This technical query paper was submitted to Revenue via the TALC Direct/Capital Taxes sub-committee following a discussion on the matter at the June 2020 TALC Direct/Capital Taxes sub-committee meeting. Revenue responded to this submission on 11 February 2021 and 13 April 2021. Both responses are included in this paper as appendixes.

ITI Submission to Revenue on the application of "subject to tax test" in Schedule 24, Paragraph 9I, TCA 1997

27 August 2020

The purpose of this note is primarily to seek confirmation from Revenue on when the "subject to tax test" in Schedule 24, paragraph 9I, TCA 1997 can be said to be satisfied in respect of dividends paid to an Irish tax resident company from a company resident in another EU Member State (or in an EEA State which has a DTA with Ireland).

Practitioners submit that there is one particular scenario where the "subject to tax test" in Schedule 24, paragraph 9I, TCA 1997 can be said to be satisfied following the outcome of a number of cases that have been considered by the Court of Justice of the European Union (CJEU) and the UK Courts.

The "subject to tax" wording is found in subparagraph 4 in the definition of amount B:

> "The rate per cent of tax…applicable to the relevant profits…"

The scenario where practitioners assert that a dividend received in Ireland can be said to satisfy the "subject to tax test" includes the situation where a dividend has been paid to an Irish company by a subsidiary out of profits which were within the charge to tax in the EU Member State of the subsidiary, but were exempt from tax by virtue of a participation exemption (e.g. a tax-exempt capital gain of a subsidiary company resident in another EU Member State).

It is common for Irish companies to have a subsidiary which in turn holds other subsidiaries, and the lack of clarity on the application of Schedule 24, paragraph 9I, TCA 1997 to the above scenario adds unnecessary complexity for groups who seek to repatriate cash from foreign subsidiaries.

1. Background

Schedule 24, paragraph 9I, TCA 1997 was introduced by Finance Act 2013 as part of Ireland's response to the judgment of the Court of Justice of the EU (CJEU) in the Franked Investment Income group litigation case[1], (hereinafter called "the FII case"). The CJEU decision in the FII case is settled case law at EU level.

In the FII case, the CJEU held, in simple terms, that the UK's pre-2009 system of taxing foreign dividends subject to credit relief for foreign taxes paid was discriminatory and contrary to EU freedoms. The UK's pre-2009 system of taxing foreign dividends and providing credit relief was similar to Ireland's current approach to the taxation of foreign dividends. The UK's response to the judgement was to introduce a foreign dividend exemption regime.

[1] C-446/04

In the FII case, the CJEU held that a Member State which taxes foreign (EU) source dividends, whilst giving credit relief for foreign taxes on the underlying profits, should ensure that the level of credit relief afforded should be the higher of 1) the foreign underlying tax actually paid in respect of the profits from which the dividend was paid, and 2) tax at the foreign nominal (headline) rate of tax on the gross amount of the dividends, provided that the income funding the dividends is subject to tax.

Following on from that judgement, the UK Courts have explored how this ‘subject to tax’ test should be applied to various commonly occurring scenarios that arise in international group structures. The key UK cases relevant to the issue at hand include the UK High Court case of *Six Continents Limited, Six Continents Overseas Holdings Limited v CIR [2016] EWHC 2426 (Ch)* (hereinafter referred to as “the Six Continents case”) and the UK High Court case of *FII Group Litigation (Test Claimants) v HMRC [2019] EWHC 2014 (Ch)* (hereinafter referred to as “the FII UK case”). In our view, the same conclusions should apply to Schedule 24, paragraph 9I, TCA 1997 and an Irish Court would reach the same conclusions as the UK High Court did in these cases.

We should point out that both these cases relate to a wide range of matters and have been working their way through the UK Courts system for a number of years. A number of matters pertaining to the cases are currently unresolved and subject to further appeal. These matters are understood to be of a procedural / computational manner. It is understood that the UK Court of Appeal has refused HMRC permission to appeal the substantive issues of the cases and hence they can now be said to be settled by the UK Courts. It is these substantive issues that are the subject of this note and discussed in the analysis below.

2. Analysis - Dividends funded from an exempt participation gain

Both the FII UK case and the Six Continents case examine whether an additional tax credit should be available in the UK in respect of a dividend received by a UK resident company from a company resident in another EU Member State under the principles of the CJEU decision in the FII case where the dividend was funded from an exempt participation gain.

In both cases, the UK High Court found the answer to this question to be yes. For simplicity, we have only discussed the Six Continents case below. The analysis in the FII UK case on this point is substantially the same.

In the Six Continents case, Six Continents Limited, a company tax resident in the UK, received dividends from Six Continents International Holdings BV (“SCIH”), a Dutch tax resident company, in the accounting periods ending 30 September 1993, 1996 and 1997. The dividends paid to Six Continents Ltd by SCIH were funded from dividends received from its Dutch and Belgian subsidiaries.

The dividends paid by SCIH in 1997 were partly funded from profits that arose from the liquidation of a subsidiary of SCIH and formed part of the profits of SCIH for 1995. These profits benefitted from a participation exemption under the Dutch Corporate Income Tax Act (“CITA”) in the hands of SCIH – the Dutch equivalent of section 626B TCA 1997.

Dividends received by UK resident companies such as Six Continents Ltd from non-UK resident companies were taxed under Case V of Schedule D (under section 18 of the Income and Corporation Taxes Act 1988). One of the questions that arose in the case was whether, on foot of the decision of the CJEU in the FII case, Six Continents Ltd was entitled to a credit at the Dutch standard rate of corporation tax for the dividends received from SCIH which were funded from the exempt participation gain on the basis that they had been subject to tax in the Netherlands. The answer to this question was yes according to the UK High Court.

In reaching this decision, Henderson J. relied on the fact that the starting point in computing the taxable income for Dutch corporate tax purposes is the profit and loss account (which would include profits realised on the disposal of the subsidiary). Various adjustments are then made to the profit amount to arrive at the taxable profits, one of which is the adjustment to exclude participation profits or gains from taxable profits.

In his judgment, Henderson J. noted that: "*The profits derived from the liquidation of the subsidiary were in principle within the charge to Dutch corporation tax, although they were excluded from the taxable amount by virtue of the participation exemption. This is therefore another example of an exemption which narrowed the tax base and reduced the effective rate of Dutch tax. As such, it falls squarely within the reasoning of the ECJ in FII (ECJ) II, and a credit at the Dutch nominal rate of corporation tax is needed in order to remedy the unlawful impact of the Case V charge on the dividend in the UK*."

Practitioners submit that an Irish resident company in receipt of a dividend, which is funded from profits arising from capital gains, for example, which were subject to an exemption in the EU/EEA State of the subsidiary, satisfies the conditions set out in the FII GLO cases (as outlined in the Six Continents case) and the Irish resident company should be entitled to a credit based on the nominal rate of tax in the EU/EEA jurisdiction of residence of the subsidiary.

We would point out that if an Irish resident company realised a gain on the disposal of a subsidiary which was eligible for relief under section 626B, TCA 1997 (i.e. a participation exemption regime) and that company then paid a dividend out of that gain to an Irish tax resident parent company, the dividend would be exempt from Irish corporation tax under section 129, TCA 1997.

Practitioners would welcome Revenue's perspectives in relation to the application of the principles arising from the Six Continents case in Ireland and, in particular, we would request Revenue's confirmation that relief under 9I would be available to an Irish resident company in receipt of a dividend from an EU/EEA subsidiary which is funded from profits such as capital gains covered by a participation exemption or similar relief in that particular jurisdiction.

Appendix I: Response received from Revenue on 11 February 2021 to the Institute's submission on the application of "subject to tax test" in Schedule 24, Paragraph 9I, TCA 1997

Revenue response to the ITI submission on the application of the "subject to tax" test in Schedule 24, Paragraph 9I, TCA 1997

Confirmation is sought that the "subject to tax test" in paragraph 9I of Schedule 24 is satisfied in the situation where a dividend has been paid to an Irish company by a subsidiary out of profits which were within the charge to tax in the EU Member State of the subsidiary, but were exempt from tax because of a participation exemption (e.g. a tax-exempt capital gain of a subsidiary company resident in another EU Member State).

In Revenue's view, in such a scenario as set out above, where a dividend is funded from profits comprising capital gains covered by a participation exemption in the foreign jurisdiction, there would be no entitlement to the additional foreign tax credit under paragraph 9I of Schedule 24.

The definition of 'tax' in paragraph 9I ensures that such exemption of foreign profits will not give rise to an entitlement to an additional foreign tax credit based on the full value of the dividend at the nominal rate applicable in the paying country's jurisdiction. However, subparagraph (4A) of paragraph 9I provides for an additional credit in situations where the dividend received by an Irish company derives from untaxed profits of a paying company and is attributable indirectly through other dividend paying companies that have suffered foreign tax.

Revenue have provided guidance on the meaning of "subject to tax" in Schedule 24, Paragraph 9I in Tax and Duty Manual 02-02-01 (Corporation Tax – General Background). It is stated on pages 11-12 that:

> "Certain jurisdictions operate dividend participation exemption regimes based on exemption of 95%, or most, of the dividend concerned. The definition of "tax" in the legislation ensures that tax paid on such dividends will not give rise to an entitlement to an additional foreign tax credit based on the full value of the dividend at the nominal rate applicable in the paying company's jurisdiction".

The submission notes that if an Irish resident company realised a gain on the disposal of a subsidiary which was eligible for relief under section 626B, TCA 1997 (i.e. a participation exemption regime) and that company then paid a dividend out of that gain to an Irish tax resident parent company, the dividend would be exempt from Irish corporation tax under section 129, TCA 1997. In principle EU law permits a Member State to apply the exemption method to domestically sourced dividends and the imputation method i.e. credit for the foreign tax charged, to foreign sourced dividends as is the case in Ireland. The CJEU in the FII case found that the system, on the one hand, of granting exemption for domestic dividends while, on the other hand, only allowing a credit for tax paid in respect of foreign-sourced dividends was not contrary to EU law. There could be parity of treatment if account were taken of the *nominal* rate of foreign tax, in the country paying the dividends, in computing the credit for foreign tax.

Having considered the UK case law and the FII case, Revenue's view is that the introduction of paragraph 9I into Schedule 24 in Finance Act 2013 provided for such parity of treatment and is appropriate in implementing the CJEU judgment in the FII case.

Appendix II: Revised response received from Revenue on 13 April 2021 to the Institute's submission on the application of "subject to tax test" in Schedule 24, Paragraph 9I, TCA 1997

Revenue response to the ITI submission on the application of the "subject to tax" test in Schedule 24, Paragraph 9I, TCA 1997

Confirmation is sought that the "subject to tax test" in paragraph 9I of Schedule 24 is satisfied in the situation where a dividend has been paid to an Irish company by a subsidiary out of profits which were within the charge to tax in the EU Member State of the subsidiary, but were exempt from tax because of a participation exemption (e.g. a tax-exempt capital gain of a subsidiary company resident in another EU Member State).

It is submitted that the "subject to tax" test has been considered in UK cases, in particular FII Group Litigation (Test Claimants) v HMRC [2019] EWHC 2014 (ch) ("the FII UK case") and Six Continents Ltd, Six Continents Overseas Holdings Ltd v CIR [2016] EWHC 2426 (ch) ("the Six Continents case"). The submission notes that in the Six Continents case, Six Continents Ltd (a UK resident company) received dividends from SCIH (a Dutch resident company). The dividends were funded from dividends received by SCIH from its Belgian and Dutch subsidiaries. The dividends paid by SCIH in 1997 were partly funded from profits that had benefited from a participation exemption under Dutch tax law in the hands of SCIH. It was held that Six Continents Ltd was entitled to a credit at the Dutch standard rate of corporation tax in respect of the dividends it had received from SCIH which were funded from the exemption participation gain.

The "subject to tax" test has also been considered in other cases. In Paul Weiser v HMRC (TC02178). HMRC contended that while the term "liable to tax" only required an abstract liability to tax, i.e. that a person is within the scope of tax generally, the term "subject to tax" required that tax is actually levied on the income. They argued that because the pension income was exempt from tax in Israel, it was not "subject to tax". The case was decided in favour of HMRC.

In Revenue's view, in such a scenario as set out above, where a dividend is funded from profits comprising capital gains covered by a participation exemption in the foreign jurisdiction, there would be no entitlement to the additional foreign tax credit under paragraph 9I of Schedule 24.

The definition of 'tax' in paragraph 9I ensures that such exemption of foreign profits will not give rise to an entitlement to an additional foreign tax credit based on the full value of the dividend at the nominal rate applicable in the paying country's jurisdiction. However, subparagraph (4A) of paragraph 9I provides for an additional credit in situations where the dividend received by an Irish company derives from untaxed profits of a paying company and is attributable indirectly through other dividend paying companies that have suffered foreign tax.

Revenue have provided guidance on the meaning of “subject to tax” in Schedule 24, Paragraph 9I in Tax and Duty Manual 02-02-01 (Corporation Tax – General Background). It is stated on pages 11-12 that:

> “Certain jurisdictions operate dividend participation exemption regimes based on exemption of 95%, or most, of the dividend concerned. The definition of “tax” in the legislation ensures that tax paid on such dividends will not give rise to an entitlement to an additional foreign tax credit based on the full value of the dividend at the nominal rate applicable in the paying company’s jurisdiction”.

While not determinative, commentary on the issue of the availability of the additional foreign tax credit in circumstances where a dividend has been funded from profits which are exempt from tax because of a participation regime also supports the view that an additional foreign tax credit would not be available. The Taxation of Companies 2021 (Maguire) illustrates by way of an example at paragraph 14.209.4.4 that the additional credit is not available where no tax was paid on a dividend due to the availability of a participation regime.

The submission notes that if an Irish resident company realised a gain on the disposal of a Subsidiary, which was eligible for relief under section 626B, TCA 1997 (i.e. a participation exemption regime) and that company then paid a dividend out of that gain to an Irish tax resident parent company, the dividend would be exempt from Irish corporation tax under section 129, TCA 1997. In principle EU law permits a Member State to apply the exemption method to domestically sourced dividends and the imputation method i.e. credit for the foreign tax charged, to foreign sourced dividends as is the case in Ireland. The CJEU in the FII case found that the system, on the one hand, of granting exemption for domestic dividends while, on the other hand, only allowing a credit for tax paid in respect of foreign-sourced dividends was not contrary to EU law. There could be parity of treatment if account were taken of the *nominal* rate of foreign tax, in the country paying the dividends, in computing the credit for foreign tax.

Having considered the UK case law and the FII case, Revenue’s view is that the introduction of paragraph 9I into Schedule 24 in Finance Act 2013 provided for such parity of treatment and is appropriate in implementing the CJEU judgment in the FII case. The UK case law, while persuasive, is not binding and furthermore, there is case law that supports the opposite view that where income is exempt from tax, it is not “subject to tax”.