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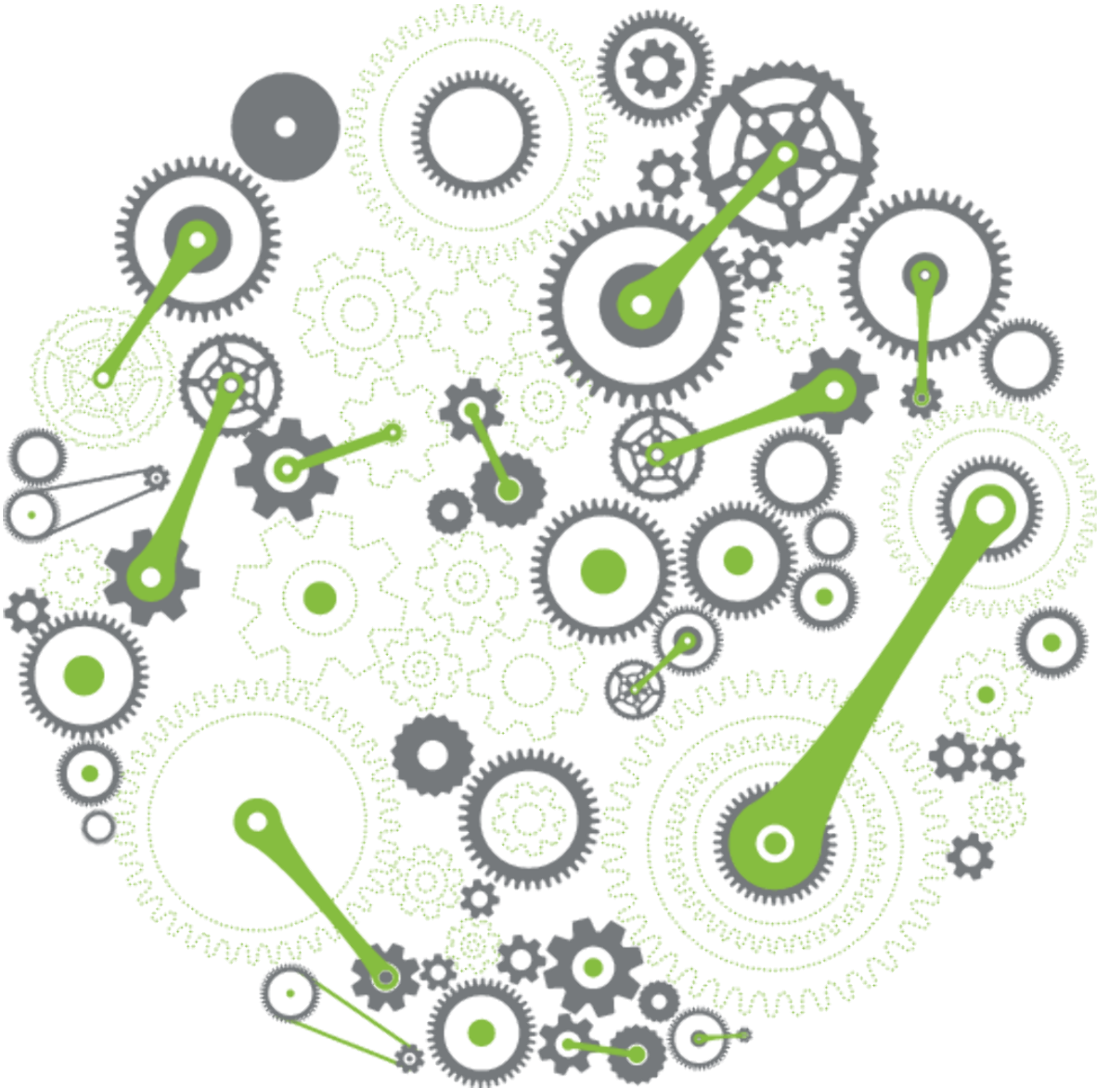

Participation Exemption for Foreign Dividends
Response to Feedback Statement: Strawman Proposal

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Participation Exemption Feedback Statement
Tax Division – Business Tax Policy
Department of Finance
Government Buildings
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By email to businesstaxpolicy@finance.gov.ie

Dear Sirs/Mesdames:

Re: Participation Exemption for Foreign Dividends Response to Feedback Statement: Strawman Proposal

We are pleased to submit comments on behalf of Deloitte in response to your 'Participation Exemption for Foreign Dividends Response to Feedback Statement: Strawman Proposal' of April 2024. 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 we 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,

Daryl Hanberry
Partner, Head of Tax and Legal

Tom Maguire

Tom Maguire
Tax Partner

1. Executive Summary

The views expressed in this submission reiterate those outlined to the Department of Finance in our response to the public consultation on the 'Roadmap for the Introduction of a Participation Exemption to Irish Corporation Tax including technical consultation' of December 2023.

We in principle agree with the proposal for a participation exemption for dividends and distributions as set out in the Strawman Proposal, but we outline several points below for your consideration.

In summary, in our view

- Any design for an Irish participation exemption regime for dividends and distributions must be broad and as simple as possible and provide certainty to taxpayers. At the same time, Ireland's competitiveness for FDI should be protected and so the exemption should apply to all income from shares.
- The participation exemption should at least include all companies within the scope of the Pillar Two rules, as well as Inclusive Framework countries who have signed up to the OECD BEPS Pillar Two rules, EEA countries, tax treaty countries, and countries that have signed up to the Convention on Mutual Administration in Tax Matters.
- Taxpayers should not be adversely impacted by the participation exemption, for example, where the taxpayer elects in error with a negative impact on its application of the Interest Limitation Rule.
- It is not clear to us why, if a minimum shareholding requirement is necessary, that a position which differs from that in section 626B TCA 1997 is adopted.
- The participation exemption will remain in law simultaneously with Schedule 24 TCA 1997 and therefore it would be appropriate for the latter to be simplified at this time.

2. Overall comments

Our overall position is that a full territorial regime (substantial shareholding exemption, participation exemption for distributions, as well as a foreign branch exemption) would be a significant positive to the Irish tax code and will only enhance Ireland's competitiveness for FDI.

In the new global tax ecosystem in which the OECD Pillar Two rules feature, competition and protection of Ireland's attractiveness to FDI has become even more important. The Irish corporation tax headline rate of 12.5% remains competitive, and in our experience the Pillar Two minimum effective tax rate is one element influencing the investment decisions of MNEs, however, Ireland must evolve and seek to implement tax reform that will maintain and increase our competitiveness.

We welcome the proposed introduction of a participation exemption into domestic legislation in Finance Bill 2024 so that foreign sourced dividends and distributions are fully exempt from tax in Ireland. This, we feel, is an important step towards an enhanced competitive tax system.
We urge your office to continue with the detailed consideration of proposals to introduce a foreign branch exemption into the Irish tax system and we look forward to engagement on this important issue during 2024.

In this submission we provide our views and comments on the Strawman Proposal. We acknowledge caution for any proposal to observe international best practice and maintain a robust tax regime. The necessity for any Irish participation regime for distributions to be as simple as possible and provide certainty to taxpayers while enhancing our competitiveness underlies our views and comments.
We agree, in principle with the Strawman Proposal, but we have several points we wish to make for your consideration.

This document proceeds by looking to each element of the proposal and commenting thereafter.

3. Strawman Proposal

Scope of Relief

> Relief will be provided in the form of an exemption from corporation tax. Where qualifying criteria are satisfied, 100% of the dividend will be in scope.

We agree, there is no need to restrict the exemption to anything less than 100%. We look forward to understanding and commenting on the abovementioned "qualifying criteria" in due course. One concern surrounds the calculation of EBITDA for the purposes of the Interest Limitation Rule (ILR)[1] and we expand on this concern later in this submission.

> Entities in scope – the regime will apply to companies within the charge to Irish corporation tax. This includes Irish resident companies and certain non-resident companies carrying on a trade in the State through a branch or agency.

We agree with this proposal, all companies that are within the charge to Irish corporation tax in respect of foreign dividends and distributions received should be within scope of the regime.

> Qualification for the regime – companies will have flexibility to opt in to the participation exemption regime, with an election to apply for a minimum period of 3 years. The election would apply in respect of all potentially in-scope foreign dividends received by the company during the period in which it is elected in to the exemption.

Any election should be required annually. We also emphasise the need for the election to be within section 959V Taxes Consolidation Act ("TCA") 1997 so that the taxpayer can amend their corporation tax return within the provisions of that section.

We reiterate our view made in prior submissions that the method of election must be simple and not subject to a time restriction. This is vital to ensure that the regime does not add to the compliance burden and complexity for taxpayers when dealing with their Irish tax affairs. In our view election on a dividend-by-dividend basis would support the move to a simpler tax regime and should result in no additional administration of the tax system by the Office of the Revenue Commissioners. Further this is suggested to facilitate a taxpayer not being put into a worse economic position with regard to the ILR as a result of the application of a participation exemption. The exemption of foreign dividend income from Irish tax under a participation exemption regime will remove such income from the calculation of relevant profit or loss and which could result in a lower EBITDA upon which the interest limitation is based for that taxpayer.

[1] Part 35D TCA 1997

Geographic scope – dividends received from companies that are resident for tax purposes in the EU/EEA or jurisdictions with which Ireland has a double taxation agreement will qualify.

The proposed restriction of the regime to EU/EEA jurisdictions or with which Ireland has a DTA is in our view too limited. Most other EU and OECD jurisdictions do not contain such a limitation as part of their participation exemption regimes. [2]

As we have stated in prior submissions, the participation exemption should at least include all companies within scope of the Pillar Two rules, as well as Inclusive Framework jurisdictions who have signed up to the OECD BEPS Pillar Two rules, EEA countries, tax treaty countries, and jurisdictions that have signed up to the Convention on Mutual Administration in Tax Matters.

We suggest that companies resident in a "listed territory" on the EU list of non-cooperative jurisdictions should be excluded from the exemption. We note that excluding such territories is proposed in section 5.3 of the Strawman Proposal. This would be in keeping with Ireland's policy and application of defensive tax measures towards "listed territories". In our previous submission we made suggestions as to how such jurisdictions could be excluded by either reference to section 835YA TCA 1997 or the introduction of a similar provision denying the exemption.

A final point when considering the jurisdictions within the scope of the regime, it is important that recognition is given to jurisdictions that do not have a concept of residency and therefore an alternative provision similar to residency must be allowed for. Our previous submission outlined how the Pillar Two rules[3] dealing with the location of an entity may be considered in this regard.

Profits in scope – qualification will not be restricted to dividends derived from trading profits.

We are of the view that the exemption should be as flexible as possible and not subject to any requirement to satisfy a trading profits test with regards to shareholdings.

Where the exemption is availed of, a tax credit will not be available in respect of foreign tax paid on the foreign dividend.

We acknowledge that a foreign tax credit would not be available for foreign tax paid on the foreign dividend under our double tax relief provisions contained in Schedule 24 TCA 1997.

Dividends/distributions in scope

The exemption will apply to foreign dividends and other types of distributions that represent income from shares or from other rights, not being debt claims, to participate in a company's profits. This includes income from other corporate rights which is subjected to the same tax treatment as income from shares by the laws of the State of which the company making the distribution is resident.

[2] International Tax Competitiveness Index 2023, Tax Foundation, page 66
[3] Section 111D(2) TCA 1997

We agree that all distributions that represent income from shares or from other rights be within scope of the regime. "Shares" should cover all classes of shares, for example, there should be no distinction between ordinary shares and preference shares once all other conditions for the exemption are satisfied.

> In broad terms, relief will apply to distributions in the nature of income, such that "capital distributions" within the meaning of section 583 TCA 1997 would not qualify (e.g. a distribution in the course of dissolving or winding up a company).

In our view the exemption should apply to all distributions, capital and income.

> Qualification for the exemption will be established by reference to a minimum level of control over the ordinary shares of the foreign subsidiary. Where that qualification has been established, the exemption may also apply in respect of dividends received from that company on other types of shares, such as preference shares. This may require anti-avoidance provisions against artificial arrangements, similar to section 138 TCA 1997 for example.

In our view the design of the participation exemption regime should be as simple and free of unnecessary complexity as possible. Ideally there would be no minimum shareholding percentage requirement. However, to the extent that the Department would consider imposing a minimum shareholding requirement then consideration should be given to similar terms and holding conditions such as those outlined in section 626B TCA 1997 and indeed that outlined in section 831 TCA 1997.

We question the need for a similar provision to that in section 138 TCA 1997 in this instance given the application of the General Anti Avoidance Rule, Controlled Foreign Companies and Anti-Hybrid provisions in our law.

> Companies must control at least 5% of the ordinary share capital for an un- interrupted period of twelve months up to and including the date of the dividend. Dividends in respect of newly acquired participations may also qualify provided the shares are subsequently held for a period of up to twelve months after the date of the dividend (i.e. a minimum overall holding period of twelve months).

We note the proposal is that the company/companies must "control" at least 5% of the ordinary share capital for an uninterrupted period of twelve months up to and including the date of the dividend. While comparable to the provisions in section 626B TCA 1997, we question why the proposal is not fully aligned with the conditions of that section and introduces a new "control" test.

> The 5% control test will be established by reference to up to four criteria; ownership of ordinary share capital (direct or indirect); holding of voting rights; entitlement to profits available for distribution; and entitlement to assets on a winding-up of the company.

We refer to our comments above. We question the need for such a control test which is also not in line with the conditions of section 626B TCA 1997.

The availability of a participation exemption as set out above is not intended to impact existing provisions relating to portfolio investments in section 21B TCA 1997.

There is no reason that we are aware of that the introduction of a participation exemption regime will require the deletion of section 21B TCA 1997. Both regimes can exist independently where the taxpayer is offered the optionality between electing to apply the participation exemption and subjecting the respective distribution to tax (in addition to the portfolio exemption in section 21B TCA 1997) as well as the reliefs available under Schedule 24 TCA 1997.

The optionality of the participation exemption regime should not impact on the availability of section 21B TCA 1997. For example, if a distribution does not qualify for the participation exemption it could still qualify for section 21B TCA 1997 subject to satisfying the conditions of that section. Likewise, if the participation exemption regime does not apply this should not impact on section 21B TCA 1997.
Finally, we recommend that consideration be given to amending section 21B TCA 1991 to broaden the residency condition so that it encompasses jurisdictions that do not have a concept of “residency”.

Anti-Avoidance

The dividend must not be deductible for tax purposes in any other jurisdiction.

We recommend that this apply at the point in time that the distribution or dividend is received.

Dividends received from a jurisdiction on the EU list of non-cooperative jurisdictions for tax purposes, as reflected in the TCA 1997 on the date of the dividend, will not qualify for relief.

We have no additional comments on the above.

Relief will apply only in respect of the payment of a dividend where it would be reasonable to consider that the payment is made for bona fide commercial purposes and does not form part of any arrangement or scheme of which the main purpose, or one of the main purposes, is the avoidance of tax.

We would question the need for the above. As commented on earlier in this submission and in our prior submissions, we are of the view that no specific anti-avoidance provisions need to be introduced given the application of the General Anti Avoidance Rule, Controlled Foreign Companies and Anti-Hybrid provisions in Irish tax law.

Administration

Relief will be available in respect of dividends received in accounting periods commencing on or after 1 January 2025.

We have no comments on the above.

The election to avail of the participation exemption will be made via the Form CT1 corporation tax return and will apply for a minimum period of 3 years in respect of all qualifying dividends received by the company. An election cannot be revoked once made.

We question the need for a three-year period and have commented earlier on this point. In our view the taxpayer should appropriately elect and should apply for each distribution and each dividend and election should be revocable to cater for the need where such election was made in error.

It must be recalled that that a participation exemption can negatively impact the application of the ILR e.g., a dividend could have been effectively exempt due to the amount of underlying tax on distributed profits but availing of the participation exemption in that instance would impact on the EBITDA calculation for ILR purposes.

The election should be within section 959V TCA 1997 so that the taxpayer can amend their corporation tax return within the provisions of that section.

The potential need for transitional provisions must be considered on the introduction of any new measure to the tax code. Where the participation exemption operates through the method of election in to the regime, this may limit the extent of transitional provisions required. However, it would at a minimum be necessary to provide rules for the use of any balance of unrelieved foreign tax credit carrying forward at the time of election into the regime.

We are unaware of a need for a transitional period if the participation exemption regime is available for dividends and distributions received on or after 1 January 2025.

We also recommend that consideration be given to providing that unutilised foreign tax credits be available to carry back to preceding accounting periods, possibly with a limit to three preceding periods.

Companies will be required to report foreign dividends subject to exemption as part of the CT1 return.

We acknowledge the need for the Office of the Revenue Commissioners to administer and monitor the participation exemption regime however, we feel it necessary to caution against an overly rigorous compliance requirement on taxpayers. This will negate the benefits of a simple and consistent regime.

The existing Schedule 24 provisions will continue to operate as normal for distributions not in scope of the exemption.

We agree with this proposal, however we reiterate our previous comments that even with the introduction of a participation exemption regime, simplification of Schedule 24 TCA 1997 must be a priority in tax policy.

In considering the potential simplification of Schedule 24 TCA 1997, broadening the categories of income on which relief may be obtained and simplification measures for the pooling and carry forward of unrelieved foreign tax must be a focus.

In line with our comments previously submitted to the Department of Finance, in respect of the categories of income for which relief may be obtained, at present, relief under Schedule 24 TCA 1997 is only afforded with respect to specific income streams. We would welcome a simplification of Schedule 24 TCA 1997 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%.

We also reiterate our comments on 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.

> A company that elects in to the participation exemption may have an amount of unrelieved foreign tax credit carrying forward at the time of the election. This credit would remain available for offset under Schedule 24 provisions against distributions not in scope of the exemption, or for use in future years if the company ceases to elect in to the participation exemption regime.

We refer to our comments earlier in this submission.