17 February 2025

Feeback to the Department of Finance via the Business Tax Stakeholder Forum (BTSF) on areas for decluttering and simplification of five EU Directives

Interest and Royalties Directive

We believe there is a compelling case to have a single Directive to replace the Interest and Royalties Directive and the Parent-Subsidiary Directive, which would deal with cross-border payments between qualifying companies.

Article 1

Article 1, paragraph (1) provides for the elimination of withholding taxes on qualifying interest and royalties but only where the beneficial owner of the interest or royalties is a company of another Member State, or a permanent establishment (PE) situated in another Member State of a company of a Member State. Paragraph (11) provides that a Member State may require an attestation to substantiate that the benefits of the Directive should apply. Paragraph (13) provides that the attestation should contain information about the beneficial ownership of the receiving company. While this is an important anti-avoidance provision, feedback from our members suggests that certain tax authorities may use this provision as a means to deny the benefits of the Directive in circumstances where it should be available by applying evidentiary standards relating to beneficial ownership which can be extremely difficult or impossible to satisfy. The Directive could be modified to ensure that its benefits are not arbitrarily withheld through the misapplication of this provision. For example, it could provide that a receiving company shall be treated as the beneficial owner of the income where certain specific conditions are met, such as the income is included in the company's financial statements and the company’s corporate income tax computation (assuming it is not tax exempt).

Article 1, paragraph (6) provides that where the PE of a company is treated as a payer or as the beneficial owner of interest or royalties then no other part of that company shall be treated as the payer or the beneficial owner. This rule makes sense in cases where the profit of the PE is not subject to tax in the jurisdiction or residence of the company concerned (e.g., where the jurisdiction in which the company is tax resident has a branch profit exemption which applies to that PE). However, this restriction does not make sense in cases where the profits of the PE concerned are included in the taxable profits of the company in the jurisdiction which it is tax resident. As such, this restriction should be limited to cases where there is a foreign branch exemption.

Article 1, paragraph (8) restricts the application of the Directive in the case of a PE if that PE is situated in a non-EU state. Such a restriction might make sense if the profits of that PE are not subject to corporate tax in the EU (e.g., where the country of residence of the company with the PE operates an exemption in respect of foreign branches such that the profits of the PE are not subject to tax in that jurisdiction). However, we believe it is inequitable to apply such a restriction where the profits of the PE are taxed in the jurisdiction where the company concerned is resident in like manner as the other profits of that company. In our view, the restriction should be limited to situations where there is a foreign branch exemption.

Article 3

Article 3, paragraph (a)(i) requires that the payer or recipient company concerned must be in one of the legal forms specified in the Annex to the Directive. We believe there is no particular need to restrict the application of the Directive to particular legal forms of a company given that there are additional requirements set out in paragraph (a) which require that the company concerned be tax resident in an EU Member State and be subject to a form of corporate income tax. There are cases where companies might be incorporated in a third territory but are resident for tax purposes and subject to corporate income tax in an EU Member State. We consider there is no clear policy rationale for excluding such companies from relief. By limiting the application of the Directive to those forms specified in the Annex, certain entities which are tax resident in an EU Member State and subject to corporate income tax

can be excluded. For example, in the case of Ireland, unlimited companies are not specified forms (but they do qualify for the Parent-Subsidiary Directive).

Article 3, paragraph (a)(iii) requires that the payer or recipient company concerned must be subject to corporate income tax in an EU Member State. This precludes tax exempt entities such as pension funds, investment funds, charitable organisations, and government bodies from availing of the benefits of the Directive. We consider the decision to exempt certain companies from corporate income tax is a policy matter for the Member State concerned and should not be a basis for denying the application of the Directive. At a minimum, we believe the requirement should be modified to acknowledge that tax may be applied through other means such as a qualifying top-up tax under the EU Minimum Tax Directive (Pillar Two rules).

Article 3, paragraph (b) requires a direct minimum 25% common ownership of capital between the payer and receiver. However, EU Member States have the option to substitute voting rights instead of capital ownership depending on their preference. We believe the ownership percentage should be aligned with the Parent-Subsidiary Directive such that it only requires a 10% relationship for the Directive to apply. In our view, it would make sense if EU Member States were obliged to apply the Directive in cases where either capital ownership or voting control is established.

Article 3, paragraph (b) also provides that the payer and receiver can be owned by a common parent provided that the parent company has a direct minimum 25% shareholding in both companies. We consider there is no clear policy rationale for denying the benefits of the Directive where the ownership relationship is indirect though intermediary entities. We believe the requirement should be changed to ‘direct or indirect’.

Article 3, paragraph (b) also sets out that the ownership relationship between the payer and recipient company must not be through companies which are established outside of the EU. We believe there is no particular policy reason to restrict the application of the Directive where the ownership chain between the payer and recipient includes companies which are established outside of the EU. Indeed, if the ownership condition is amended, as suggested above, to permit indirect ownership

through other companies, this impediment becomes even more important. If there are particular concerns about broadening the condition, an anti-avoidance measure could be introduced to restrict the application of the Directive where the ownership is through companies that are located in an EU listed non-cooperative jurisdiction or a zero-tax territory.

Article 4

Article 4, paragraph (1) permits EU Member States to disapply the provisions of the Directive in certain circumstances including where the payment of interest or royalties is treated as a distribution of profits, or debt claims with a profit participating coupon, or debt claims which are convertible. Essentially, these provisions attempt to give EU Member States the authority to disapply the Directive if the debt claims concerned have certain equity features and, consequently, are more akin to shares economically.

While this provision may make sense, there can be cases where a debt claim might come within one of the categories but might not be entitled to relief under the Parent-Subsidiary Directive. This can give rise to inequitable situations where a payment is not entitled to relief under either directive even though the necessary relationship between the payer and recipient is established.

We believe these provisions should be modified so as to apply to situations where the payment is re-characterised as a distribution under the domestic law of the EU Member State concerned. The equivalent provisions in the Parent-Subsidiary Directive should be amended to ensure payments which are recharacterised as a distribution are captured. This would allow relief under one of the two Directives.

Parent-Subsidiary Directive

As outlined above, we believe there is a compelling case to have a single Directive that would replace the Parent-Subsidiary Directive and the Interest and Royalties Directive to deal with cross-border payments between qualifying companies.

Article 1

As mentioned above, Article 1, paragraph (1) of the Parent-Subsidiary Directive allows EU Member States to disapply the benefits for payments with certain debt instruments with equity characteristics. However, where relief is denied in respect of such payments under the Interest and Royalties Directive, it is not clear that the benefits of the Parent-Subsidiary Directive apply to those recharacterised interest payments. This is because there is no comprehensive definition of ‘distribution’ included in the Parent-Subsidiary Directive.

We believe there should be an inclusive definition which makes it clear that where relief is precluded by an EU Member State under the Interest and Royalties Directives because the debt instrument has certain equity characteristics, such payments should be within scope of the Parent-Subsidiary Directive.

Article 2

Article 2, paragraph (a)(i) of the Parent-Subsidiary Directive requires the payer or recipient company concerned to be one of the forms listed in the Annex to the Directive. As with the Interest and Royalties Directive, we do not consider there is a need to restrict the application of the Directive to particular legal forms of a company given there are additional requirements in paragraph (a) which stipulate that the company concerned must be tax resident in an EU Member State and be subject to a form of corporate income tax. There are situations where companies might be incorporated in a third territory but are resident for tax purposes and subject to corporate income tax in an EU Member State. We believe there is no clear policy rationale to exclude such companies from relief.

Article 2, paragraph (a)(iii) requires the payer or recipient company concerned to be subject to corporate income tax in an EU Member State. This precludes tax exempt entities such as pension funds, investment funds, charitable organisations, and government bodies from availing of the benefits of the Directive. As stated above, in our view, the choice to exempt certain companies from corporate income tax is a policy matter for the Member State concerned and should not be a basis for denying the application of the Directive.

Given many Member States have a participation exemption for dividends, it seems inequitable to us to allow the benefits of the Directive to apply to a dividend received by a company which is within the charge to tax but exempt from tax on that dividend under a participation exemption but deny the benefits of the Directive where the recipient is exempt from tax on the dividend for other reasons. At a minimum, we believe the requirement should be modified to recognise that tax may be applied through other means such as a qualifying top-up tax under the EU Minimum Tax Directive (Pillar Two rules).

Article 2, paragraph (b) effectively limits the application of the benefits of the Directive in respect of payments made to a PE to cases where the PE is situated in an EU Member State. Such a restriction might make sense if the profits of that PE are not subject to corporate tax within the EU (e.g., where the country of residence of the company with the PE operates an exemption in respect of foreign branches such that the profits of the PE are not subject to tax in that jurisdiction). However, we consider it inequitable to apply such a restriction where the profits of the PE are taxed in the jurisdiction where the company concerned is resident in a similar manner to the other profits of that company. In our view, the restriction should be limited to cases where there is a foreign branch exemption.

Article 3

Article 3, paragraph (1) requires a minimum 10% direct ownership relationship between the parent and subsidiary company concerned. However, it does not allow for indirect ownership to be considered. For example, a company might own 5% of the shares in a subsidiary directly and another 5% through another company in the

group. Even though the overall 10% requirement is met, the Directive does not apply in those circumstances. We believe there is a compelling case to allow for direct and indirect shareholdings when considering the 10% ownership criteria.

Furthermore, we query the need to restrict the application of the Directive because the ownership chain between the payer and recipient includes companies which are not established within the EU. As suggested in the case of the Interest and Royalties Directive, if there are concerns about broadening the scope, an anti-avoidance measure could be introduced to restrict the application of the Directive where the ownership is through companies that are located in an EU listed non-cooperative jurisdiction or a zero-tax territory. While the Directive would not apply to distributions made to shareholders in a non-EU Member State, we believe relief should apply where another company in the group has shares and is resident in an EU Member State, and in combination with the non-EU shareholder, the 10% threshold is reached.

Article 3, paragraph (2) allows EU Member States to impose a minimum ownership period of at least two years before applying the benefits of the Directive to any particular group. We believe it should be made clear in the Directive that any distribution made during that two-year period can qualify for the benefit of the Directive, provided the two-year period is ultimately satisfied (i.e., it should be clear that it is not necessary to wait for two years before applying the benefit of the Directive. Provided the two-year ownership period is ultimately satisfied, the benefit of the Directive should apply from the first day when the ownership percentage condition is satisfied.)

Transparent Entities

The Parent-Subsidiary Directive does not allow for situations where a parent and subsidiary might have a tax transparency entity sitting between them (such as a partnership). We recommend that the Directive permits the ability to ‘look through’ such an entity for the purpose of applying the benefits of the Directive. In our view, the Directive could specifically confirm that nothing in it shall disapply the provisions

of the Anti-Tax Avoidance Directives (ATAD1 and ATAD2) with specific reference to the rules applying to hybrid entities and reverse hybrid entities.

Capital Gains

We believe the policy rationale espoused in the Preamble to the Directive should similarly apply to gains realised by a non-resident parent company on shares in its subsidiary. At present, an EU Member State might seek to impose taxation on a capital gain realised on shares of a company resident in that State (even where those shares are not held by the foreign parent company through a local PE). However, the same Member State may have an exemption from capital gains tax available to resident companies in respect of their subsidiaries (both foreign and domestic).

Regarding the taxation of dividends, the Preamble states: *"the tax provisions governing the relations between parent companies and subsidiaries of different Member States varied appreciably from one Member State to another and were generally less advantageous than those applicable to parent companies and subsidiaries of the same Member State."* Consequently, we believe the Parent-Subsidiary Directive should be extended to also apply to the taxation of capital gains. If a full exemption cannot be agreed, we consider, at a minimum, that the Directive should be amended to require Member States that have an exemption from capital gains available to residents of that State to extend it to qualifying parent companies.

Merger Directive

Article 2

Article 2 provides that the definition of merger, division, and partial division are limited to situations where in exchange for the transfer of assets and liabilities, there is only an issue to the shareholders of the transferring company securities and, if applicable, a cash payment. The restriction to non-share-based remuneration to a cash payment precludes the possibility for other assets to be transferred instead. In our view, the terms of the Directive should be modified so that the definitions can capture other forms of consideration apart from cash.

In addition, Article 2 provides that the maximum amount of cash payment may not exceed 10% of the nominal value of the securities issued or, in the absence of a nominal value, the accounting par value of those securities. However, the securities issued may well have a nominal value below market value because, for example, there may be amount of share premium recorded in the accounts. Consequently, we believe the restriction to which the 10% threshold applies should be framed with reference to the market value of the securities rather than their nominal value.

Article 3

Article 3, paragraph (a) requires that the companies concerned be one of the forms listed in the Annex to the Directive. As outlined above with regard to the other two Directives, we do not understand the need to restrict the application of the Merger Directive to certain legal forms of a company given there are additional requirements which stipulate that the company concerned must be tax resident in an EU Member State and be subject to a form of corporate income tax. There are cases where companies might be incorporated in a third territory but are resident for tax purposes and subject to corporate income tax in an EU Member State. In our view, there is no clear policy rationale to exclude such companies from relief.

Similarly, Article 3, paragraph (c) requires that the companies concerned must be subject to corporate income tax in an EU Member State. As stated previously, this

precludes tax exempt entities like pension funds, investment funds, charitable organisations, and government bodies from availing of the benefits of the Directive. We believe the decision to exempt certain companies from corporate income tax is a policy matter for the Member State concerned and should not be a basis for denying the application of the Directive. We recommend, at a minimum, that the requirement should be modified to recognise that tax may be applied through other means such as a qualifying top-up tax under the EU Minimum Tax Directive (Pillar Two rules).

Article 4

Article 4, paragraph (4) provides that the benefits of the Directive will only apply where the receiving company computes any new depreciation and gains or losses in respect of the assets and liabilities transferred, according to the rules that would have applied to the transferring company if the merger had not occurred. While this provision exists to avoid any misuse of an arbitrage between different sets of rules, it overlooks the possibility that there could be a change of law in a Member State, which applies to new transactions but not pre-existing arrangements. Consequently, we recommend for an exclusion from this provision to be inserted so that the benefits of the Directive can be availed of as a result of a change of law in the relevant Member State.

Article 4, paragraph (5) provides that the benefits of the Directive will not apply where the receiving company exercises an option to have any new depreciation and gains or losses in respect of the assets and liabilities transferred in a manner different to the rules that would have applied to the transferring company if the merger had not occurred. While this provision is an attempt to address any potential misuse of an arbitrage between different sets of rules, it overlooks that the alternative treatment might not result in any overall difference in taxes paid. For example, the taxpayer might have the option to claim tax depreciation over a longer period than the transferring company, but the overall amount of depreciation claimed would not be different. Consequently, we believe an exclusion from this provision should be inserted so that the benefits of the Directive can be availed of provided the aggregate tax benefits arising from the exercise of that option do not materially exceed the tax benefits which would have been available had they not.

Article 8

Article 8, paragraph (4) provides that the benefits of the Directive will only apply if the shareholder does not attribute to the securities received a value for tax purposes which is higher than the value of the securities exchanged had immediately before the merger, division, etc. Whether or not a higher value applies to those shares is a matter of national law and generally will not be the choice of the taxpayer. Therefore, it could be considered inequitable where the tax laws of a particular jurisdiction provide for a higher value and the taxpayer has no option but to apply that rule.

This would be particularly unfair in a situation where the jurisdiction concerned has a capital gains tax exemption such that the value attributed to the shares is irrelevant because the gain will not be taxed in any event. While the purpose of the restriction is to ensure that there is no misuse of an arbitrage between tax rules, nevertheless it would seem inequitable to deny the benefits of the Directive in all such circumstances.

In our view, the Directive could be amended to require that Member States, which would otherwise apply a higher value to the securities exchanged, to permit the taxpayers to opt to adopt a lower value that would allow them avail of the Directive. This approach should protect the Exchequer of that Member State while still permitting legitimate taxpayers access to the benefits of the Directive. A similar point arises in relation to paragraph (5) insofar as it applies to partial divisions.

Article 11

Article 11, paragraphs (1), (2), and (3) contain provisions which allow a Member State to deny the benefits of the Directive in certain circumstances where the merger or division includes a tax transparent entity. While the purpose of the restriction is to ensure that there is no misuse of an arbitrage between tax rules, nevertheless it would seem unfair to deny the benefits of the Directive where the shareholders or members of that tax transparent entity would otherwise be able to avail of the Directive had that tax transparent entity not been in place. Paragraph (4) attempts to address this issue by providing that where a Member State considers that a non-

resident receiving company to be fiscally transparent, it may apply the benefits of the Directive to any direct or indirect shareholders as it would, had the receiving entity not been tax transparent. We believe this provision should be made mandatory.

Directive on Administrative Cooperation (DAC)

The Institute responded to the European Commission's public consultation on its evaluation of the DAC on 19 July 2024.

Key recommendations for the DAC review which have been identified by our members are as follows:

- The European Commission should streamline local data collection requirements under the DAC in order to alleviate the compliance burden for taxpayers and tax authorities.

- The reporting timeframe for intermediaries and taxpayers to disclose reportable arrangements under DAC6 should be extended from 30 days to 90 days. This would provide a more appropriate timeframe to conduct a comprehensive analysis of the arrangement, consult with affected parties and mitigate the risk of over-reporting.

- The European Commission should establish a whitelist which confirms that certain arrangements do not come within the scope of the DAC6 assessment and reporting requirements. This could include specific arrangements that:

    i. are already known to tax authorities (e.g., liquidations, cross-border mergers, cross-border conversions that are disclosed on a national trade register), or
    ii. are commercial in nature (e.g., cash-pooling arrangements, stock-option remuneration plans), or
    iii. utilise tax advantages that are in line with the intention of policymakers (e.g., use of tax exemptions, exercising options provided under the national tax law of a Member State).

- The European Commission should assess whether the current list of hallmarks in Annex IV of the Directive leads to unnecessary compliance requirements for

taxpayers and intermediaries and tax administrations. For example, the Commission could consider removing the Hallmarks under C.1 that address cross-border arrangements involving payments between associated enterprises that are subject to no or a low level of taxation in the recipient jurisdiction due to the applicable corporate tax rate, a preferential tax regime or a tax exemption. These hallmarks are less relevant following the introduction of the Pillar Two rules (and its increased disclosure and compliance requirements) and other recently introduced defensive measures (e.g., outbound payment defensive measures).

- The Commission could also consider providing a list of unilateral safe harbours which do not give rise to a reporting requirement under Hallmark E.1 (i.e., arrangement which involves the use of unilateral safe harbour rules) to reduce the reporting of transactions which are uncontroversial and are clearly commercial in nature.

Anti-Tax Avoidance Directive (ATAD)

The Institute **responded** to the European Commission's public consultation on its evaluation of ATAD on 11 September 2024. We have outlined below in more detail the recommendations for the ATAD review which have been identified by our members.

Controlled Foreign Company (CFC) rules

We believe ATAD should be amended to exempt Pillar Two in-scope groups from the scope of national CFC regimes. This would reduce the administrative burden for companies and reduce duplication.

CFC rules should also be updated with a requirement for Member States to credit tax imposed under a Qualified Domestic Minimum Top-up Tax (QDMTT) in a relevant jurisdiction, whether that jurisdiction is in or outside the EU. This should help to safeguard against double taxation.

Interest Limitation Rule (ILR)

30% EBITDA threshold

Since the Directive was introduced in 2016, the cost for companies accessing capital has increased. Indeed, the ECB interest rate in June 2024 stood at 4.5% as compared to 0.25% in March 2016. We believe that the negative impact of high borrowing costs on growth and investment could be alleviated through measures that reduce the after-tax cost of debt. In this context, we believe that the deductibility threshold of up to 30% of the taxpayer's EBITDA should be reconsidered to reflect changes in interest rates.

De Minimis threshold

Consideration should be given to increasing the current *de minimis* threshold of €3 million or provide Member States with the flexibility to increase the threshold within a

set range (which could be a multiple of the current €3 million threshold). The current threshold is set at a fixed amount which has no regard to the fact that prevailing interest rates have increased since it was introduced.

We recommend a higher *de minimis* threshold should apply to groups (e.g., a *de minimis threshold* of €10 million could apply to groups with more than three entities in the relevant Member State). In a group context, the €3 million *de minimis* threshold currently applies to the group as a whole.

We believe the 'cliff edge' aspect of the *de minimis* threshold should be removed, such that the relief applies to the first €3 million of interest expense. For example, an alternative might be to include a tapering of the relief or providing that national governments can allow taxpayers to disclaim amounts of interest in excess of the €3 million threshold, such that the taxpayer can effectively self-administer a form of tapering of the relief.

Meaning of interest equivalent – treatment of financial instruments

The European Commission should provide more clarity on the treatment of certain financial instruments and the associated characterisation of interest or interest equivalent in respect of them (e.g., the treatment of returns on non-performing loan portfolios acquired by a financial institution or the fair value movement of financial assets and liabilities).

Treatment of capitalised costs

Property developers typically capitalise interest incurred on building projects on their balance sheet throughout the course of the project, with the capitalised interest subsequently unwound to the income statement when the project is completed. Under the ILR, where the unwind of the interest expense exceeds €3 million in that accounting period, a restriction may apply to the amount of deductible interest expense notwithstanding that not all of the interest was incurred in that accounting period.

We believe the rules should be amended to provide that the deduction of such interest will not be restricted by the ILR in the year of unwind to the extent that the restriction would not have applied in the accounting period during which the interest was capitalised.

Company expansion in Europe – Issue with unused capacity restrictions

In practice, the one-size fits all time-limit placed on unused capacity fails to recognise the commercial reality that some business and sectors, by their nature, require extended periods of development/ expansion during which no profits are earned. Companies in such circumstances can be disadvantaged because of a permanent loss of unused capacity due to the operation of the five-year carry forward rule. This can be detrimental to growth and the competitiveness of the EU. We recommend permitting Member States to apply a longer time horizon for spare capacity for all sectors or, at a minimum, for sectors where distortions are identified as commonly occurring.

Long-term public infrastructure projects

The Preamble to ATAD notes that, without prejudice to EU State aid rules, Member States can allow for the exclusion of exceeding borrowing costs (for the purposes of the ILR) incurred on loans used to fund long-term public infrastructure projects. It is further noted that such financing arrangements are considered to present little or no base erosion and profit shifting risks. Within the limitations set out in ATAD, which defines a *"long term public infrastructure project"* as "*a project to provide, upgrade, operate and/or maintain a large-scale asset that is considered in the general public interest by a member State"*, we believe that the long-term public infrastructure project exemption under ILR should be broadened.

The scope of the long-term public infrastructure project exclusion could be expanded to cover a wider range of infrastructure projects. This could boost European competitiveness in the face of pressure from other jurisdictions (e.g., the Inflation Reduction Act in the US). Member States could be provided with increased flexibility

to determine which projects are considered to be in the general public interest. This may vary across Member States depending on their specific infrastructure needs.

Anti-hybrids

Group Taxation

There is insufficient flexibility under the Directive to deal with certain group taxation regimes, the operation of which does not fit into the current definitions of income inclusion under the Directive. For example, the US operates a worldwide group taxation regime under which foreign entities may be treated as equivalent to foreign branches, with the intragroup transactions between such entities being ignored (i.e., disregarded payments). As such entities are disregarded for US tax purposes, the income is only recognised further up the chain, at the level of the first US entity that is regarded for tax purposes.

Individual Member States, including Ireland, have attempted, in some instances, to legislate for this. However, the approach has been inconsistent across the EU resulting in significant variations, with additional pressure in terms of burden of proof placed on taxpayers. We believe a consistent approach for dealing with disregarded payments throughout the EU Member States would be preferable to help avoid disparities in the application of the anti-hybrid rules and to prevent situations in which the inclusion rule results in double or even multiple taxation outcomes.