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By email: ctreview@finance.gov.ie

Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2 D02 R583

Re: Implementation of Pillar Two - Consultation

A Chara,

We welcome the opportunity to make a submission to this consultation and we have set our comments below.

General

1. Are there any specific features of the Rules that warrant particular attention with regard to their implications for Ireland's tax code and tax policy?

Constitutional issue

In our view Ireland has a constitutional issue with signing up to the proposed draft directive, hereinafter referred to as the "**Pillar Two Directive**". The Irish legislation which would be required to implement the Pillar Two Directive would be considered a "money bill" and, therefore, it is beyond the power of a minister (through the EU Council of Ministers or otherwise) to enter into this Pillar Two Directive.

The EU Commission has proposed the Pillar Two Directive which would require all Member States to implement these rules in a manner compliant with the Pillar Two Directive. After the point of implementation, it would not be possible for any Member State to deviate from the provisions of the Pillar Two Directive without a further directive amending the Pillar Two Directive. Directives are intended to set out general principles to be implemented into domestic law and to leave a margin of discretion to Member States. The Pillar Two Directive seems to leave little discretion to Member States and goes beyond the scope of the Organisation for Economic Co-operation and Development ("**OECD**") by including large, purely domestic groups. It is arguable that since this goes beyond what is necessary to implement the OECD agreement, it does not accord with the principle of subsidiarity.

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As it is a taxation measure, unanimity of the 27 Member States is required to pass the Pillar Two Directive. This has not yet been achieved. To resolve this, the alternative approach of "enhanced cooperation" as a means of implementing the Pillar Two Directive has been proposed. This would enable the Pillar Two Directive to be implemented by only some of the Member States, and would bind only those Member States that agreed to it. The Oireachtas may normally enter into international agreements and organisations on behalf of the people. Any laws that are "**necessitated by**" our membership of the EU cannot be invalidated by any other provision of Bunreacht na hÉireann so gain Constitutional protection. Different considerations apply to the Pillar Two Directive.

The Pillar Two Directive imposes a minimum tax rate of 15% on certain corporate profits and contains extensive provisions to calculate the tax base to which that rate applies. It also requires the imposition of an undertaxed payment rule and an income inclusion rule.

If the Pillar Two Directive is "**necessitated by**" EU membership, then all would be fine, but it is not. As unanimity is required for the Pillar Two Directive to be adopted, Ireland does not have to sign up to it, i.e. acceptance of the Pillar Two Directive is not "necessary" as part of our EU membership. In addition, it appears that it is possible to adopt the Pillar Two Directive through "enhanced cooperation". This means that some Member States may legitimately decline to sign up to the Pillar Two Directive and so, it cannot be considered "necessary" for EU membership.

Unlike other directives outside the tax area, the Government cannot agree to the directive and make it binding on Ireland. The Government (i.e. the executive branch) is specifically denied power to initiate money bills by Article 21.1.1 of Bunreacht na hÉireann. Instead, Dáil Éireann (the Irish parliament's lower house) has exclusive competence to initiate money bills. Accordingly, the only way in which this tax policy can be enacted is where it is initiated by Dáil Éireann. It cannot be initiated by a Minister (part of the executive) signing up to it in the EU Council of Ministers.

Dáil Éireann approval

The Pillar Two Directive cedes Ireland's policy-making ability in relation to certain aspects of corporation tax in the future. For example, if implemented, a future Dáil Éireann would not be able to change the Pillar Two rules to (say) reduce the 15% rate to corporation tax to 12.5% or to change the computation of the tax base to which that rate is applied.

A "money bill" is a bill that contains "*only provisions dealing with all or any of the following matters, namely, the imposition, repeal, remission, alteration or regulation of taxation…*"[i][1] The reason money bills are specifically recognised as different from other types of legislation is because the ability to determine economic policy is a fundamental feature of an independent democratic republic and the confiscation of a citizen's property through taxation is only legitimate if done in accordance with strict democratic principles.

Taxation (the means by which the State takes resources from some in society to allocate those resources to others in society) can have a profound impact on the persons from whom the resources are taken. Arbitrary taxation will also have a negative long-term economic impact on investment decisions in a society and will likely make that society poorer. This is why money bills are treated differently from other types of legislation and why only a directly elected Dáil Éireann can initiate and decide on money bills.

Seanad Éireann (the upper house of the legislature, which is not directly elected) has a larger role in relation to other types of legislation, however it has limited ability to comment on money bills and cannot amend money bills. The duty and right of Dáil Éireann in relation to money bills is so important that it cannot be abdicated or delegated. Dáil Éireann is clearly identified in Bunreacht na hÉireann as

[1] Article 22, Bunreacht na hÉireann.

the only organ of State that has the ability to initiate and determine tax policy. No other part of the legislature nor any other branch of government has this right.

It is a fundamental point of the parliamentary system that one Dáil cannot bind a future Dáil. This is not expressed specifically in the Constitution, but flows from the nature of democracy. If a new Dáil Éireann wished to change the decisions of a prior Dáil Éireann, the act of democracy in voting in a new Dáil Éireann would not be respected unless the new Dáil Éireann could change decisions of a prior Dáil Éireann.

Two conclusions follow. First, no member of the executive has the power to initiate or decide on a money bill such as the Pillar Two Directive. Secondly, since Dáil Éireann cannot bind a future Dáil Éireann it cannot agree the Pillar Two Directive.

Enhanced Cooperation

Articles 29.4.7 of the Irish Constitution permit the State to exercise the options or discretions "*to which Article 20 of the Treaty on European Union relating to enhanced cooperation applies*." This must be read in light of the Constitution as a whole (via the doctrine of harmonious interpretation) and also Article 29.4.6 (the "necessitated by" clause). If enhanced cooperation is the means used to adopt the Pillar Two Directive, it seems that by definition, the Pillar Two Directive is not a law that is "necessitated by" EU membership. As a result, it would need to comply with the Constitution generally.

Article 29.4.7 (enhanced cooperation) also requires the "*prior approval of both Houses of the Oireachtas*". Article 21.1.2 limits the involvement of Seanad Éireann in the passage of money bills, however, to "recommendations" only. This conflict cannot be resolved unless it is accepted that Article 29.4.6 (the "necessitated by" clause) qualifies Article 29.4.7 (enhanced cooperation). As a result, Article 29.4.7 cannot be used as a Constitutional mechanism to implement the Pillar Two Directive under enhanced cooperation since it conflicts with Article 21.1.1.

This approach is consistent with the Supreme Court decisions in *Crotty* and *Pringle* and with general constitutional theory.

Irish Government options

There are at least two ways to introduce the Pillar Two rules into Irish law which will not offend the constitutional principles discussed.

The first is by constitutional referendum. Clarke J noted in *Pringle* that although the Constitution does not require that all international agreements be put to the people for approval through a referendum, international agreements that "*[breach] the terms of the Constitution [do require] an appropriate amendment to be made to the Constitution*".[1] As discussed above, the Pillar Two Directive is one such agreement. Practically, however, this route may be unattractive.

The second way is to introduce the Pillar Two rules through a normal money bill that is initiated by Dáil Éireann. This could be achieved simply by including the legislation in an appropriate Finance Bill. This practice would usually happen in any event so is no extra burden on State resources. From an EU political perspective, however, it means that, although Ireland will be compliant with the Pillar Two Directive, it will not have signed up to it. As a result, the only way in which the Pillar Two changes could be implemented at an EU level is through enhanced cooperation. Unanimity is not possible as Ireland cannot constitutionally sign up to the Pillar Two Directive. Ireland would have to communicate that it has no objection to a Pillar Two Directive being introduced by enhanced cooperation but that it is not constitutionally permitted to agree to be bound by the Pillar Two Directive and so will implement the terms of Pillar Two into Ireland's domestic law via its domestic legislative process.

[1] *Pringle*, paragraph 4.19 *per* Clarke J.

This achieves the political and economic objective of Ireland implementing Pillar Two, but it has some subtle differences (in addition to being compliant with Bunreacht na hÉireann). First, the CJEU would have no jurisdiction over the Irish implementation of Pillar Two and the Irish courts would adjudicate on disputes under the legislation. This may make little practical difference as the Irish courts would undoubtedly adopt a similar interpretative approach as the CJEU. Secondly, a future (directly elected) Dáil Éireann could amend the legislation to attune it to the future needs of Ireland without the need to obtain agreement to a new EU directive.

In light of the concerns expressed above and in order to be of assistance, we are also providing a copy of these responses to the Office of the Attorney General given the Attorney Generals' role as guardian of the Constitution.

2. When implementing the Rules, are there any specific issues which should be considered with respect to implications for the Irish tax code arising from US corporate tax reform proposals, with particular reference to the significance of US MNEs operating in Ireland?

In our view, Ireland should not agree to the ratification of the EU directive until the US position on Pillar Two is clear. US multinationals have a significant presence in Ireland and those businesses may be disadvantaged by a mismatch in rules between the EU and US implementation of Pillar Two. Ireland's future position as a hub for US foreign direct investment will be dependent on the proper functioning of international tax rules for US multinationals and any difficulties in applying differing Pillar Two rules across the EU and US will disproportionately affect Ireland. In particular, the co-existence and interaction of GILTI and Pillar Two remains unclear and this should be resolved before Ireland proceeds to implement Pillar Two.

3. Are there other considerations of significance that should be taken into account when implementing the Rules in domestic legislation?

In the context of proposed international tax reform, intellectual property ("**IP**") incentives are an area of key importance as part of a suite of measures to ensure that Ireland retains its competitiveness as a location for international businesses. Other measures which we have previously advocated for as part of this suite include introducing a dividend and branch profits exemption and reforming Ireland's interest deductibility rules post ATAD, (see further comments in response to Question 3).

The government should monitor other countries reactions to these measures as international tax competition is likely to increase in this area. In this context consideration should be given to increasing the rate of the R&D tax credit, expanding what qualifies for the credit (subject to State aid rules) and to other modifications of both the Knowledge Development Box ("**KDB**") and research & development ("**R&D**") tax credits to increase the attractiveness of the Irish IP regime.

It is important that Ireland should signal its intentions in this area early as international groups are already reviewing their arrangements in the context of the OECD Pillar One and Pillar Two proposals and other proposals for international tax reform including the EU Unshell proposal.

The detailed provisions of the Pillar Two rules may determine the effectiveness of Ireland's IP incentives for international business including for example whether R&D tax credits are considered to be a "qualified refundable tax credit" for the purpose of the global minimum tax rate so that they may be treated as income (and not a reduction in taxes paid) in calculating the group's effective tax rate.

Although the application of the KDB may reduce the effective tax rate on certain profits of a company to 6.25%, it will not necessarily result in the application of the global minimum effective tax rate where (1) the company/group is not in scope of the rules; (2) the substance based carve outs apply; or (3) the other activities of the group in Ireland result in a blended rate of at least 15%. It may be the case that uncertainties with regard to the position of an in-scope group will result in the continued low uptake of

the KDB while groups work through the implications of international tax reform, but it is important that Ireland continues to offer and (where possible) improve this regime.

Ireland should also consider the interaction of Section 291A TCA with Pillar Two rules and Revenue guidance should specifically deal with this including deferred tax impacts of the effective tax rate calculation where Section 291A allowances apply.

4. Are there any amendments needed to Ireland's existing tax code to ensure that existing legislation does not result in any unintended outcomes under the Rules when they are implemented in domestic legislation?

In our view it is critical in the context of the Pillar Two implementation that Ireland's complex tax regime should be reformed. In the absence of such reform complexities and mismatches are inevitable for multinational businesses operating in Ireland. In particular our current tax and credit system for foreign dividends and branch profits and our interest relief regime are in need of urgent reform.

Foreign Dividends Credits

The complexity of the current credit system gives rise to considerable difficulties for Irish headquartered groups and foreign multinationals in claiming double tax relief. As with many of our tax provisions, the double tax relief provisions have gone through various "sticking plaster" amendments to deal with developments in this area including EU case law. The result of this approach is that the current system includes a myriad of rates and reliefs applicable to foreign income and the complexity of this system, which requires the tracing of the source of the foreign dividends and related tax credits, creates significant uncertainty for these groups. Where the quantum of such income is significant, this can represent an unacceptable tax exposure for a multinational group even though the current regime is not (and should not be) a significant revenue generator for the Irish exchequer. In addition, even where there is reasonable certainty with regard to the availability of tax credits, there is a significant compliance burden associated with calculating and evidencing the available credits and maintaining appropriate records.

Irish holding companies have already waited a long time for this regime to be implemented and any further delays could be detrimental to Ireland's competitiveness as a holding company location. Various reasons for the delay have been given by Government, including that Ireland did not have a CFC regime, that Ireland did not have a broadly applicable transfer pricing regime or that there was insufficient time or capacity in Government to implement it, notwithstanding that the introduction of CFC rules and broadly based transfer pricing rules were well flagged in advance of their introduction. There are now no barriers to the introduction of a full exemption system so there is no reason to delay. All that is being requested is to conform the Irish system to an international norm: an exemption system for foreign dividends and branches.

We appreciate that with international and EU tax proposals such as the ATAD, OECD Pillar One and Pillar Two proposals and the new EU Unshell proposal, the resources of the Department of Finance and the Revenue Commissioners have been and continue to be constrained. However, the implementation of these proposals should be seen as an additional reason for the immediate introduction of a full exemption system rather than a barrier to it. Layering these measures over Ireland's unusual tax regime (it differs from most EU/OECD countries) is likely to cause additional complexity and potential mismatches in applying the Irish tax rules so, we believe, will utilise greater resources of the Department of Finance and the Revenue Commissioners.

This international tax reform will influence decision-making within multinational groups. For example, holding companies are becoming increasingly linked to other business activities with significant employment due to substance rules (including most recently the EU Unshell proposal). As a result, Ireland risks losing businesses providing employment in Ireland if its holding company regime is not competitive with other EU and OECD countries.

The OECD model Pillar Two rules and the Pillar Two Directive provide that dividends, other than short-term portfolio dividends, are generally excluded for the purpose of the global minimum tax calculation which is consistent with a participation exemption regime.

In addition, a permanent establishment is treated as a "constituent entity" for the purpose of calculating the minimum effective tax rate and the model rules and draft directive include provisions for allocating income between the main entity and the permanent establishment. Accordingly, a failure to exempt branches and introduce a participation exemption for dividends will cause problems as it is out of step with the design of Pillar Two. A failure to exempt EU branches is also in breach of *ICI v Colmer.*[2]

Interest Deductibility Rules

In addition, we have long advocated for a complete restructuring of the Irish interest relief regime. It is a consistent message when discussing these issues with our clients that Ireland's regime is already more restrictive than most other EU countries. In our view, Ireland should move to a genuine commercial purpose test, subject to the normal restrictions such as transfer pricing, anti-hybrid, interest limitation and general anti-avoidance rules. A group consolidation regime would also simplify the ability to claim interest relief in a group context and is common in other EU countries. Without a consolidation regime, it is necessary to retain a deduction for debt used to acquire shares otherwise it will not be economically viable to use normal commercial third party debt to fund an acquisition of an Irish company.

Questions 5-15

Questions 5-15 of the consultation deal with the implementation of the computational aspects of the Pillar Two rules. We have no comments on the specific questions raised but in our view the following points should be borne in mind in Ireland's implementation.

- It is essential that the implementing legislation and guidance is clear, unambiguous, administrable, and consistently applied.

- Given the technical nature of the Pillar Two rules and the possible impact on large corporate groups multinationals with an Irish presence, we would welcome the early publication of feedback statements and Revenue guidance, with adequate opportunity for meaningful engagement with stakeholders.

- If Ireland signs up to the Pillar Two Directive, Ireland is unlikely to have much optionality in how these rules are implemented and, therefore, early Revenue guidance on Ireland's interpretation of the rules will be of equal importance.

- Given that these rules will be based on OECD rules and an EU Directive, it will be of critical importance that Ireland's implementation minimises any mismatches in interpretation between the rules as they are implemented in other OECD and EU countries.

- As a simplification measure, consideration should be given to allowing in-scope groups to elect to pay their Irish corporation tax based on the Pillar Two rules rather than having to compute Irish tax based on one set of rules and then topping up to the 15% Pillar Two rate.

Qualified Refundable Tax Credits

16. Do you have any comments on the potential interaction of tax credit provisions, as currently set out in the corporation tax code, with the definition of "Qualified Refundable Tax Credit"?

[2] Case C-264/96.

It is important in the context of Ireland's competitiveness that the Irish R&D Tax Credit is considered a "qualified refundable tax credit" for the purposes of the Pillar Two rules so that in-scope multinationals are not subject to a disadvantageous treatment under those rules.

To meet the criteria of a "qualified refundable tax credit", the credit must be paid as cash or available as cash equivalents within four years from when the company is eligible to claim it.

Ireland's R&D Tax Credit is offset against a company's corporation tax liability for a particular year. If the company is not paying enough tax in any year to offset the R&D Tax Credit in full, it can first forward indefinitely or can be allocated to another member of the group. If the company exhausts all these options and there is still a surplus credit, it can make a claim to have that excess paid to it in cash by Revenue in three instalments over a period of 33 months.

Even though the Irish rules provide for a cash refund of surplus R&D Tax Credits within the 4-year timeframe stipulated by the OECD Pillar Two Model rules, the refund mechanism only applies to surplus credits and often, companies eligible for such refunds do not receive the cash due within the 33-month period.

Therefore, we believe a legislative amendment is necessary to ensure Ireland's R&D Tax Credit is fully compliant with the criteria for a "qualified refundable tax credit" in the OECD Pillar Two rules, such that refunds are mandated to be paid within the four years even in situations where a claim is subject to an open Revenue Compliance Intervention at the time. Of course, the legislation should provide for a clawback of any amount of the repaid R&D Tax Credit that may be determined to be incorrectly claimed following the completion of the review.

Qualified Domestic Top-up Tax ("QDTUT")

17. In your view, should a QDTUT be implemented by Ireland? If so, what should be the features of such a QDTUT and how should it operate? In particular, please provide your view on the charging and administrative rules that should apply.

For example, could a QDTUT form part of the corporation tax liability of a company and be returned as part of the corporation tax return? How should the jurisdictional calculation of the QDTUT be addressed in return filings, particularly where entities in an MNE group in scope in Ireland might have different intermediate parents?

Ireland should adopt a QDTUT but as signaled by the Department of Finance the 12.5% rate should be retained for those groups that are not in scope of Pillar Two. It is important that Ireland continues to reaffirm its commitment to this rate as many businesses are not within scope of Pillar Two and the messaging should be clear that the 12.5% rate will remain available. The QDTUT should apply only where the IIR or UTPR would apply to entities within the group so that there should be no incremental tax for in-scope groups on a global basis.

We consider that the inclusion of the QDTUT in the corporation tax returns for a period would be difficult on the basis that additional calculations and reporting will be required under the Pillar Two rules within 15 months of the period end and it may be difficult for Irish groups to have all required information by the 9 month deadline for corporation tax filings and aligning the dates would be a significant burden for businesses. In our view the deadline for any QDTUT filing and payments should be based on the 15 month deadline either by means of a supplementary return or by extending the corporation tax filing deadline for in-scope groups. Only one group return should be required for in-scope groups.

Given the uncertainties arising in respect of the Pillar Two calculations (particularly in the initial years) we would consider that it would be reasonable that:

1. The QDTUT should not form part of the corporation tax liability for a period for preliminary tax purposes.
2. Interest on late payment of QDTUT should not arise in the event that an insufficient payment is made by the payment deadline where the underpayment is:
   - Not more than 20% of the final assessed amount, or
   - If more than 20%, the underpayment arises based on calculations which were prepared in good faith based on available law and guidelines at that time.
3. Penalties for incorrect returns should not be levied where either of the two conditions above are met.

Administration – Payment and Filing

18. Do you have any views on how the reporting obligations of entities that are in scope of the Rules, should be satisfied?

Ireland should allow the maximum 15 month reporting deadline as prescribed by the Pillar Two Directive. The reporting should be made on one group return for in-scope groups.

19. How should liabilities arising under the IIR or UTPR be reported and paid/collected? Do you have any views on the frequency of such payments and the deadlines that should apply?

Liabilities should be collected annually via the Revenue Online System following the 15 month reporting deadline. Given the uncertainties arising in respect of the Pillar Two calculations (particularly in the initial years) we would consider that it would be reasonable that:

1. any payment arising under the Pillar Two Directive should not form part of the corporation tax liability for a period for preliminary tax purposes;
2. interest on late payment of any such amount should not arise in the event that an insufficient payment is made by the payment deadline where the underpayment is:
   - not more than 20% of the final assessed amount; or
   - if more than 20%, the underpayment arises based on calculations which were prepared in good faith based on available law and guidelines at that time; and
3. penalties for incorrect returns should not be levied where either of the conditions at 2 above are met.

20. Do you have any views on whether Irish constituent entities should be made joint and severally liable for any Irish GloBE liabilities of the Irish constituent entities of the same MNE Group? In this regard, would you differentiate between IIR liabilities and UTPR liabilities?

We would not favour joint and several liability for Irish liabilities of the Irish constituent entities of the same multinational group. Joint and several liability which applies to VAT groups can result in unnecessary complexity in M&A transactions where companies which would not otherwise have had a liability to VAT assume responsibilities of other group companies. In our view Ireland's implementation of the Pillar Two Directive should allow groups to opt out of joint and several liability where constituent entities in the group agree to the split of the group's top-up for which each entity

should be liable. This should allow the liability of any company to be limited to its share of the top-up tax.

21. Do you have any views on whether Irish constituent entities should be made joint and severally liable for the QDTUT (if Ireland were to adopt such a provision) of the Irish constituent entities of the same MNE Group?

See our answer to question 20 above.

22. What group entity should be made initially liable for paying UTPR tax? Is your answer dependent on whether UTPR tax is collected by way of denial of deduction or direct charge?

Each group should nominate the entity which should be made initially liable for the UTPR tax.

Transition Rules

23. Are there any aspects of the Transition Rules that require further clarification in domestic legislation?

We have no comments on this question.

Subject to Tax Rule ('STTR')

24. Should amendments to any domestic legislation be considered to address potential application of, or interactions with, the STTR?

The STTR is a proposed treaty-based rule that allows source jurisdictions to impose source taxation on certain related party payments subject to tax below a minimum rate. The proposed minimum rate is 9%. On the basis that Ireland's corporation tax rates are 12.5% and 25% the STTR should generally not be applicable for payments made to Irish tax resident companies.

The STTR may have implications for those companies availing of the KDB as the effective tax rate of activities benefiting from the KDB is 6.25%. However, as the uptake of the KDB has been low to date this may not be a significant issue in practice.

Also, it is currently unclear whether payments made to companies benefiting from a lower rate due to the application of an IP incentive regime which meets the OECD's modified nexus standard will be affected by the STTR. This position should be monitored. To the extent that a lower rate of KDB relief is being considered to avoid the application of the STTR, consideration should also be given to broadening the relief (for example by allowing gains on the disposal of IP to fall within the regime) and, in our view, such extension of the relief should be considered in any event.

Large Scale Domestic Groups

25. The proposed Directive on Pillar Two will also apply to large-scale domestic groups. Are there any aspects of the application of the Rules to large-scale domestic groups that require further clarification in domestic legislation?

EU competence does not extend to solely domestic matters. From a jurisdictional and constitutional perspective, it is difficult to see how the executive branch of government could agree to the inclusion of a solely domestic rule in EU legislation.

Please do not hesitate to contact us to discuss any of the points raised.

Yours faithfully

ARTHUR COX