recipient is located in a 'specified territory' the exemptions will not apply.

In our view the proposed legislation goes beyond Ireland's commitment under the National Recovery and Resilience Plan outlined above.

Question 5 Comments are invited on these possible consequential amendments to the Taxes Consolidation Act 1997. Are there other possible consequential amendments which may be necessary to achieve the objective of these measures?

The proposed amendments to other provisions contained in the TCA 1997 follow from the proposed new legislation to be inserted into the TCA 1997. Any consequential amendments are conditional on acceptance of our comments in this submission in relation to the new legislation for payment of interest, payment of royalties and making of a distribution, and related definitions, and our suggested amendments to same

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