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ATAD Implementation - CFC Feedback Statement
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Controlled Foreign Company (CFC) Rules Feedback Statement

Dear Sir/Madam

The publication of the Controlled Foreign Company (CFC) Rules Feedback Statement (the Statement) is a very welcome development on this critical tax policy issue, following the consultation on Coffey Review earlier this year. It provides stakeholders with the opportunity to have input into the detail of the proposed CFC rules. The opportunity to comment on the proposed CFC rules in this way is in line with best practice internationally and is very beneficial to the wide range of businesses that may be impacted by this legislative change.

The short timeframe that exists between the publication of the Finance Bill and its subsequent enactment is not conducive to having a considered review of tax technical legislation and can lead to unintended consequences. Advance consultation such as this is therefore very welcome.

We have set out below our remarks on the proposed approaches to some of the technical aspects of the CFC rules contained in the Statement.

1. Definition of "control"

"Control" for the purposes of a CFC charge is defined in the Statement on page 5 in accordance with the provisions of section 432 Taxes Consolidation Act 1997 (TCA), under the close company provisions. By using section 432 TCA 1997, concepts, such as participators and associated persons (which can include relatives), are brought into the definition for CFC purposes, which are inappropriate in the context of CFC rules. We would suggest that a new definition of associate which is aligned with the definition of 'associated enterprise' in Article 2 of Anti-Tax Avoidance Directive ("ATAD")[1] may be more appropriate than the definition contained in section 433 TCA 1997.

[1] EU Council Directive 2016/1164

Section 432 was specifically drafted for close companies and its purpose is to identify where there is five or fewer "participators" in a company. The definition considers a person to be a participator even where a person cannot direct how the affairs of a company is carried on. Control for the purposes of the CFC rules should seek to determine where the ability (directly or indirectly) to control a company lies.

As a result of the inclusion of the term participator in the definition of control, loan creditors will be be taken into account when considering control. Although there is an exclusion in section 433(6)(b), where a loan is provided by a person carrying on the business of banking, no such exclusion exists for non-bank lenders.

Consequently, non-bank lenders will come within the scope of the definition of control even in circumstances where the finance being provided is on commercial terms. This distinction is inappropriate as it places non-bank lenders on an unequal footing with bank lenders even in circumstances where the finance is provided on similar commercial terms.

The definition for control also refers to the "*composition of its board of directors"* which adds further to the complexity of the definition.

It also refers on page 6 to a third person directly or indirectly "…*entitled to acquire not less than 25 per cent of the share capital or issued share capital…"*, which would appear to require share options, as future rights to shares, to be included when considering control of a company. This is not a factor when considering control under the ATAD.

Linking the definition of control to section 432 TCA 1997 and including references to the composition of the board and future entitlement to shares, significantly widens the definition beyond what is required under ATAD and renders the definition unnecessarily complex. We would welcome clarity that the actual CFC charge is limited to cases where there is an actual shareholding as distinct from prospective rights. Undoubtedly, control can be easily determined in cases where there is 100% share ownership, which would not be impacted by the proposed extended definition of control, but the potential impact on joint ventures would need to be considered.

Alternatively, control for the purposes of a CFC charge could be defined by reference to section 11 TCA 1997, which defines control by the ability of a person to direct that the affairs of the company are conducted in accordance with the wishes of that person. This ability may be evidenced by the person's holding of shares or possession of voting rights in the company or by the existence of any powers conferred by the constitution, articles of association or other document regulating the company. The definition of control in section 11 would be more easily understood by companies and would be in line with the policy objectives of the ATAD.

2. Effective Tax Rate Test

Page 7 of the Statement outlines the proposed approach to the "Effective Tax Rate Test" under the ATAD and refers to *"foreign tax paid"* by the CFC when determining the test. However, the section defining what constitutes *"foreign tax paid"* is not included in the Statement.

It would be essential that the phrase "*foreign tax paid"* be clearly defined in the legislation for businesses to be able to apply the new CFC rules in practice. We understand that the legislation will include a clear definition of *"foreign tax paid"*, which will refer to such foreign taxes, as withholding taxes, Irish taxes paid where there is a foreign branch and other CFC charges paid elsewhere by the CFC.

3. Calculation of the effective rate

Page 8 of Statement sets out an approach to calculating the effective rate required under article 7(1)(b) of ATAD. The section refers to "*corresponding chargeable **profits** in the State of a controlled foreign company for an accounting period".* Our understanding is that the term "profits" in this section only refers to income and not to chargeable gains. However, it would be important for this point to be clarified in the legislation, given that "profits" is defined in section 4 TCA 1997, for the purposes of the corporation tax acts, as meaning "income and chargeable gains".

For the purposes of determining the *"corresponding chargeable profits"* a CFC is permitted to claim *"any allowance, credit, deduction, relief or repayment under the Taxes Act……..which would give **the maximum amount** of allowance, credit, deduction, relief or repayment…"*

We understand that where a CFC has assets qualifying for capital allowances before coming within the charge to the CFC rules for the first time, a similar approach will be taken to determine the amount of capital allowances that can be claimed, as is the case when a company migrates its tax residence to Ireland.

This means that the value of any existing assets owned by the company before becoming an Irish CFC may be written down when the company comes within the CFC charge for the first time and therefore, the CFC can only claim capital allowances to extent that there are any capital allowances available from that date.

In addition, we understand that the reference to *"the maximum amount"* can be interpreted to mean that the CFC under Irish law in selecting the basis of the claim can select the option that best suits their circumstances.

For example, a company claiming capital allowances on specified intangible assets under section 291A TCA 1997 can opt to base its capital allowances claim on either the amount of amortization charged in the company's accounts or write down the expenditure on a straight-line basis over 15 years. This is unclear from the draft provision and we would suggest that the proposed wording be amended to include the words "*up to"* before the words *"the maximum amount."*

Furthermore, the test is at an entity level and there is no reference to fiscal unity consolidation or group relief. We recommend that such circumstances are taken account of when considering the effective rate test, i.e., that tax paid by the nominated group taxpayer on behalf of members of a fiscal consolidation can be attributed to the CFC and treated as tax paid by that CFC.

4. The CFC charge

Pages 10 and 11 of the Statement outline the approach to be taken to assess the CFC charge.

Definition of "controlled foreign company group"

Section 1(a) refers to "*controlled foreign company group"*, which is not defined in the section. Further clarity would be welcome in the legislation on the scope of this term and the interaction between a CFC group and a CFC company.

Definition of "creditable tax"

Section 6 on page 11 of the Statement refers to "creditable tax". It is critical that the term "*creditable tax*" is clearly defined in the legislation. We understand that this term will be broadly defined in the legislation to ensure that double taxation is eliminated and it will include such taxes as, withholding taxes, third country taxes, Irish taxes paid by a branch of the CFC and any CFC charges payable in other EU Member States.

Interpretation of section 9(a)

As highlighted below, section 9(a) contains several negatives which may make it difficult to interpret:

> *9(a) This section shall not apply in relation to an accounting period of a controlled foreign company where –*
>
> > *(i) at **no** time did the controlled foreign company hold assets or bear risks under an arrangement where it would be reasonable to consider that the essential purpose of the arrangement was **not** to secure a tax advantage, or*
> > *(ii) the controlled foreign company does **not** have any **non**-genuine arrangements in place.* (emphasis added)

Given the importance of section 9(a) to the operation of the CFC rules, we would suggest that further consideration could be given to the wording of this section to facilitate ease of interpretation. In particular, the reference to *"at no time"* would appear to have no qualitative restriction and this should be addressed.

In addition, it will be necessary to publish detailed guidance, with clear real-life examples, on the meaning of "*essential purpose*" and "*non-genuine arrangements*" in section 9(a), given that these terms will be core components in determining if an Irish CFC charge arises.

Definition of "instrumental"

Section 9(b)(ii) on page 11 of the Statement states that an arrangement would be regarded as non-genuine to the extent where "*the relevant Irish activities were instrumental in generating that income".*

The word "*instrumental*" is not defined in current Irish tax law and therefore, we would welcome clarification on the meaning of this term in the context of a CFC charge. We understand that the term *"instrumental"* may signify that the relevant Irish activities must be the core factor in generating the CFC income and would welcome confirmation of such, as part of the guidance to be issued on this charge.

5. "Cash Box" companies

Page 12 of the Statement confirms that additional CFC provisions relating to "cash box" companies are currently under consideration, but details are not provided in the Statement. We believe that it would be important to seek stakeholder input on any proposed legislation relating to "cash box" companies, to ensure that the legislation does not give rise to any unintended consequences, given the complexities involved and potential EU treaty implications.

It is our view that it would be more appropriate to consider potential "cash box" companies as part of the consultation on updating Ireland's transfer pricing rules, planned for early 2019 and also in the context of the move to a more territorial regime and EU developments regarding blacklist countries.

6. Exempt Period

Pages 13 and 14 of the Statement outline a potential option to allow a grace period of 12 months for newly acquired subsidiaries, following the acquisition of a corporate group, which would be a very welcome provision in Irish CFC legislation.

Due date for payment of CFC charge where the conditions for the exempt period have not been met

We would welcome confirmation in the legislation and in any accompanying guidance that in cases where a subsidiary continues to be a CFC after the 12-month grace period, that the subsequent CFC charge arising would not become payable until the condition for exemption has not been met in the second year.

Potential impact on scaling of companies

Section 2(c) includes an anti-dumping provision whereby the assets held and risks borne by the CFC at the end of the grace period must be *"equal to or less than"* the assets held and risks borne by the company when it comes within the Irish CFC charge for the first time.

Concerns have been raised by our members that this provision could act as barrier to a company wishing to scale up its operations within the exempt period, given the look-back element of the provision. For example, if a parent company wishes to increase the level of activity within the newly acquired subsidiary, to ensure that it is no longer considered a CFC following the grace period, could result in the subsidiary not meeting the condition for the exemption in Year 1, due to the increased level of assets and risks borne by the subsidiary.

7. Definition of SPF

Page 15 of the Statement confirms that the term "SPF" should be construed in accordance with the OECD 2010 Report.[2] As this is 2010 guidance that has already been superseded by further guidance from the OECD, it is critical that detailed guidance is provided on the definition of a SPF to help business to apply Irish CFC rules in practice.

Clarification would also be welcome on how to attribute a SPF to an intermediary holding company, which could be in receipt of dividends from its subsidiaries. It is not fully clear from the legislation how a SPF could be determined in such circumstances.

[2] OECD Report on the Attribution of Profits to Permanent Establishments of the OECD, 22 July 2010

8. Definition of undistributed income

Page 16 of the Statement sets out the definition of the undistributed income.

Distributable profits

Section 1 refers to "*distributable **profits** for an accounting period".* Similar to the provisions for calculating the effective rate, we understand that the term "distributable profits" in this section is confined to income and does not include chargeable gains. However, it would be important for this point to be confirmed in the legislation.

Legal prohibition on distribution

Section 2 provides that distributable profits of a CFC includes amounts that are available for distribution "*notwithstanding any prohibition under the laws of the controlled foreign company's territory of residence or otherwise".*

Concerns have been raised that a company may suffer a CFC charge in circumstances where there is a genuine third-party restriction preventing the subsidiary from making the distribution and therefore, the provision could be contrary to EU law. It is worth noting that the close company provisions[3] do not impose a surcharge in circumstances where a company is restricted under company law from making a distribution.

Calculation of relevant distribution

It appears there may be an unintentional difference in the formula to calculate a relevant distribution in section 3. Part B of the formula refers to "distributable profits" while part C refers to "profit before taxation". Both parts should refer to either "profit before-tax" or "profit after tax", otherwise mathematically, a CFC charge could arise, even if a company has distributed all of its income.

In addition, there appears under section 3(i)(I) to be a distinction between situations where there is a credit system as opposed to an exemption system. Further clarity on the matter would be welcome.

Furthermore, section 3(iii) refers to tax that "has been paid", which we believe could give rise to potential difficulties in practice, both in terms of the timing of payments of foreign taxes and in cases where no tax is paid, due to the availability of a participation exemption and credit for underlying tax.

To conclude, much of the work in applying CFC rules can be a process to confirm that no additional tax charge is due. Recital 12 of the ATAD confirms that Members States may use white, grey or blacklists of third countries when transposing CFC rules into their domestic legislation. We believe that a white list could be used to reduce the significant compliance burden associated with applying the Irish CFC rules. The white list could include for example, EU Member States and tax treaty countries, provided the CFC has genuine activities and is tax resident and subject to tax in the white listed country.

If the Institute can be of further assistance in this consultation process, please do not hesitate to contact us.

[3] Section 434(7) TCA 1997

Yours truly

Marie Bradley

Marie Bradley
President