Irish Tax Monitor

In this month's Roundtable the panel analyses the 'structural' advantages that Irish-domiciled ETFs have in comparison to other jurisdictions, owed, in part, to its strong tax treaty network. However, all is not rosy in the ETF space, notably for Irish investors, with the 'deemed disposal' rule and elevated tax rate on returns in comparison to equities both highlighted. Recent BEPS guidance for insurance companies is also analysed, and welcomed, with the added clarity set to avoid any unintended consequences for that sector. The key short-term challenges facing tax managers are also analysed as are recent changes around corporation tax rules guidance and how the EU's incoming DEBRA rule could change the debt/equity financing mix for M&A activity.

The Deloitte Contributors in the April Roundtable Panel consisted of:
Jamie Ralph, Manager, Corporate Tax, Financial Services, Deloitte; Edel Webb, Senior Manager, Corporate Tax, Financial Services, Deloitte; Danielle Conlon, Manager, Corporate and international Tax, Deloitte; Peter Boyle, Manager, Corporate Tax, Corporate and International, Deloitte; Meabh O'Grady, Manager, Corporate and International Tax, Deloitte.

Can you outline the characteristics of an ETF and any tax advantages Irish ETFs have in comparison to other EU-domiciled ETFs?

Jamie Ralph, Manager, Corporate Tax, Financial Services, Deloitte: By way of background, exchange-traded funds (ETFs) are a particular type of investment fund whose shares can be traded on a stock exchange. The ETF's share price fluctuates as its shares are bought and sold by investors. The underlying investment portfolio of an ETF can contain a wide variety of investments (e.g. stocks, commodities, bonds, etc.) which it trades regularly; there are also synthetic ETFs available in the market which invest in derivatives referring underlying indices rather than in physical stock shares. In summary, ETFs offer the benefits of a standard investment fund (e.g. the pooling of investments, diversification, etc.) with the added attraction of being exchange-traded, while also being more accessible to a wider demographic, such as individual investors.

The European ETF industry has continued to grow significantly over the last number of years, with the market developing new products by expanding the nature of the ETFs and the assets under management. As reported by Funds Europe, at the start of 2023, Ireland hosted 67% of the total European ETF market, making it the largest domicile for ETFs in Europe currently.

Irish ETFs are typically structured as investment companies (i.e. public limited companies) or Irish Collective Asset-management Vehicles (ICAVs). Irish ETFs reap the benefits of the Irish funds tax regime i.e. they are not chargeable to Irish corporate tax or capital gains tax on their income and gains, but they are also capable of accessing Ireland's broad double treaty network to reduce/eliminate withholding taxes on such income/gains. However, it is important to note that the ability of an Irish ETF to access double tax treaties can vary depending on the jurisdiction and some jurisdictions can challenge the status of the Irish ETF as a "resident" under the treaty. Nevertheless, as an example, Irish ETFs are often in a position to access the reduced rates of withholding tax provided for under the US/Ireland Double Tax Treaty, which non-ETF funds will sometimes find more challenging.

Jamie Ralph

Finally, it is worth noting that Irish investors in Irish ETFs will generally be subject to tax on any income or gains arising as a result of their investments in an ETF under the standard self-assessment tax regime.

BEPS & Insurance

The OECD included specific guidance for the application of GloBE rules for insurance companies in its recent, major update. What are the key insurance specific points and the implications for insurance companies in scope of the rules?

Edel Webb, Senior Manager, Corporate Tax, Financial Services, Deloitte: As many will be aware, the OECD's Model Rules (known also as the

Edel Webb

GLoBE rules) are set to be introduced into Irish tax law shortly. The GLoBE rules include the Income Inclusion Rule (IIR) which apply from fiscal years commencing from 31 December 2023 and the Under Taxed Payment Rule (UTPR) applying for in-scope groups for fiscal years commencing from 31 December 2024. The purpose of GLoBE is to ensure profits of large groups (those with consolidated revenues in excess of €750m) are subject to a minimum effective tax rate (ETR) of 15% in every jurisdiction in which they operate. It should be noted that Ireland's corporate tax rate of 12.5% remains unchanged and the top up tax bringing the ETR to 15% will apply as a result of separate legislation.

While Irish tax legislation is currently under construction, on 1 February 2023, the OECD issued a document covering 'Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)'. This document specifically included a section detailing the applicability of the GloBE Rules to insurance companies to clarify a number of points which could have had unintentional consequences for insurance groups.

The guidance includes updates such as Article 7.6 being updated to apply to Insurance Investment Entities, similarly to its application to Investment Entities, affording an election to apply the Taxable Distribution Method. The document includes a proposed addition to the definition of Intermediate Parent Entity and Partially-Owned Parent Entity in the Model GloBE Rules. Previously, the definitions excluded Investment Entities. It is proposed to amend these exclusions to also exclude Insurance Investment Entities from these definitions.

In terms of Article 3.2.10, the GloBE Model Rules provide regulations that generally treat Additional Tier One Capital in the same manner as a debt instrument and as such, distributions are treated as expenses. This Guidance has extended such rules to insurers with Restricted Tier One Capital instruments. It is proposed to amend Article 7.5 to include an election to treat an Insurance Investment Entity held by mutual insurance companies as a Tax Transparent Entity.

Also the Guidance specifies that an expense or deduction is not allowed in respect of a movement in insurance reserves related to Excluded Dividends or Excluded Equity Gains or Losses from securities held on behalf of policyholders when computing GloBE Income or Loss.

All amendments provide some further clarity to insurance entities on the application of the GLoBE rules which are set to be implemented into Irish tax law later this year.

Tax Management

What are key challenges facing the corporate tax manager in the coming 12-18 months? What steps can be taken to prepare to meet these challenges?

Danielle Conlon, Manager, Corporate and international Tax, Deloitte: Key challenges facing the corporate tax manager is the continuous evolution of the laws and regulations surrounding corporation tax both on a European and Irish level. The quantity of changes is so vast it is impossible to refer to them all, key examples are as follows:

The OECD's two pillar BEPS 2.0 action plan which introduces a proposed global minimum tax rate of 15% for multinational groups with

Danielle Conlon

a turnover more than €750 million, whereby, companies within scope will be required to pay a top-up tax i.e. the difference between the 12.5% corporation tax rate currently chargeable in Ireland and the 15% rate which should be charged. However, it doesn't end there, the Subject to Tax Rule (STTR) is the next Pillar two change approaching which will operate as a tax treaty override position and apply a minimum 9% tax to payments such as interest and royalties.

Due to the current economic climate the government are constantly updating the support schemes available for businesses. The Department of Finance issued a press release on March 1st confirming an extension to the temporary business support scheme until April 30th 2023 and confirmed the monthly limit on aid under the scheme was increased to €15,000 per qualifying business subject to a cap of €45,000. Further changes are expected in the forthcoming Finance Bill.

What steps can be taken to prepare to meet these challenges? Every day is a 'school day' could not be a more truthful reflection of the role of a corporate tax manager. With all the recent changes it is important that we are upskilling regularly and ensuring we are aware of the upcoming amendments to the corporate laws and regulations to offer the most up to date advice to our clients.

M&A - Debt vs Equity

What are key tax implications for companies choosing between equity or debt to finance an investment or acquisition and how could the introduction of DEBRA change this?

Peter Boyle, Manager, Corporate Tax, Corporate and International, Deloitte: Unlike a handful of our EU counterparts, the domestic Irish tax

Peter Boyle

regime does not currently allow for a notional interest deduction on equity. As such, investments financed via debt have a distinct tax advantage over equity financed investments given the availability of a corporation tax deduction on interest (albeit with a plethora of manageable conditionality) whereas no corporation tax deduction is available on distributions to equity holders. As the global economy emerges from a historically low interest rate environment, mixed with accelerated borrowing brought on by the COVID-19 pandemic, global debt levels are at an all-time high, and the debt-equity bias is one of a number of drivers for the preference of corporate groups to look to debt as the preferential financing instrument.

The significant levels of debt held by corporate groups globally has inspired the EU's Debt-Equity Bias Reduction Allowance Directive ('DEBRA'), which aims to address this debt-equity bias. At a high level the two independent components to the Directive are:

1. the introduction of a notional interest deduction on increases to net equity, and
2. a limitation on the deductibility of net interest costs (exceeding borrowing costs) to 85%

The amount of a tax deduction for equity under DEBRA will be based on a Notional Interest Rate (NIR) which incorporates a risk free rate and risk premium and should therefore track expected further increases to Central Bank interest rates in the future. The deduction available would be limited by reference to 30% of a taxpayer's EBITDA. Given the recent implementation of the Interest Limitation Rule (ILR) in Ireland which limits a deduction to net financing costs to 30% of a tax calculated EBITDA, the DEBRA Directive should take a step towards bridging the gap between the debt equity bias, giving tax payer's an opportunity to review their capital structure for a cocktail of debt and equity which optimises corporation tax deductibility on the cost of financing.

In relation to the second component of DEBRA, which seeks to limit interest deductibility to 85%, the European Commission has indicated that ILR's implemented under ATAD will operate in conjunction with the DEBRA rules whereby whichever rule allows for the lower amount of interest deductibility will be the operative provision. As such, although a notional interest deduction for equity provided by DEBRA is a welcome measure, adding additional complexity to an already highly complex rule base for interest deductibility is not and will further increase the compliance burden for tax payers.

Corporation Tax

The Revenue Commissioners has updated its guidance on charges on income for corporation tax purposes. Can you explain the changes and the implications for affected taxpayers?

Meabh O'Grady, Manager, Corporate and International Tax, Deloitte: Irish Revenue updated their Tax and Duty Manual Part 08-02-01 on February 1st 2023 regarding the deduction of interest for corporation tax purposes. There were two key changes summarised as follows:

Interest payments to non-residents: Interest paid by an Irish tax resident company to a non-resident is generally deductible in arriving at taxable profits where the conditions under Section 243(5) TCA 1997 are met. One of the conditions to treat the interest as being deductible in Section 243(5) TCA 1997 is that withholding tax should be applied on the payment and paid to Irish Revenue. Certain interest payments can be made without the application of

Meabh O'Grady

withholding tax where the company is authorised to do so by Irish Revenue. Section 2.2 of the Tax and Duty Manual Part 08-02-01 was updated in February 2023 to account for a scenario where a company makes an interest payment to a non-resident company without the application of withholding tax by virtue of relief available under a double tax treaty. The updated Tax and Duty Manual provides that where relief from withholding tax is obtained via treaty relief and all compliance obligations to obtain the relief have been met per Tax and Duty Manual Part 08-03-06 then the interest is treated as being authorized by Irish Revenue for the purposes of Section 243(5)(a)(I) TCA 1997.

Availability of Section 247 TCA 1997 Relief: At a high level, Section 247 TCA 1997 provides that where interest is incurred by a company on a loan borrowed to acquire shares in or loan money to another company the interest can be allowed as a charge provided certain conditions are met. Section 3.4 of the Tax and Duty Manual Part 08-02-01 was updated in February 2023 to confirm that where Section 247 TCA 1997 relief applies and subsequently a merger or division results in the dissolution of either the company borrowing the funds (i.e., the investing company) or the company where the money is invested in or lent to (i.e. the investee company) then the conditions under section 247 TCA 1997 are not deemed to be met and the relief will cease to apply.