Deloitte.

Participation Exemption for Foreign Dividends: Second Feedback Statement

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Participation Exemption Feedback Statement
Tax Division – Business Tax Policy
Department of Finance
Government Buildings
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Dublin 2 D02 R583

By email to businesstaxpolicy@finance.gov.ie

Dear Sirs/Mesdames:

Re: Participation Exemption for Foreign Dividends – Second Feedback Statement

We are pleased to submit comments on behalf of Deloitte in response to your 'Participation Exemption for Foreign Dividends Second Feedback Statement' of August 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 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
Tax Partner

Comments

> ‘relevant territory’ means –
>
> (a) an EEA state other than the State,
> (b) not being a territory referred to in paragraph (a), a territory with the government of which arrangements having the force of law by virtue of section 826(1) have been made, or
> (c) not being a territory referred to in paragraph (a) or (b), a territory with the government of which arrangements have been made which on completion of the procedures set out in section 826(1) will have the force of law,
> but does not include a listed territory.

The proposed definition of a ‘relevant territory’ 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. 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 states, tax treaty countries, and jurisdictions that have signed up to the Convention on Mutual Administration in Tax Matters.

We acknowledge the supporting narrative to the proposed definition of a ‘relevant territory’ in the Feedback Statement document. However, we feel that it is necessary that there is a stated commitment from government to further considering broadening the scope beyond what is currently proposed.

> ‘relevant distribution’ means a dividend paid, or other distribution made, out of profits in respect of a relevant subsidiary’s share capital other than redeemable share capital, that constitutes income in the hands of the recipient for the purposes of corporation tax, but without prejudice to the generality of the foregoing, does not include –
>
> (a) a distribution that has been, or may be, in any accounting period, deducted for the purposes of tax in any territory outside the State under the law of that territory, (b) a distribution in a winding up, (c) any interest or other income from debt claims providing rights to participate in a company’s profits, (d) any amount considered to be interest equivalent within the meaning of section 835AY, or (e) any dividend paid or other distribution made by an offshore fund within the meaning of section 743;

“out of profits”

The “out of profits” requirement is limiting factor considering the different ways distributions can occur under foreign company law. The proposed legislation does not take account of different jurisdictions’ company law requirements.

The “out of profits” requirement will put Ireland’s regime at a competitive disadvantage compared to other jurisdictions whose participation exemption regimes do not include such limitations. We suggest the removal of the “out of profits” requirement.

"redeemable share capital"

We understand that there may be a policy intention to exclude any distributions that arise from debt. In our view the reference to excluding "redeemable share capital" should be removed. Any income from debt is covered by subpart (c) and (d) in the proposed definition's exclusions above and thus distributions from debt should be excluded from being a 'relevant distribution'.

However, if the Department feels it necessary to retain the wording "redeemable share capital" in our view consideration could be given to restricting this to such share capital that is accounted for as a debt in the subsidiary's financial statements. Any reference to redeemable share capital may need to be amended to reflect the fact that such share capital may contain an equity (as opposed to a debt) element depending on the contents of the instrument.

Further, it is unclear whether the definition of a "relevant distribution" is intended to cover all forms of the return of share capital for example a share buyback.

'relevant subsidiary' means a company which –

(a) is subject to a tax imposed in a relevant territory which corresponds to corporation tax in the State in respect of profits, without the possibility of being exempt or an option of being exempt, and

(b) is, by virtue of the law of a relevant territory, resident for the purposes of tax in a relevant territory at the date of making a relevant distribution and was so resident throughout the period out of the profits of which that relevant distribution was made, and

for the purposes of determining the profits out of which a relevant distribution was made, subparagraphs (iii) and (iv) of section 21B(1)(b) shall apply with any necessary modifications as is references in those subparagraphs to a dividend paid by a company were references to a relevant distribution made by a relevant subsidiary.

The rationale or benefit of the words "in respect of profits" is unclear. Such drafting could result in unintended consequences such as the removal of dividends from the scope of the exemption in situations they are paid out of profits which themselves have been exempted for legitimate reasons. For example, a Dutch entity which receives income via distribution may exempt such income from tax under the Dutch participation regime; the above section could cause distributions made out of those profits to an Irish company to be removed from the scope of the participation exemption; the rationale or benefit to such an outcome is not, in our view, apparent. References to the "possibility of being exempt or an option of being exempt" is also cause concern and is in our view unnecessary; such an approach could act to deny the participation exemption in cases where even though no exemption has in fact been claimed or availed of it remains an option under the law of the relevant subsidiary jurisdiction. In our view, if such form of assessment is necessary then it is the nature of the subsidiary's tax position rather than its profits that should form the basis of whether the participation exemption is available to an Irish tax resident recipient; once the distribution is or would otherwise be subject to Case III in the hands of the recipient, this should be sufficient.

However, if the policy intent is to permit the participation exemption only in cases where the foreign law of the payer jurisdiction has a tax equivalent to corporation tax with no exemption or possibility of same, then adopting an approach similar to section 21(1) Taxes Consolidation Act ("TCA") 1997 (which speaks to companies being charged to corporation tax generally as opposed to profits being "subject to tax") should, in our view be considered.

(2)(a) For the purposes of this section, a parent company shall be regarded as having a relevant participation in a relevant subsidiary where the parent company directly or indirectly holds ordinary share capital that is not redeemable, in the relevant subsidiary, by virtue of which it –

(i) owns not less than 5 per cent of the relevant subsidiary's ordinary share capital,

(ii) is beneficially entitled to not less than 5 per cent of the profits available for distribution to equity holders of the relevant subsidiary, and

(iii) would be beneficially entitled on a winding up to not less than 5 per cent of the assets of the relevant subsidiary available for distribution to equity holders.

(b) **For the purposes of paragraph (a) –**

(i) **subsections (2) to (10) of paragraph 9 shall apply with any necessary modifications,**

(ii) **a holding of ordinary share capital in a relevant subsidiary shall not be determined by reference to any share capital –**

(I) **held through an** intermed**iary company that is not resident, by virtue of the law of a relevant territory, for the purposes of tax in that relevant territory,**

(II) **owned directly in a company if a profit on a sale of the shares would be treated as a trading receipt of its trade, or**

(III) **owned indirectly and which is owned directly by a company for which a profit on the sale of the shares would be a trading receipt, and**

(iii) **sections 413 to 419 shall apply with any necessary modifications as they apply for the purposes of Chapter 5 of Part 12 but –**

(I) **without regard to paragraph (c) of section 411(1) in so far as it relates to those sections,**

(II) **as if subparagraph (ii) of section 413(3)(b) were deleted, and**

(III) **as if "In this Chapter, "the relevant accounting period" means the accounting period current at the time in question" were substituted for section 419(1).**

We note from the Feedback Statement and the draft subsection 2 above that it is envisaged that a parent company will be subject to a requirement to hold (directly or indirectly) the ordinary share capital in a relevant subsidiary (references to "redeemable share capital" should be removed). Such an approach may in fact exclude certain forms of bodies corporate from the application of the participation exemption where such entities do not in fact have "ordinary share capital". In such a case, the widening of the above subsection 2 to allow for an "ownership interest" as defined in section 111A TCA 1997 could mitigate these concerns. An ownership interest for section 111A TCA 1997 purposes is defined as "…any equity interest that carries rights to the profits, capital or reserves of an entity or a permanent establishment". OECD Guidance[1] on the point defines an equity interest as "an interest that is accounted for as equity under the financial accounting standard used in the preparation of the Consolidated Financial Statements" and would be expected to bring within its remit other types of corporates beyond those with ordinary share capital.

[1] OECD (2024), *Tax Challenges Arising from the Digitalisation of the Economy – Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2023): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/b849f926-en, Chapter 10 at Paragraph 85

(3)(a) Subject to subsection (8), where in an accounting period –
(i) a relevant subsidiary makes a relevant distribution to a parent company, and
(ii) subject to paragraph (b), the parent company would, but for this section, be chargeable to corporation tax in respect of the relevant distribution under Case III of Schedule D,
then, except where otherwise provided by the Corporation Tax Acts, corporation tax shall not be chargeable on the relevant distribution nor shall the relevant distribution be taken into account in computing income for corporation tax.
(b) A relevant distribution referred to in paragraph (a)(ii) shall not include a relevant distribution where the amount on which the parent company is chargeable to tax under Case III of Schedule D is computed in accordance with the provisions applicable to Case I of that Schedule.

Section 110(2) TCA 1997 provides that profits arising to a "qualifying company" as defined in that section, "*in relation to activities carried out by it in the course of its business, shall, notwithstanding any other provisions of the Tax Acts, be treated as annual profits or gains within Schedule D and shall be chargeable to corporation tax under Case III of that Schedule,"*. Subsection 2(a) thereof explains "the profits or gains shall be computed in accordance with the provisions applicable to Case I of that Schedule,".

Consequently, subsection (3)(b) of the proposed legislation may carve out distributions arising to a "qualifying company" under section 110 TCA 1997 from the meaning of a "relevant distribution" thus such distributions may not be within scope of the proposed participation exemption. In our opinion, the exclusion of companies falling within section 110 TCA 1997 would represent a lost opportunity to enhance Ireland's competitiveness within the Financial Services industry comparative to other asset holding regimes such as the regimes in UK and Luxembourg which provide access to participation exemption on dividends and other distributions. We would accordingly request that (b) above be given further consideration in light of our comments on the matter.

(4) Subsection 3 shall apply only in respect of a relevant distribution made to a parent company where the parent company holds a relevant participation in the relevant subsidiary concerned for an uninterrupted period of not less than 12 months that includes the date on which the relevant distribution is made by the relevant subsidiary.

The above provision is silent as to the approach to be taken in the case of changes of ownership or corporate restructuring within a group. This stands in contrast to the specific provisions of section 626B TCA 1997, which provides that group ownership can be considered in assessing whether the holding period requirements are met[2]. No such provision would appear to apply with respect to the holding period required for a company to avail of the participation exemption. We would accordingly recommend that consideration be given to permitting a parent company to take on the period of ownership of another group company in assessing whether the conditions outlined in subsection 4 of the draft participation exemption legislation are met.

Furthermore, section 626B(1)(b)(iv) TCA 1997 provides that in the context of CGT relief on disposals of shares by a parent, where a company is in liquidation, that fact is effectively ignored as the actions of the liquidator are taken as actions of the company. In our view, consideration should be given to the application of a similar approach in the context of the participation exemption.

[2] See s626B(1)(b)(ii) and Schedule 25A TCA 1997

> (5)(a) Subsection (3) shall not apply to an arrangement, or part of an arrangement, which –
> (i) has been put in place for the main purpose of, or one of the main purposes of which is, obtaining a tax advantage, and
> (ii) is not genuine having regard to all the facts and circumstances.
>
> (b) For the purposes of paragraph (a)(ii), an arrangement shall be regarded as not genuine to the extent that it is not put into place for valid commercial reasons which reflect economic reality.

We would question the need for the above. As commented in our prior submission[3], 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. Further, the conditions of the proposed exemption provide for the necessary anti-avoidance protections i.e., the scope of the exemption is limited to "relevant subsidiary" and "relevant distribution", including additional provisions is unnecessary.

> (8) (a) Subsection (3) shall not apply in respect of a relevant distribution made by a relevant subsidiary to a parent company unless the parent company makes a relevant claim for the accounting period in which the relevant distribution is made.
> (b) In this subsection, a "relevant claim" in relation to an accounting period means a claim by a parent company that subsection (3) shall apply in respect of all relevant distributions made to the parent company by its relevant subsidiaries in the accounting period.
> (c) A relevant claim for an accounting period shall be made by a parent company in the return required to be delivered under Part 41A in respect of the accounting period.

Subsection 8(b) above explains that a relevant claim is to mean a claim made in respect of "all relevant distributions". This "all or nothing" approach is reflected further in the Feedback Statement.[4].

In our previous responses to the Department, we noted that it is our view that a dividend-by-dividend basis, or a distribution-by-distribution 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. We would recommend this be reconsidered.

In line with our previous response, we would recommend that the legislation should allow relevant entities to elect for the participation exemption on a distribution-by-distribution (i.e., dividend-by-dividend) basis, rather than requiring the exemption to apply to *all* relevant distributions made to the parent company by its relevant subsidiaries in the accounting period.

Alternatively, where such a basis is not considered appropriate, we would ask that the Department considers a 'relevant claim' to have been made on a participation-by participation/subsidiary-by-subsidiary basis.

[3] Department of Finance website
[4] Page 10

Consequential amendments

Controlled Foreign Company ("CFC") provisions.

We note from the Feedback Statement that an amendment is proposed to section 835Q TCA 1997 as follows:

> (z) in section 835Q(4), by the substitution of the following paragraph for paragraph (c):
>
> "(c)(i) where subparagraph (i) of paragraph (a) applies, as has been subject to tax in the relevant Member State referred to in that subparagraph, or
> (ii) where subparagraph (ii) of paragraph (a) applies, a relevant claim in respect of an accounting period has not been made under section xxxx"

As noted in our previous submissions, the CFC rules in Part 35B TCA 1997 operate by attributing undistributed income of a CFC to a chargeable company with the CFC charge arising on an amount equal to the undistributed income. Section 835Q TCA 1997 addresses undistributed income to form the basis of a CFC charge applicable to a chargeable company and in particular ss4 addresses the meaning of "distributions made in respect of the accounting period", in particular requiring the distribution to have been subject to tax in the hands of the recipient (section 835Q(4)(c) TCA 1997). This provision permits distributions made by a CFC to its Irish parent to be treated as distributions for the purpose of calculating undistributed income, as such distributions are subject to tax albeit with double tax relief under Schedule 24 TCA 1997 providing a de facto participation exemption such that no incremental Irish corporation tax is likely to arise.

The proposed amendment above would treat distributions subject to the participation exemption as falling outside the scope of section 835Q TCA 1997 and thus not reducing the undistributed income of a CFC; such an outcome could in theory result in a CFC charge for a chargeable company where one would not have arisen had the participation exemption not been availed of.

While the requirement that the distribution be subject to tax is already well established in section 835Q(4)(c) TCA 1997, we cannot see any reason why the application of a participation exemption to the distribution made should alter the status of the distribution for CFC purposes. In our previous submission to the Feedback Statement of April 2024, we had noted that consideration may be needed to amend the current CFC rules; however, the amendment above does not, in our view, achieve the intended aims of equalising treatment between Irish companies who avail of the participation exemption and those do not (i.e., and continue to apply Schedule 24 TCA 1997).

In our view, the proposed amendment could give rise to EU law concerns. The FII GLO[5] case provides that Member States are *"in principle, free to prevent the imposition of a series of charge to tax on dividends received by a resident company by opting for the exemption method where the dividends are paid by a resident company and for the imputation method when they are paid by a non-resident company. Those two methods are in fact equivalent provided, however, that the tax rate applied to foreign sourced dividends is not higher than the rate applied to nationally sourced dividends and that the tax credit is at least equal to the amount paid in the State of the company making the distribution…"*[6]. Accordingly, the use of an exemption for domestic dividends and a credit method for foreign dividends can stand alongside one another; however, the amendments proposed to section

[5] FII Group Litigation v CIR (FII GLO No 2) (Case C-35/11) [2010], accessible here
[6] Para 39 of the judgment at footnote 4

835Q TCA 1997 would, in our view, deviate from this permitted comparison and would look to treat holdings in certain foreign companies differently. We would recommend that the above amendment to section 835Q(4) TCA 1997 be reconsidered in light of this, to permit dividends subject to the participation exemption to be qualifying dividends for the purpose of calculating undistributed income.

Other consequential amendments

The Feedback Statement notes that a number of amendments are under consideration, namely:

- Dividends paid out of foreign profits (section 129A TCA 1997);
- Unit trusts/Undertakings for collective investment (section 738 TCA 1997);
- Purchase and sale of securities (Part 28 TCA 1997);
- Taxation of shares issued in place of cash dividends (section 816 TCA 1997); and
- Treatment of dividends on certain preference shares (section 138 TCA 1997).

No further detail has been provided with respect to these potential amendments; accordingly, it is difficult to provide our view with respect to same. However, we would be of the view that stakeholder engagement on any suggested amendments would be preferable to ensure that unintended consequences are mitigated where possible.

Other comments

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

It is important that the Irish participation exemption for dividends and distributions is introduced in a manner that achieves the government's stated aim[7] of simplifying the Irish corporate tax system while also ensuring that Ireland remains a competitive location for FDI. A piecemeal regime may not achieve these aims and may only introduce uncertainty into the Irish tax system.

We eagerly await a progress update on the commitment to consider introducing a foreign branch exemption into the Irish tax system.

[7] Department of Finance press release, 27 August 2024. https://www.gov.ie/en/press-release/31a24-minister-chambers-publishes-2nd-feedback-statement-on-participation-exemption-in-irish-corporate-tax-system-for-foreign-dividends/

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