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Minister Paschal Donohoe TD
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

2 November 2020

Re: Finance Bill 2020

Dear Minister

The Institute is very glad to see that many recommendations we made in various submissions to you reflected in Finance Bill 2020 as published by your Department on 22 October. In particular, we welcome the provisions to give legal effect to the many supports for SMEs announced by you in Budget 2021.

The extension of debt warehousing to include income tax liabilities and the innovative Covid Restrictions Support Scheme will be of enormous benefit to viable businesses that are now struggling under the pandemic restrictions. These measures, along with the Employment Wage Subsidy Scheme will play a crucial role in giving impacted sectors of our economy a chance to return to the profitability they enjoyed just a year ago.

However, two changes contained in the Bill greatly concern the Institute and its members. The first, in Section 67 of the Bill, removes a well-established[1] obligation on Revenue to pay interest where a disputed assessment is discharged by the taxpayer in advance of a tax appeal that is subsequently upheld by the Tax Appeals Commission. The second is the significant rewriting of the rules on transfer pricing in Section 15 of the Bill. We have set out our reservations about these two changes in more detail below.

Repayment or refund of payment made in excess of liability to tax assessed by taxpayer

Section 67 of the Bill inserts a new section 960GA into Part 42 Taxes Consolidation Act 1997 (TCA 1997). The section applies where a taxpayer appeals an assessment and

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[1] Section 865A TCA 1997 was introduced in Finance Act 2003.

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discharges the disputed tax liability but subsequently wins the appeal. The current legislation requires Revenue to pay interest at the rate of 0.011% per day, annualised at 4% per annum, on tax refunds following a successful appeal. The proposed new section would free Revenue from that requirement.

The Institute believes this provision is unfair and, if introduced, it would unbalance the appeals process to the detriment of the taxpayer. In effect, the change, as proposed, would result in all the odds being stacked against taxpayers who make appeals. If they dispute an assessment, they must pay the tax liability in full or incur interest at a rate of 8% or 10% per annum while the appeal is pending, and the waiting list is not short. If they lose, they remain liable to the current daily interest rate of 0.0219% or 0.0274%, annualised at 8% or 10% per annum. Meanwhile, this provision would remove any obligation on Revenue to pay interest in the event of a successful appeal.

One of the hallmarks of a fair tax system is an effective dispute resolution regime. A tax legislative measure that penalises taxpayers who appeal Revenue assessments undermines the effectiveness of the appeals process and runs contrary to the fundamental principle of fairness in the tax system. It could be argued that the appeals process is already balanced in favour of Revenue with the differential in the interest rates payable of 4% per annum compared to 8% or 10%. If the risk of incurring even this reduced interest rate is removed, what brake is there on Revenue's assessment process and who will monitor any impact on behaviour?

The Institute urges you to withdraw this section of the Bill, as published at Committee Stage and we respectfully suggest that any changes in the balance between Revenue powers and the rights of taxpayers should only take place following consultation with stakeholders and a full review of the relevant sections of the TCA 1997.

Indeed, we believe any change to the interest obligation on Revenue should only be considered as part of an overall review of the interest rate regime in the tax system, which we have long argued is excessively onerous by comparison with other countries. Any change needs to protect the taxpayer as well as the Exchequer.

Transfer Pricing

Section 15 of the Bill includes two amendments to Part 35A TCA 1997 relating to transfer pricing. Our concern is with the second of these amendments which proposes a complete redesign of the legislative framework underlying the 'Ireland to Ireland' rule as set out in section 835E TCA 1997.

The crux of the matter is that the changes proposed in the new section would hinder the ability of large indigenous businesses to utilise cash within their groups at a time when access to cash is so important. Your budget was based on the working assumption of a 'no trade-deal' Brexit and we are battling a pernicious pandemic that shows no sign of abating. At a time when the Government has done so much to support businesses, this amendment will create difficulties for a particularly important cohort of companies who provide significant employment.

It should also be noted that while the new section would currently apply only to large groups,

if at some future date, the SME provisions are commenced by way of ministerial order[2], the economic impact would be much wider, with many incurring tax liabilities on deemed income.

We understand that some of the proposed changes to the new section 835E TCA 1997 have been influenced by EU law. However, the concept of corporate groups transacting in a tax neutral manner is a long-established feature of the Irish tax system, as evidenced by the existence of capital gains tax group relief, corporate loss group relief and VAT group relief amongst others. Such reliefs take a “single economic undertaking” approach to their design and operation, and a similar approach is adopted in many other European tax systems in one form or another (e.g. fiscal unity rules).

Transfer pricing regimes in other EU countries either grant exemptions for transactions between two domestic entities or provide for a corresponding deduction where income is attributed to the supplier in a transaction (examples include the UK, Germany and the Netherlands). We would ask you to consider adopting a similar approach for transactions between two domestic entities in Ireland.

Given the complexity involved in this section we have set out our technical analysis in the attached appendix. We would very much welcome constructive engagement with your Department on these issues in advance of Committee Stage to help you achieve your policy objective without disadvantaging our indigenous businesses.

Public Consultation on Interest Limitation Rules
Finally, we welcome the commitment in your Budget speech to publish shortly an update on Ireland’s Corporation Tax Roadmap, outlining areas for consultation and action over the coming months. We strongly urge your Department to publish the Feedback Statement on Interest Limitation Rules for consultation with stakeholders before the end of year as signalled in September[3]. These are a complex set of tax measures contained in the EU’s Anti-Avoidance Directive (ATAD), that will profoundly impact existing provisions of the corporate tax code, including prevailing interest deductibility measures, anti-hybrid rules and transfer pricing. They will require careful consideration by stakeholders and time will be needed for meaningful engagement on the complex issues involved.

We hope that all the matters outlined above can be considered in the context of the Committee Stage discussions on the Bill.

Yours sincerely

Sandra Clarke
Institute President

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[2] Provision was made in Finance Act 2019 to bring SMEs within the scope of transfer pricing rules. Depending on their size SMEs will either be fully exempt from or have significantly reduced transfer pricing documentation requirements. SMEs will come within the scope of transfer pricing rules in the future on the making of a commencement order by the Minister for Finance.

[3] TSG 20-03 Corporation Tax

Appendix I
Institute Feedback on Section 15 Finance Bill 2020, as initiated

Overview

In legislating for modified transfer pricing rules in the case of 'Ireland to Ireland' transactions, the Department of Finance clearly recognised the merits of such a move from a policy perspective. The policy was legislated for via section 835E Taxes Consolidation Act 1997 (TCA 1997) in Finance Act 2019. The Finance Bill 2020 amendments to section 835E TCA 1997 involve a complete redesign of the legislative framework underlying the 'Ireland to Ireland' rule.

We understand that some of the proposed changes to the new section 835E TCA 1997 have been influenced by EU law. However, the concept of corporate groups transacting in a tax neutral manner is a long-established feature of the Irish tax system, as evidenced by the existence of capital gains tax group relief, corporate loss group relief and VAT group relief amongst others. Such reliefs take a "single economic undertaking" approach to their design and operation, and a similar approach is adopted in many other European tax systems in one form or another (e.g. fiscal unity rules).

In terms of transfer pricing rules, many other EU territories have either granted exemptions for transactions between two domestic entities or have provided for a corresponding deduction in circumstances where income is attributed to the supplier in a transaction (examples would include the UK, Germany and the Netherlands). We would ask that consideration is given to implementing similar provisions to these jurisdictions in the Irish corporate tax code for transactions between two domestic entities.

The difficulties arising have at their core the differential in the tax rates applicable to trading (12.5%) and passive (25%) income, but also the manner in which relief is provided for under section 247 TCA 1997 (interest as a charge on income). These aspects of the Irish regime result in significant competitive disadvantages for Ireland Inc. compared, for example, with fiscal unity regimes that prevail in other territories.

The application of the transfer pricing provisions to non-trading transactions between Irish entities with the resultant problems in the ability to utilise cash within the Irish group, is causing significant practical issues for Irish groups and it is a source of serious concern for them. The ability to utilise cash within Irish groups is needed now more than ever given the prevailing difficulties facing Irish businesses because of the COVID-19 pandemic and the public health restrictions.

Constructive engagement on these matters with the Department of Finance in preparation for the Committee Stage process of the Finance Bill would be very much welcomed in an effort to ensure that the new section 835E TCA 1997 is a measure that reflects the discussions that have taken place with Revenue throughout 2020 and does not hinder the capacity of Irish groups to utilise cash within the group.

Impact on Irish Businesses

Many Irish businesses have undertaken significant reorganisations to address the complexities caused by the application of transfer pricing to transactions between two Irish companies since 1 January 2020. These Irish businesses are now faced with the prospect of having to undertake further significant reorganisations. At the time of the introduction of the original transfer pricing provisions by Finance Act 2019, there appeared to have been a view among policymakers that it would be easy to settle or eliminate balances between two Irish companies but this was never the case and it causes difficulties for a myriad of reasons.

The commercial reality is that some groups were experiencing (and continue to experience) significant difficulties in rearranging their intra-group Irish balances. For example, the lending of funds on an interest-free basis within Irish groups has always been common in order to create liquidity at particular levels in the group with the result that many intra-group balances would have come into existence. No interest was charged on such loans. The extension of the transfer pricing rules to non-trading transactions means that a lending entity could be exposed to tax at the rate of 25% on deemed interest income but, in many instances (particularly holding company situations), no corresponding deduction would be available in the borrowing entity**.** This is an income inclusion without a corresponding deduction outcome that the Finance Act 2019 rules failed to address and which the proposed Finance Bill 2020 rules are exacerbating because of the very narrow set of circumstances in which the exclusion from transfer pricing for Ireland to Ireland transactions can apply.

The one-sided nature of the transfer pricing charge and the restrictive nature of Ireland's deduction regime (particularly for interest) makes these rules particularly difficult for holding companies. The outcomes produced are incompatible with key OECD principles such as, the avoidance of double taxation, and are inconsistent with the principles enunciated in the recently introduced anti-hybrid legislation. The income inclusion without deduction result may be capable of being remedied through amendment to the corresponding adjustment provisions in section 835H TCA 1997 to allow for a deduction for transfer pricing adjustments in holding companies which is capable of being surrendered by way of group relief against the income inclusion. We would request the Department of Finance to consider this as an alternative approach to the issues arising.

The current and proposed revisions to section 835E TCA 1997 discriminate against transactions between two Irish resident entities as compared with transactions between an Irish entity and a non-resident entity. The transaction between the Irish entity and the non-resident entity would give rise to income in Ireland, while a deduction in the foreign territory may be available under domestic law or by treaty provisions. However, in a similar scenario between two Irish resident companies, there would be deemed income with no corresponding deduction, which disadvantages domestic groups.

The proposed changes to the new section 835E TCA 1997 are currently relevant for large

groups. However, in the event that the SME[4] provisions are commenced in the future by way of ministerial order[5], and if the legislation remains as proposed, the application of section 835E TCA 1997 will potentially have an even wider impact. Significant issues will arise for the SME sector, with many incurring tax liabilities on deemed income, at a time when cashflow, recovery and, in some cases, survival of their businesses are particularly acute.

Impact of Proposed Section 835E TCA 1997

As currently drafted, the proposals contained in Finance Bill 2020 would render the modification of the transfer pricing rules for Ireland to Ireland transactions as being very impractical for Irish groups as it severely limits the application of the relief. If it is envisaged that the new section 835E TCA 1997 in its current form is to remain and come into effect for chargeable periods commencing on or after 1 January 2021 as part of Finance Act 2020, then at a minimum we believe that a number of technical amendments are required and are set out below.

A. New Section 835E (4) TCA 1997 - Free use of assets

The use of property or other assets intra-group is very common within Irish groups. Often this is done to ring-fence assets from trading risks or to prevent double taxation. In the vast majority of cases, the assets are provided free of charge. Under the proposed rules to be enacted by Finance Bill 2020, these arrangements will be unable to qualify for relief under the Ireland to Ireland provisions because no consideration for the use of those assets is levied. Relief may be available if consideration “greater than a nominal amount” is charged but this is very subjective. Therefore, these arrangements could lead to the production of taxable income at the rate of 25% notwithstanding the fact that the assets are almost always being used to produce trading income for the group.

This exacerbates the adverse outcomes already noted above, not only for multinational groups but also more significantly for large Irish corporates (non-SMEs), and a large cohort of SME shareholders and other associated entities that traditionally provide finance and other assets free of charge in the domestic economy. The impact will be immediate on large Irish corporates that do not meet the existing SME definition and therefore cannot avail of the current transfer pricing exemption for SMEs. These Irish businesses are already experiencing immense difficulties because of the ongoing COVID-19 pandemic and the potential fallout of a ‘no trade’ deal Brexit at the end of the year. It is critical for such Irish businesses that the proposals contained in Finance Bill 2020 are revisited.

B. New Section 835E (5)(a)(ii) TCA 1997 - “qualifying loan arrangement”

The “qualifying loan arrangement” tests in the proposed new section 835E TCA 1997 limit the application of the relief to loan situations where the borrower is:

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[4] The definition of Small and medium-sized enterprises (SMEs) is based on the Annex to the EU Commission Recommendation 2003/361/EC.

[5] Provision was made in Finance Act 2019 to bring SMEs within the scope of transfer pricing rules. Depending on their size SMEs will either be fully exempt from or have significantly reduced transfer pricing documentation requirements. SMEs will come within the scope of transfer pricing rules in the future on the making of a commencement order by the Minister for Finance.

1. A company which carries on a trade or trades, i.e. a trader.
2. A company whose income consists wholly or mainly of profits or gains chargeable to tax as Irish rental income, i.e. a Case V rental company.
3. A direct holding company of traders or a direct holding company of Case V rental companies.

Given the manner in which other aspects of tax legislation have been amended in recent years to encompass holding companies owning trading companies through multiple levels of intermediate holding companies, for example, section 247 TCA 1997, there would appear to be little discernible rationale for confining the provision to direct holding companies.

ITI Recommendation

We would request that this aspect of the new section 835E TCA 1997 be reviewed and extended to encompass multi-tiered holding companies. This is important to enable the provision to be capable of meaningful application and it would also respect the layered structures found within groups as they grow and evolve.

C. New Section 835E (5)(a)(iii) TCA 1997 - "qualifying loan arrangement"

Three further aspects of the "qualifying loan arrangement" test are also a cause for concern and demonstrate the narrow scope of the proposed legislation.

i. Firstly, a basic condition of the test is that there must be a "loan". It is well established that a "loan" requires a movement of cash but many legacy intra-group balances within groups would not have involved a transfer of cash but, rather, the creation of a debt. For example, a target entity may have been acquired and its trade/assets transferred into the main trader in the group and the consideration would have been left outstanding as a debt. This may not be regarded as a loan and, therefore, it would not represent a "qualifying loan arrangement". We would therefore submit that if section 835E in its proposed form is to remain that the references to a "loan" is clarified to ensure it includes any debts.

ii. Secondly, the holding company aspect of the "qualifying loan arrangement" provision is very prescriptive as it requires "the proceeds of the loan" to be used to acquire shares in a trading company or Case V company. This point is an extension to the "debt" point above, as a trading company or Case V company may have been acquired from another group company and the consideration left outstanding as a debt. Therefore, there is no loan and there are no "proceeds of the loan" and consequently, the conditions do not appear to be satisfied. We would suggest that the position should be reviewed and broadened for clarity.

iii. Thirdly, the "qualifying loan arrangement" conditions when applied to holding companies do not presently permit the holding company to borrow to refinance existing borrowings nor do they permit the company to borrow to pay section 247 interest for example. These limitations will cause significant difficulties and complex problems in practice, and we would also request that the position with regard to these matters be reviewed and accommodated within the new section 835E.

ITI Recommendation

We would request that references to a “loan” is broadened to include any debts. Equally, we would recommend that the position relating to “the proceeds of the loan” is reviewed and broadened. We would also suggest that the position relating to replacement loans for holding companies is reviewed and accommodated within the new section 835E TCA 1997.

Further Engagement

Although the existing provisions of section 835E 1997 had some limitations, taxpayers and practitioners were engaging constructively with Revenue over the past year to get a clear understanding of how the rules should be interpreted and applied. Those discussions saw proposed guidance being brought to a very advanced stage of near completion by Revenue and this guidance was expected to be finalised over the next few weeks. That guidance was the subject of discussion with Revenue at a TALC meeting on 12 October 2020, less than two weeks prior to the publication of the new version of section 835E TCA 1997 in Finance Bill 2020. There was no indication that legislative changes to section 835E TCA 1997 of the scale proposed were under consideration.

We understand that some of the proposed changes to the new section 835E TCA 1997 have been influenced by EU law. However, as outlined above, the concept of corporate groups transacting in a tax neutral manner is a long-established feature of the Irish tax system and many of our group reliefs take a “single economic undertaking” approach to their design and operation. A similar approach is adopted in many other European tax systems in one form or another (e.g. fiscal unity rules).

Many other EU countries have either granted exemptions for transactions between two domestic entities or have provided for a corresponding deduction in circumstances where income is attributed to the supplier in a transaction in their transfer pricing regimes (e.g. the UK, Germany and the Netherlands). We would ask that consideration is given to implementing similar provisions to these jurisdictions in the Irish corporate tax code for transactions between two domestic entities.

The Institute would welcome the opportunity now to engage with your officials on these matters in preparation for the Committee Stage process in an effort to ensure that the new section 835E TCA 1997 is a measure that reflects the discussions that have taken place with Revenue throughout 2020 and does not hinder the capacity of Irish groups to utilise cash within the group.

The new measures will apply from 1 January 2021. Notwithstanding the importance of the Finance Bill 2020 provisions, urgent engagement is now also required to provide clarity on the position that will apply for taxpayers in 2020, many of which have approaching financial year ends and had anticipated a near future resolution to discussions at TALC.