ARTHUR COX

Arthur Cox LLP
Ten Earlsfort Terrace
Dublin 2
D02 T380

+353 1 920 1000
dublin@arthurcox.com
dx: 27 dublin

Dublin
Belfast
London
New York
San Francisco

arthurcox.com

10 September 2021

Consultation on OECD International Tax Proposals,
Tax Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2
D02 R583

BY EMAIL ONLY: intltax@finance.gov.ie

Re: Response to Public Consultation on OECD International Tax Proposals

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1. Introduction

We welcome the opportunity to respond to the Department of Finance's Public Consultation on OECD International Tax Proposals. We consider it is beneficial that the Department of Finance engages in regular and detailed consultations on these very important policy matters.

Initially, we note that the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy as agreed at the OECD/G20 Inclusive Framework meeting on Base Erosion and Profit Shifting ("**BEPS**") on 1 July 2021 (the "**Statement**") diverges in some respects from the blueprints, released in October 2020 in respect of Pillar One and Pillar Two (the "**Pillar One Blueprint**" and "**Pillar Two Blueprint**", together the "**Blueprints**"). Not only do some of the concepts as outlined in the Statement, deviate from what was set out in the Blueprints, but the Statement also lacks sufficient detail to allow for a thorough review of how these measures may be implemented. The extent to which the detail in the Blueprints applies to the Statement remains unclear and this is something clarity will need to be sought on.

2. Responses to Questions on Ireland's approach to the international tax proposals being discussed at the OECD/G20 BEPS Inclusive Framework

Question 1 – Do you have views on the broad policy objectives of the OECD international tax proposals?

We have reviewed the proposals contained in the Statement (the "**Proposals**"). In principle, we welcome a co-ordinated OECD approach rather than unilateral approach by individual nations or groups of nations taking divergent and potentially discriminatory action.

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However, there are a number of elements of the Proposals, as currently drafted, which raise concerns.

Interaction with other International Tax Reform

The principles of BEPS ensure that profits from intangibles are linked to value creation by putting greater emphasis on the key "DEMPE" functions and the arms-length principle. We are concerned that the Proposals move away from these principles to what may be more arbitrary reallocations of the profits of MNEs based on untested concepts and/or formulaic approaches.

We consider it premature to consider the introduction of additional BEPS measures until a thorough assessment is made on the effect of the existing OECD BEPS measures. We are of the view that many of the BEPS 1.0 measures are already having an impact in changing the structures used by multinational enterprises ("**MNEs**") and profit allocation within MNEs. The full impact of the effect of those measures is as yet unknown. For example, CFC rules and anti-hybrid rules adopted by all EU Member States from 1 January 2019 and 1 January 2020 are designed to achieve similar objectives to Pillar Two.

Furthermore, international tax reforms such as changes to the OECD Transfer Pricing Guidelines, revisions to Ireland's residency rules for Corporation Tax and the changes to the US tax code introduced by the Tax Cuts and Jobs Act of 2017, are impacting on profit allocation. An example of this is the profile of outbound royalty payments from Ireland. These outbound payments were €84.3 billion in 2019 and preliminary figures for 2020 show a figure of €83.6 billion. Under the pre-2018 US tax regime, these outbound royalty payments were primarily routed to low tax jurisdictions. While these royalty payments continued to be made from Ireland, in 2020, around 60 per cent of the royalty payments from Ireland went to the United States[1] indicating that revenues are increasingly being allocated to large jurisdictions. Given that the extent and impact of these changes, in conjunction with the BEPS 1.0 measures, is only coming to light now, time should be given to allow for a proper assessment prior to introducing further changes.

We also find it curious that, in circumstances where the objective is to collect higher levels of tax in large jurisdictions, the current VAT and other consumption tax systems are not being utilised to achieve this. The existing framework for such consumption taxes is based on a commonly accepted system and principles (the US being an outlier) similar to the European VAT Directive which has been implemented widely. These rules tax consumption which naturally leads to the intended objective of increased tax revenues in consumer countries, such a result being achieved in a much simpler manner. Making small changes to impose a higher VAT burden on carbon intensive activities, would also achieve some of the climate objectives discussed below. Also, the effect on prices would be clear and transparent, unlike increased corporation taxes which indirectly increase prices in a way the citizenry cannot easily understand. It is a pity that this approach was not investigated more thoroughly.

Disproportionate effect on peripheral OECD nations

Ireland, as a small island nation distant from its markets, operates at a competitive disadvantage to larger countries and to countries in mainland Europe which can rely on land based trade with large markets. In many cases, transport costs make the costs of operating non-service industries prohibitive for Irish businesses. Economic development in Ireland has arisen in large part by being a place from which physically small, high value goods are made and services are supplied. These activities are less affected by transport costs so Ireland can compete with on an almost equal footing with continental economies. Due to geography, Ireland cannot compete in heavy industry with complex supply chains. One could view the current proposals as a means of undermining fair competition from such small, peripheral island nations and tilting the "playground" in favour of large economies with good connectivity to large markets.

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[1] Coffey, Seamus (2021). The changing nature of outbound royalties from Ireland and their impact on the taxation of the profits of US multinationals.

It is a legitimate policy tool for developing countries to incentivise development in particular sectors and to seek to bring their citizens out of poverty. Naturally, poorer countries will utilise their tax policy to compensate for their competitive disadvantages such as location, access to markets, resources and size. The implementation of policies such as freeports have contributed to the growth and investment of smaller economies in industries in which they would otherwise be unable to compete. Tax holidays are used to promote the growth of clusters which by their nature somewhat counter the disadvantages of geographical distance. Implementing the Proposals will not only increase barriers to trade but will also inhibit the ability of poorer countries to utilise targeted and proportional policies to promote poverty reducing investment in their countries. For example, if Poor Country A implemented a corporation tax reduction or holidays to kick start a cluster for a specific industry, any benefit for a MNE in investing there would be countered by the Proposals. The negative impact on the ability of poorer countries to use sensible tax policies to rise out of poverty is significantly diminished by the Proposals. Perhaps it is no coincidence that the Proposals are being driven by large countries with established industrial-based economies.

Under Article 2(c) of the OECD Convention, the OECD commits to pursuing policies designed to achieve economic growth and internal and external financial stability and to avoid developments that might endanger their economies or those of other countries. In our view, the implementation of the Proposals as currently drafted may have a disproportionately negative effect on peripheral OECD countries like Ireland in contravention of Article 2.

Furthermore, because it is one of the World Trade Organisation's primary objectives, lowering and eliminating barriers of trade has been the appropriate approach taken by international organisations towards tax reform in recent times. The Proposals, in many respects, contemplate taxing based on trade barriers. In our view, this is a retrograde step as it is anti-efficiency and anti-globalisation. As the global economies seek to emerge from the challenges of the Covid-19 pandemic, the OECD should focus on pro-growth policies to assist recoveries.

Freedom of Establishment principles

We are further concerned that some of the Proposals, specifically those provided for under Pillar Two, may be incompatible with the Freedom of Establishment principles established under the Treaty on the Functioning of the European Union ("**TFEU**").

For instance, implementing an income inclusion rule, operating on a country-by-country basis within the EU, strikes us as incompatible with settled case-law of the Court of Justice of the European Union ("**CJEU**") where it has been stated, and reinforced on a number of occasions, that "*any advantage resulting from the low taxation to which a subsidiary established in a Member State other than the one in which the parent company was incorporated is subject cannot by itself authorise that Member State to offset that advantage by less favourable tax treatment of the parent company. […] The need to prevent the reduction of tax revenue is not one of the grounds listed in Article 46(1) EC or a matter of overriding general interest which would justify a restriction on a freedom introduced by the Treaty.*"[2]

On that basis, the CJEU has determined that freedom of establishment principles preclude measures that provide for taxation of a subsidiary in one Member State in respect of profits made by a foreign company in another Member State, unless such measures relate only to wholly artificial arrangements intended to escape national tax normally payable.

[2] Court of Justice of the European Union decision in *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*, Case C-196/04 14

In addition, the CJEU in *Eurowings*[3] determined that a difference of tax treatment based on the place of establishment of the provider of services cannot be justified by the fact that the taxpayer established in another Member State is subject to lower taxation nor could such difference be justified on grounds linked to the need for coherency of taxation. In addition, when designing withholding tax collection mechanisms under Pillar Two, regard should be had to CJEU decisions such as *Brisal*[4] which highlight that the manner in which withholding taxes are imposed on an intra-EU basis could infringe free movement principles. In this context, detailed analysis will have to be carried out in respect of the proposed subject to tax and undertaxed payment rules and their operation within the EU.

Climate Change

Separately, the IMF and OECD, in their report on Tax Policy and Climate Change[5], expressed that the progressive transition to net zero greenhouse gas emissions by around the middle of the century is essential for containing the risks of dangerous climate change. This detailed report, addressed to all G20 Finance Ministers and Central Bank Governors, emphasised the need for a comprehensive package of measures, including effective pricing of greenhouse gases, to enhance the overall effectiveness and acceptability of climate change mitigation strategies. The Proposals seem to ignore the most pressing issue of our time: climate change. Perhaps similar effort should be put into aligning the Proposals to the response required to address this global issue. At a very minimum, it is imperative that tax incentives offered to promote investment in green initiatives are not negatively impacted by the Proposals, i.e. tax reliefs offered by a country to promote green initiatives should not be countered under the Proposals by tax measures in other countries.

Question 2 – Are there specific implications for Ireland's corporation tax regime that would arise from adopting and implementing the OECD proposals that require particular consideration? What are the benefits and challenges for Ireland?

Implementation of the Proposals

The Proposals would raise a number of challenges for Ireland and implementation of the Proposals should be given very careful consideration. Unless an agreement is reached whereby the OECD's largest economies (i.e. USA, China, the United Kingdom, etc.) each agree to implementation of the Proposals and removal of all unilateral actions that are inconsistent with the agreed approach (e.g. Diverted Profits Tax in the United Kingdom, Digital Services Tax in France and the proposed EU Digital levy), then we are of the view that Ireland should refrain from agreeing to implement the Proposals.

Importantly, Ireland should not agree to an EU Directive. It is our view that an EU code of conduct obliging EU Member States to implement the Proposals is sufficient and has proved effective in the past. Implementation of such a Directive may breach Article 21.1.1 of the Constitution of Ireland (the "**Constitution**") as it may infringe on Dáil Éireann's sole and exclusive right to initiate money bills. The implementation of such a Directive may not come under the exception provided for under Article 29.4.6 of the Constitution. Agreeing to a Directive that has the scope to prevent Dáil Éireann from initiating a money bill on these issues at any point in the future, is an action that may require a referendum. On that basis, a concerned citizen could reasonably seek an injunction to prevent the Minister for Finance from agreeing such a Directive, unless a referendum was held.

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[3] Court of Justice of the European Union decision *in Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna*, Case C-294/97.

[4] Court of Justice of the European Union decision in *Brisal*, Case C-18/15.

[5] IMF/OECD (2021), Tax Policy and Climate Change: IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors, April 2021, Italy, https://www.oecd.org/tax/tax-policy/tax-policy-and-climate-change-imf-oecd-g20-report-april-2021.pdf

Furthermore, Directive (EU) 2016/1164 ("**ATAD**") has demonstrated that broad-brush EU law on complex taxation matters is inefficient and imposes ill-fitting measures on an economy that is different from many others. Ireland needs to retain the ability, within the framework of the international agreement, to implement the Proposals with the full flexibility they provide in a manner that suits its economic needs (as they change from time to time). For example, it would be unwise for Ireland to agree to a Directive that would prevent it from implementing aspects of the Proposals. If, on the other hand, a Directive did not diverge from the Proposals, why is it necessary to have a Directive? In effect, if it's the same as the Proposals it is unnecessary; if it is different, it is unwise.

Reform of the Irish tax system

The implementation of BEPS 1.0 and ATAD into our already complex tax regime is not yet complete and has caused major issues for Ireland. This is because ATAD did not reflect the full nuances of the BEPS proposals and adopted a broad brush approach to complex issues. The added layer of complexity that the Proposals will bring represents an additional challenge for Ireland and will increase further the already complex tax compliance regime to which Irish taxpayers are subject.

In essence, our tax regime is not in line with the primary countries driving these changes. For example, most systems do not operate multi-rate structures for corporate taxation; Ireland does. Very few systems operate a schedular system of taxation with unique computational rules for each schedule; Ireland does. Ireland has five "Cases" for business income with inconsistent computational rules for each "Case"; most countries have a simpler system. Most countries tax capital gains of companies at a lower rate than income of companies; Ireland taxes it at a higher rate. Interest deductibility rules follow normal commercial principles in most countries but, outside trading principles, Irish rules depart significantly from commercial principles. Some systems do not distinguish between income and capital. Most systems operate a group consolidation system; Ireland's is only a partial and patchy group relief system. Many systems have a coherent system for taxing debt and other financial instruments but Ireland does not. These differences will inevitably give rise to anomalies in the implementation of the Proposals in Ireland. Some, but not all, of these anomalies could be tackled by a significant reform of many aspects of our regime.

As we have recommended in previous submissions, given the unprecedented rate of change to which the Irish corporation tax system has been subject over the last few years, we are strongly of the view that a fundamental review of the structure and legislative basis of that tax system should be undertaken. To this end, the following reforms would not only assist MNEs in managing their Irish tax affairs with little to zero impact on tax receipts, but they would also simplify implementation of the Proposals:

- **Consolidating the rates**

  To be clear, we do not support any increase in corporate tax rates as it is the least economically effective way of raising a unit/euro of tax. We do support a single low rate of tax on all corporate profits.

  A separate point is the significant rate differential between the trading rate of tax (12.5%) and the capital gains tax rate (33%) which is causing significant difficulties for corporates. The categorisation of assets as "trading" or "capital" or payments as "revenue" or "capital" is a historical hangover from trust law. More practically, it is not a clear distinction and this leads to the possibility of significant disputes and can lead to a largely arbitrary fluctuation in the effective tax rate for a business. An example of this in the recent *Perrigo*[6] case which highlighted the fine line between the trading and capital investment for Irish tax purposes and

[6] *Perrigo Pharma International DAC v John McNamara, the Revenue Commissioners, the Minister for Finance, Ireland and the Attorney General* ([2020] IEHC 552).

led to high profile stock exchange announcements by Perrigo due to the scale of the tax liability at stake.

In order to resolve this, we would suggest that all assets that are used wholly and exclusively for the purposes of a trade of a company should, on disposal, be treated as the disposal of a trading asset, triggering tax at 12.5% on any gain. All of the "base cost" would be deductible as a trading expense. As a result, any loss should be deductible against income taxed at 12.5% so that there is symmetry. In order to address the potential for sheltering assets in corporates by Irish resident individuals, we would advocate that a look through provision would be imposed to deem a gain to arise to Irish resident shareholders in these corporates in proportion to their shareholding. For example, Section 590 of the Taxes Consolidation Act 1997 (the "**TCA**") could be extended to Irish resident close companies to either deem the gain to arise to individuals (all individuals for assets specified in Section 29 TCA and Irish resident individuals for all other assets) or, better still, reduce their base cost in their shareholding, including to a negative amount, so that the gain is triggered on disposal of the shares. Credit would be given for tax paid at 12.5% by the company making the disposal so that only the rate differential would be payable by the shareholder.

- **Simplify Interest Deduction Rules**

  Interest deduction rules should be simplified by permitting a deduction for interest on debt incurred for genuine commercial purposes, i.e. expenses should be deductible "to the extent" that they are incurred for the purpose of earning taxable profit. This could be subject to the normal restrictions such as transfer pricing, anti-hybrid rules and interest limitation.

- **Group consolidation**

  The current group relief rules are overly complex and unsuited to modern group structures. Most jurisdictions operate corporate consolidation systems, e.g. the US consolidated group concept, the German organschaft concept, Dutch fiscal unity, etc. Ireland should introduce a consolidation system similar to one of these examples. This would simplify administration (as with an Irish VAT group) and prevent temporal mismatches arising within corporate groups. For example, currently a loss in Company A can become "stranded" if group Company B has profits but not in the same year as the loss arose in Company A. It would be utilisable if it arose in a single company. As a result the corporate group makes an economic loss but can make a taxable profit. Reform could be achieved in a simple manner by altering the application of the existing group relief rules so that, instead of being able to surrender losses, the companies could elect to be consolidated. Other consolidation systems could be examined to ensure that opportunities for avoidance are eliminated.

- **Simplifying Tax Credits– moving to a territorial system**

  We have set out in prior submissions our view that the current foreign tax credit system is unnecessary since the controlled foreign company rules were introduced, as well as being unwieldy, arbitrary and, in many instances, in breach of EU law. As we have stated in previous submissions, we will be submitting in the future consultation on a territorial system that Ireland should move to a full territorial system. However, an elective participation exemption system should be introduced in the very short term.

- **Widening the Capital Gains Tax ("CGT") participation exemption**

  In respect of CGT, we are of the view that the system would benefit from a relaxation of the trading requirement for third party disposals. Secondly, the definition of residence should be widened to include certain countries, which do not have a concept of residence (e.g. Hong Kong). Where a company is resident in a territory under the terms of a Double Tax Agreement, it should be treated as resident there for the purposes of the participation exemption.

- **Ireland's intellectual property regime**

  We further recommend that the operation of Ireland's intellectual property regime is reviewed and, where necessary, reformed to ensure that it interacts with the Proposals on an optimal basis. Investment in innovation should not be adversely affected and tax incentives such as Research and Development tax credits ("**R&D credits**"), the Knowledge Development Box relief, relief under Section 291A of the TCA ("**Section 291A relief**") and tax credits available in respect of inbound royalties are among a number of such incentives that should be considered in this context.

- **Deductions on a "paid" basis**

  Tax deductions on a "paid" basis may also give rise to specific complexities with respect to Pillar Two as it is unclear how timing differences will be dealt with, as is further discussed below.

The fundamental issue is that there will be significant mis-matches between the Irish taxable base and the taxable base assumed by other countries in their implementation of the Proposals. This will lead to year-on- year variations which could lead to counter measures simply due to short terms swings in effective tax rates ("**ETR**"). This needs to be addressed comprehensively as otherwise the Irish tax system will become unworkable in an international context and MNEs operating in Ireland will not be able to forecast their ETR.

As a stop-gap, non-SMEs should be able to elect to compute their profits based on the rules set out in the Proposals instead of Irish domestic rules. This means that the taxable base would match the Proposals and the agreed global minimum tax rate could simply be applied to that profit.

Question 3 – Are there specific features in the design of the Pillar One proposals which, in your opinion, may have particular implications for Ireland and our tax policy?

Pillar One

We note that the thresholds applying in respect of Pillar One (i.e. to apply to MNEs that have more than EUR 20 billion of global turnover and profitability above 10 percent) will be reduced to EUR 10 billion seven years from when Pillar One enters into force, contingent on successful implementation. Noting that the agreed scope is a dramatic departure from what was contained in the Pillar One Blueprint, careful consideration should be given to the extent of additional tax reallocation from Ireland in circumstances where the threshold is reduced to EUR 10 billion.

We further note that there are exclusions for extractives and regulated financial services. It is unclear whether the definition of "financial services" and the meaning of "regulated" for this purpose will be the same as those provided for in the Pillar One Blueprint. Clarification in this regard is of the utmost importance for Ireland's financial services industry. Further, in line with the OECD's position on climate change referred to under our responses to question one above, it is odd that extractives should be excluded given their negative impact on the environment.

It is noted in the Proposals that "losses will be carried forward". Clarification on whether this will include the indefinite carry forward of pre-regime losses is important. It would be unfair to allocate the residual profits to a jurisdiction without also allocating the tax attributes such as losses carried forward, tax depreciation, etc. Many businesses invest heavily in R&D and commercialisation of products in the early phase of the life-cycle and relief for related expenses should not be disturbed by their reallocation to another jurisdiction.

Interaction with Ireland's tax system

The Proposals indicate that double taxation of reallocated profits will be avoided by using a credit or exemption system.

We are concerned that if income becomes exempt in Ireland due to reallocation elsewhere this may have an impact on the utilisation of Irish loss carry forwards, interest relief as a charge, etc., which may be trapped in an entity due to our restrictive group relief rules. It should also be considered if such an exemption will affect EBITDA for the purposes of the interest limitation restriction.

If a credit system is used, this may result in interest relief as a charge within an entity which would otherwise have been available for group relief being used before the foreign tax credit under Ireland's current rules.

In circumstances where the computation under Pillar One results in the reduction of an Irish entity's taxable profits, consideration should be given to how this will impact on Section 291A relief limits and R&D tax credit limits. In our view, those limits should be based on the pre-Pillar One adjustment position.

Dispute resolution

Given the complexity of the Pillar One proposals and uncertainties arising as a result of their divergence from normal tax and transfer pricing principles. Dispute resolution will be key. We welcome the proposed mandatory dispute resolution (excluding certain developing countries) but specific features of the process will be important.

The diversion of taxpayer (and Revenue) resources to lengthy international tax disputes would be unwelcome and, as such, it is critical to ensure that Ireland's approach to implementation of the Proposals places appropriate emphasis on timely and effective dispute resolution. Such a policy should support increased Irish Competent Authority resourcing to ensure that there is sufficient capacity to deal with disputes involving Irish taxpayers as they arise.

In our view, Ireland should advocate for a bilateral/multilateral position on the resolution of international disputes, such that penalties and interest should not apply to entities in Ireland or another OECD jurisdiction where there is merely a reallocation of tax between countries on settlement of a dispute.

Question 4 – Pillar Two proposals include agreeing to adopt an Income Inclusion Rule, an Under-Taxed Payments Rule and a Subject To Tax Rule. Are there any specific features of introducing these rules that warrant particular attention with regard to their implications for Ireland's tax code and tax policy?

Interaction with Ireland's tax system

While we maintain that Ireland should continue to advocate for a 12.5% minimum corporate tax rate, we recommend that contingency planning should commence immediately for a higher rate.

As the base for the purpose of the GloBE rate will be different than for the purpose of calculating Irish corporation tax payable, the Department should model the differential between, for example, a 15% GloBE rate based on accounting profits versus 12.5% of taxable profits for Ireland's affected MNE taxpayers. This will assist in decision making on our future corporate tax rate. Consideration should also be given to allowing an MNE that is taxed under Pillar Two the option to calculate its Irish tax under Pillar Two principles instead of domestic Irish rules. This would solve many issues of the interaction between the Irish domestic rules and the Pillar Two Rules.

A key issue arising in relation to the interaction of the Irish tax regime and Pillar Two is that many tax deductions in Ireland's tax regime give rise to timing differences between the accounts and tax computations including tax depreciation, interest relief as a charge, royalties, pensions, etc. These may give rise to anomalies depending on how Pillar Two is finally implemented (noting that the Proposals include a reference to mechanisms to address timing differences). Ireland should monitor this aspect carefully so that MNEs with operations in Ireland are not disadvantaged by the interaction of the Irish tax regime and Pillar Two.

The treatment of R&D tax credits for the purpose Pillar Two will be important to Irish MNEs and Ireland should consider any adjustments required to this regime depending on the final details of Pillar Two.

Pillar Two proposals

The Proposals provide that the Income Inclusion Rule and the Under-Taxed Payments Rule (the "**GloBE rules**") will apply to MNEs that meet the EUR 750 million threshold as determined under BEPS Action 13 (country-by-country reporting), albeit countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold. In our view, clarity should be sought on whether the EUR 750 million threshold test is applied to the year under consideration or the preceding year as in the case in respect of country-by-country reporting.

It is important that carry forward losses (including pre-regime losses) would not negatively impact the effective tax rate of an entity. As noted at Question 3 above, many businesses invest heavily in R&D and commercialisation of products in the early phase of the life-cycle and such expenditure on innovation should not be disincentivised by the Proposals.

Consideration should be given to fair and equitable simplification measures to deal with the complexities of determining the appropriate tax base and effective tax rate for the purpose of applying the GloBE rules.

For example, complexities and anomalies may arise due to:

- the use of accounting rules which still differ across jurisdictions even though there has been some convergence in recent years;
- the requirement to apply the rules on a jurisdiction-by-jurisdiction basis which may require a national sub-consolidation which would not otherwise be required; and
- the different design elements of tax regimes in different jurisdictions.

The final detail on a number of aspects of the Pillar Two proposals will be important for MNEs with operations in Ireland including:

- details of the carve-outs including the "*de minimis*" and the formulaic substance carve-out that will exclude an amount of income that is at least 5%-7.5% of the carrying value of tangible assets and payroll;
- the design of the exclusion for MNEs in the "the initial phase of their international activity";
- the design of elements to ensure "limited impact on MNEs carrying out real economic activities with substance"; and
- the scope of simplification measures, including "safe harbours and/or other mechanisms".

The precise parameters of the above are key to assessing the impact of the implementation of the Proposals and their interaction with the Irish tax system.

Financial Services

The Proposals exclude the following from the scope of the GloBE rules: "*government entities, international organisations, non-profit organisations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organisations or funds.*" We are firmly of the view that sovereign wealth funds that act as commercial entities should not be excluded. Such an exclusion will lead to a distortion of competition.

Careful consideration will need to be given to the likely definitions and the effect on Ireland's funds industry. We note that the Pillar Two Blueprint defines investment funds as:

> "*an entity or arrangement that meets all of the following criteria set out in paragraphs (a) to (f) below:*
>
> (a) *it is designed to pool assets (which may be financial and non-financial) from an Excluded Entity or a number of investors (at least some of which are not connected);*
>
> (b) *it invests in accordance with a defined investment policy and/or to reduce transaction costs and research and analytical costs and/or to spread risk collectively;*
>
> (c) *it is primarily designed to generate investment income and/or gains or protection against a particular or general event or outcome;*
>
> (d) *investors have a right to return from the assets of the fund, or income earned on those assets, based on the contributions made by those investors;*
>
> (e) *the fund, or the management of the fund,* ***is subject to the regulatory regime for investment funds in the jurisdiction in which it is established or managed*** *[emphasis added] (including appropriate anti-money laundering and investor protection regulation); and*
>
> (f) *it is managed by fund management professionals on behalf of the investors*."

Pillar Two is largely targeted at multinational corporate groups rather than financial services entities. In order to provide a level playing field and to avoid a breach of competition law, entities that perform similar functions to an Alternative Investment Fund ("**AIF**") but are differently regulated must also be excluded. This would include FVCs ("**Financial Vehicle Corporation**") and companies that are subject to non-FVC reporting to the Irish Central Bank. The rational for these regimes is that the entities can be economically equivalent to an AIF and therefore the level of information provided to the Central Bank ought to be equivalent. We would also suggest, for similar reasons, excluding any company that falls within the EU Securitisation Regulation[7].

We note also the Pillar Two Blueprint proposals to extend the rules to certain orphan entities. Ireland should ensure that a market standard securitisation company should not be treated as an orphan entity for the purposes of Pillar Two. Such a company may be established with its entire issued share capital held on trust for charitable purposes for reasons including as a requirement of the European Central Bank, rating agencies and commercial lenders, rather than any tax avoidance purpose. As long as a company is not part of a consolidated group for financial accounting purposes, a normal securitisation

[7] EU Regulation No. 2017/2402/EU.

company, all of the shares of which are held on trust for charitable purpose for bona fide reasons, should be excluded from the application of Pillar Two.

This is consistent with the Pillar Two Blueprint[8] which states the following in relation to the application of the GloBE rules to "investment funds"

"*The entities or arrangements excluded from the scope of the GloBE rules all have a particular purpose and status under the laws of the jurisdiction in which they are created or established. This status is likely to result in that entity not being exposed to domestic income tax in order to preserve a specific intended policy outcome under the laws of that jurisdiction. The domestic tax outcome may, for example, be designed to ensure a single layer of taxation on vehicles used by investors (e.g. funds) or on retirement plans used by employees, or because the entity is carrying out governmental or quasi-governmental functions. The tax policy objectives of the domestic tax exemption for these types of entities neither are inconsistent with the tax policy objectives of the GloBE rules nor create a competitive distortion that would undermine the tax policy objectives of the GloBE proposal. Subjecting the income of such entities to tax under the GloBE rules would undermine the policy objectives that the domestic jurisdiction is seeking to achieve by granting the exemption without furthering the tax policy objectives of the GloBE rules[emphasis added]…*"

Question 5 – Are there any specific issues which should be considered in respect to implications for the Irish tax code arising from the GILTI, SHIELD and other US corporate tax reform proposals, with particular reference to the significance of US MNEs in Ireland?

It will be important to ensure that the interaction of various tax incentives under the Irish tax regime (e.g. Section 291A relief, Section 247 interest as a charge, R&D credits, etc.) with GILTI, SHIELD and other US corporate tax reform proposals is optimal.

How the Proposals, and in particular the Income Inclusion Rule, will be co-ordinated with GILTI rules in the U.S. will be an important consideration in respect of how the Proposals would impact on US MNEs in Ireland. As currently stated, GILTI and the Proposals differ in the following ways:

- GILTI imposes a tax at a lower rate (currently half the U.S. rate, or 10.5 %) to income in excess of a deemed return of 10% of tangible assets. The rate is due to rise to 13.125% after 2025 but there are proposals to increase the rate to 21%. This compares with the Proposals rate of 15% on profits in excess of a fixed return for the carrying value of tangible assets and payroll. This carve-out under the Proposals, although not yet fully specified is wider than that under GILTI (which currently applies only to tangible assets).

- GILTI achieves the "top-up" tax by imposing the full tax and then allowing credits against the GILTI tax for 80% of foreign taxes paid, up to the amount of U.S. tax due. Consideration should be given specifically to the interaction of the GloBE rules, the Irish corporation tax rate and the 80% foreign tax credit under GILTI so that US MNEs with Irish operations are not at a particular disadvantage

- The Proposals would allow carry-forwards of losses and excess taxes, which is not currently allowed under GILTI.

[8] Paragraph 72, OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en.

Question 6 – Are there specific considerations of particular significance that should be taken into account in deciding how any final agreement should be implemented?

The proposed timing of Inclusive Framework members coming to a final decision on the design elements within the agreed framework by October and the proposed effective date for implementation of both Pillar One and Pillar Two in 2023 is ambitious. If the proposed timelines are achieved, Ireland will need to dedicate extensive resources to ensuring our tax regime is fit for purpose when the Proposals begin to be implemented here and elsewhere.

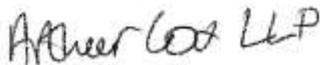
As stated under our response to Question 2 above, Ireland is likely to be unable to agree to an EU Directive absent a referendum. It is our view that an EU code of conduct or similar guidelines obliging EU member states to implement the Proposals would be both practical and effective.

Some aspects of the Proposals will require a multilateral instrument and the implementation of this will take some time.

Question 7 – Are there any further considerations that should be taken into account, including in respect to Ireland's wider industrial policy arising from the OECD proposals?

Implementation of the Proposals, however agreed, will inevitably weaken Ireland's tax competitiveness globally. With less tax competition to offset our lack of natural resources and our lack of connectivity, the government must improve its delivery of infrastructure generally in areas such as renewable energy, housing, power systems and broadband. Further attention must also be given to improving Ireland's tax offering in other areas such as individual taxation.

Yours faithfully



ARTHUR COX LLP