



## **Feedback on issues discussed at the Business Tax Stakeholder Forum Subgroup on a Participation Exemption for Foreign Dividends**

**2 August 2024**

The Department of Finance have requested further information on a number of issues arising from discussions at the meetings of the Business Tax Stakeholder Forum (BTSF) Subgroup on a Participation Exemption for Foreign Dividends on 17 and 30 May. In addition, the Department has requested details on participation exemption systems in other EU jurisdictions, in particular any subject-to-tax elements. We have set out below the feedback which we have received from our members on these issues.

At the outset, we would reiterate Ireland is currently a significant outlier, being the only EU Member State and one of a very small number of OECD countries that does not operate some form of participation exemption for foreign dividends. To ensure Ireland can compete on a more level playing field with other countries, it is important that the rules governing the Irish participation exemption are clear and simple with limited exceptions and have a broad territorial scope.

We strongly urge for the participation exemption to apply on a global basis with appropriate safeguards included where necessary, such as excluding dividends received from jurisdictions included in Annex 1 of the Council conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes. Adopting a participation exemption with no limitation on geographical scope would align the Irish regime with key European competitor jurisdictions such as the UK and Switzerland and with global competitors such as Singapore and Hong Kong who have territorial regimes which typically do not tax foreign sourced income.

### **1. Detail on how Pillar Two inclusion could be used to evidence taxation of profits and potential alternative methods for smaller groups that fall outside of its scope**

Entities subject to the 15% Pillar Two Global Anti-Base Erosion Rules (GloBE) Rules (either via a local Qualified Domestic Minimum Top-up Tax (QDMTT), or whose profits are subject to the minimum tax via the Income Inclusion Rule or the Undertaxed Profits Rule) which generate distributions for Irish companies should be considered as being subject to tax irrespective of where the subsidiary is resident for tax purposes.

We do not believe that such an approach would give rise to any issues under the Pillar Two Rules as it is simply a method of using readily available information (which will soon be shared via GloBE Information Returns) to confirm the taxation of income within a group and evidence that income has been subject to tax. This use of the Pillar Two scope is in line with the overarching objective of the Pillar Two Rules which is to ensure that in scope groups pay a minimum level of tax on the income arising in each jurisdiction where they operate.

For companies which are not in scope of Pillar Two, if policymakers consider the application of a subject to tax test is necessary, it is important that the test only applies in very limited circumstances. In our view, it is essential that the test does not apply where distributions are received from EU/EEA jurisdictions or jurisdictions with which Ireland has a double tax agreement (DTA). In addition, we do not believe that the test should apply to jurisdictions which have ratified the Joint Council of Europe / OECD Convention on Mutual Assistance in Tax Matters (the Convention).

As additional jurisdictions may ratify the Convention following the passing of the Finance Act, policymakers may wish to ensure that such a provision refers to those jurisdictions which have ratified the Convention on the date of the passing of the Finance Act and in the event that additional jurisdictions ratify the Convention after that date, the list could be updated by means of Ministerial Order. Such an approach would be similar to the position which has been adopted in the context of the meaning of OECD Transfer Pricing Guidelines for the purposes of section 835D Taxes Consolidation Act 1997. Section 835D defines “transfer pricing guidelines” as the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations published by the OECD on 20 January 2022 supplemented by such additional guidance, published by the OECD on or after the date of passing of the Finance Act 2022, as may be designated by Ministerial Order.

#### *Subject-to-tax test and the approach adopted in other EU Member States*

In the limited circumstances where it may be appropriate to apply a subject-to-tax test, it is essential that the test is applied on a jurisdictional basis, i.e., the test is that the payor company is, in principle, liable to tax on its profits in that jurisdiction without the need to trace through to the underlying profits which funded the distribution. This would be in line with the approach adopted in other jurisdictions.

As highlighted by practitioners at the BTSF subgroup meetings, a requirement to trace back to the original profits would replicate the complexities in Schedule 24. It has been acknowledged that Schedule 24 often results in limited amounts of incremental tax becoming payable in Ireland on foreign earnings and that the implementation of Pillar Two across jurisdictions is expected to lead to increased taxes incurred in other jurisdictions that would in turn qualify for double tax relief, further reducing the potential for incremental tax in Ireland for in-scope entities.

While there are a number of participation exemption systems in EU jurisdictions which apply a subject-to-tax test, the approach adopted varies significantly across Member States. It must also be borne in mind that while a subject-to-tax test may be a feature of certain participation exemptions, the test will usually be disapplied or deemed to be

satisfied in certain circumstances such as where the EU Parent-Subsidiary Directive applies or where the payor is resident in a DTA jurisdiction.

As the Irish tax system differs from those in other EU Member States, rather than attempting to replicate the regime that exists in another EU Member State, the Irish participation exemption should be drafted with a view to ensuring it is available to a broad range of businesses with certainty of access so that it will enhance Ireland's position as an attractive location for investment to the maximum extent possible.

Where policymakers view that it is necessary to restrict the participation exemption in light of a specific policy concern, the restriction should be narrowly drafted to address that specific concern taking into account existing provisions in the Irish tax code. For example, the outbound payment defensive measures introduced in Finance (No.2) Act 2023 already recognise that a foreign tax at a nominal rate greater than zero and supplemental tax including a CFC charge and a Pillar Two top-up tax or similar taxes can be sufficient safeguards against double non-taxation.

## **2. Application of the participation exemption**

As set out in our response to the first Feedback Statement, in our view, the participation exemption should apply automatically where the necessary conditions are satisfied similar to section 626B TCA 1997 but with an option to elect out for an accounting period. Applying the participation exemption automatically would reduce the compliance risk for taxpayers in most cases, as an inadvertent failure to elect into the participation exemption could have significant consequences for a taxpayer.

The potential for taxpayers having the option to apply the participation exemption or double taxation relief under Schedule 24 on a dividend-by-dividend basis has been discussed at the BTSF subgroup with stakeholders noting that this approach has been adopted in the UK.

As set out above, in designing a participation exemption, it is important that it equals, if not exceeds, the offering of our competitors including EU Member States and the UK. A dividend-by-dividend approach would enhance the attractiveness of Ireland as a location for investment and we do not believe that such an approach would result in an additional administration burden for Revenue.

## **3. Examples of definitions of dividend/distribution and consideration of any particular types of dividend/distribution whose treatment may be unclear**

We consider that the participation exemption should apply to all distributions out of income and capital to the extent that the distributions are categorised as income of the recipient for Irish tax purposes.

All income from shares or from other rights and interests should be within scope of the regime. Shares should include 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. It is important that the exemption provides for distributions

derived from equivalent or similar interests to equity including, for example, member interests in US LLCs.

#### **4. Examples of entities for which the term “ordinary share capital” may not be clear**

The Strawman Proposal set out in the first Feedback Statement outlined that the 5% control test would be established by reference to up to four criteria, one of which included ownership of ordinary share capital.

As outlined above, it is important that the exemption provides for distributions derived from equivalent or similar interests to equity such as member interests in US LLCs. The meaning of the term “ordinary share capital” may not be clear in the context of the legal form of certain equity interests. For example, Limited Liability Partnerships (such as a Guernsey LLP), GK companies (Japan) and Industrial Provident Societies (New Zealand) would also need to be considered.

#### **Conclusion**

The introduction of a participation exemption for foreign dividends into Irish law represents an opportunity for Ireland to maintain the attractiveness of Ireland as a location for investment. However, to achieve this objective, the participation exemption should have broad global reach and the rules should be clear and simple with limited exceptions.

As set out in our response to the first Feedback Statement, the participation exemption should apply in respect of any dividends received on or after 1 January 2025. Restricting the availability of the exemption to dividends received in accounting periods commencing on or after 1 January 2025 could result in companies whose accounting periods are not aligned with the calendar year delaying the repatriation of funds to Ireland, but where it is not commercially possible to do this, such companies would be unfairly penalised on account of their accounting year end.

The Institute looks forward to further engagement with the Department officials on the introduction of a participation exemption and the publication of the second Feedback Statement.