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

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

By email to: businesstaxpolicy@finance.gov.ie

RE: Response to the Feedback Statement containing the strawman proposal for a participation exemption for foreign dividends

A Chara,

We welcome this opportunity to comment on the framework for a new participation exemption regime for foreign dividends. Arthur Cox, along with clients and other advisers, have engaged continuously with the Department in recent years to demonstrate the importance of introducing the participation exemption for foreign dividends, and while we reiterate our concern as to the loss of Ireland's tax competitiveness from a delay in its introduction, we welcome the commitment from the Department and the steps being taken to ensure its introduction from 1 January 2025.

We note that the Department has taken into account many of the comments and views of stakeholders from the previous consultation conducted in December 2023 that the new participation exemption must be as broad, competitive, and simple as possible. A 100% exemption is welcome however, we stress that it must be part of a regime that is otherwise as broad and easy to administer as possible. As we set out in our submission below, Ireland is an open economy that relies heavily on foreign direct investment and capital importation, it is imperative that the Irish tax regime remains competitive for maintaining and attracting investment. Since most capital is imported into Ireland, the return generated when that capital is exported outside Ireland should not be taxed in Ireland. This principle should inform the Department of Finance's approach to the relief.

Equally the Department must consider the loss of Ireland's tax competitiveness in light of Pillar Two both in terms of rate differential and the administrative burden of compliance on Irish headquartered in-scope groups. In a post Pillar Two environment in-scope groups are assessing their global operations and a full and simple participation exemption that will allow the repatriation of profits to facilitate further investment in Irish operations is the preferred approach for both taxpayers and the continuing growth of the Irish economy.

As we set out in our submission, in order to achieve the aim of implementing a simple and easy to administer regime, the following must be considered when drafting proposed legislation:

- The geographic scope should not be limited to dividends received from EU /EEA or jurisdictions with which Ireland has a double taxation agreement. As set out in our previous submission, this exemption is being introduced into a tax code that already has the full suite of ATAD compliant anti-avoidance measures thereby mitigating the need for restrictions based on geographic scope. If a geographic limitation is to be included it should be confined to the EU list of non-cooperative jurisdictions.

- The new regime should be the default, with an option to elect into the existing foreign tax credit system contained in Schedule 24 of the Taxes Consolidation Act 1997 ("TCA"). The election should not be imposed for a 3-year period but on a dividend-by-dividend basis.

- We welcome a broad scope inclusion of the nature of in-scope dividends / distributions. As outlined in our previous submission, it is vital that unnecessary complications are not included in this legislation, and in light of the fact that it is possible for distributions to arise in respect of other classes of shares (including preference shares) the proposed scope is the preferred approach.

- We do not believe that a distinction should be drawn so as to exclude capital distributions for reasons set out below in our submission, namely that a distinction based on concepts that are not internationally recognised leads to tax uncertainty and problems in application for both taxpayers and tax authorities. We also note that the UK initially had the distinction, however, removed the distinction to be applicable regardless of whether the distribution is income or capital in nature.

We believe that this is the sensible time to modernise and simplify section 626B TCA and Schedule 24 TCA. We take this opportunity to again reiterate the urgent need to simplify the rules on interest deductibility that no longer have a policy rationale. Ireland has one of the most restrictive and counter-intuitive regimes for interest deductibility internationally. Now that Pillar Two is in force and its interest deductibility rules align with normal international principles, the overly restrictive Irish rules create mismatches. A simple solution would be to align the computation of the Irish domestic corporation tax liabilities of Irish groups within scope of Pillar Two with Pillar Two rules, so mismatches do not occur between the Irish QDTT and Irish domestic corporation tax rules.

We set out in more detail our responses to the points raised in the Strawman Proposal at Appendix 1 below. We would be very happy to engage in further discussions on any of the issues contained therein.

Yours faithfully

Arthur Cox LLP

ARTHUR COX LLP

APPENDIX 1

RESPONSE TO STRAWMAN PROPOSAL FIRST FEEDBACK STATEMENT		
1.	**SCOPE OF THE RELIEF**	
	(a)	**The Relief will be provided in the form of an exemption from corporation tax. Where qualifying criteria are satisfied, 100% of the dividend will be in scope.**
		AC Comment: We welcome that the Department took into consideration the comments provided in the previous public consultation that the new participation exemption must be as broad, competitive, and simple as possible. Therefore, 100% is welcome but must be part of a regime that is otherwise as broad and easy to administer as possible.
	(b)	**Entities in scope – the regime will apply to companies within the charge to Irish corporation tax. This includes Irish resident companies and certain non-resident companies carrying on a trade in the State through a branch or agency.**
		AC Comment: Ireland is an open economy that relies heavily on foreign direct investment and capital importation, it is imperative that the Irish tax regime remains competitive for maintaining and attracting investment. In relation to the entities in scope, having a broad scope for eligible entities is desirable. Since most capital is imported into Ireland, the return generated when that capital is exported outside Ireland should not be taxed in Ireland. This principle should inform the Department of Finance's approach to the relief.
	(c)	**Qualification for the regime – companies will have flexibility to opt in to the participation exemption regime, with an election to apply for a minimum period of 3 years. The election would apply in respect of all potentially in-scope foreign dividends received by the company during the period in which it is elected into the exemption.**
		AC Comment: In light of the necessity to ensure a competitive, and easily administrable system, the proposed 3-year rule adds an additional layer of complexity. As stated in our previous submission, an election based on a dividend-by-dividend basis is preferable. The current Schedule 24 TCA effectively allows relief on a dividend-by-dividend basis. In addition, as set out in the previous submission, given the similarities in the tax systems, and the generally positive view of the UK participation exemption regime, it should be a useful model from which to guide some policy choices in this iterative process. In this instance, it is instructive that the UK legislation allows very broad-based elections to be made, including on a distribution-by-distribution basis, with the overarching criterion being that the election clearly identifies the distributions to which it applies unambiguously. Ireland has lost tax competitiveness due the introduction of complex rules (ILR, anti-hybrid etc.) over uncommercial and dated rules (such as section 247 TCA etc.) as well as conceding its tax rate as part of acceding to the EU Council Directive 2022/2523 implementing the OECD Pillar Two Model Rules ("Pillar Two").

		Accordingly, a broad-based exemption, with limited eligibility conditions is essential to mitigate this. In a post Pillar Two environment these companies are assessing their global operations and a full and simple participation exemption that will allow the repatriation of profits to facilitate further investment in their operations is the preferred approach for both taxpayers and the continuing growth of the Irish economy.
	(d)	**Geographic scope – dividends received from companies that are resident for tax purposes in the EU/EEA or jurisdictions with which Ireland has a double taxation agreement will qualify.**
		AC Comment: For the reasons set out in out in our previous submission, the geographic scope should not be restricted as is currently proposed in the strawman (in addition to the reasons set out above in relation to the importation of capital). If a restriction is imposed, it should be limited to those jurisdictions on the EU list of non-cooperative jurisdictions. The Strawman proposal states that the purpose of this is to protect against the use of the regime for double non-taxation. Given the existence of anti-avoidance measures transposing the EU Anti-tax Avoidance Directives 1 & 2 ("ATAD") already in the Irish tax system, in addition to Pillar Two regime in many jurisdictions globally, this policy rationale is not a valid one. If, however, a limitation is seen as unavoidable, then one based on the EU list of non-cooperative jurisdictions should be imposed. In all circumstances, the exemption should be applicable to companies within scope of Pillar Two through the Qualifying Domestic Top-up Tax ("QDTT"), Income Inclusion Rules ("IIR") or Undertaxed Profit Rules ("UTPR"). We also note that the alternative system contained in Schedule 24 TCA applies regardless of the source jurisdiction so for ease of application between both systems and for consistency the same principles should apply, so far as is practicable.
	(e)	**Profits in scope – qualification will not be restricted to dividends derived from trading profits.**
		AC Comment: The distinction based on trading profits that is evident in Irish tax legislation causes confusion internationally and uncertainty as to the operation of the relief. For the reasons outlined above, this is not desirable. The delineation of income between trading and passive is not an internationally recognised one and given its complexity causes undue confusion and uncertainty. It is therefore welcome that the proposal envisages broad application that dispenses with the limitation to trading profits / entities.
	(f)	**Where the exemption is availed of, a tax credit will not be available in respect of foreign tax paid on the foreign dividend.**
		AC Comment: This is reasonable.

2.	DIVIDENDS / DISTRIBUTIONS IN SCOPE
(a)	**The exemption will apply to foreign dividends and other types of distributions that represent income from shares or from other rights, not being debt claims, to participate in a company's profits. This includes income from other corporate rights which is subjected to the same tax treatment as income from shares by the laws of the State of which the company making the distribution is resident.**
	AC Comment: (a) We welcome a broad scope inclusion of the nature of in-scope dividends / distributions. As outlined in our previous submission, and as stated above, it is vital that unnecessary complications are not included in this legislation, and in light of the fact that it is possible for distributions to arise in respect of other classes of shares (including preference shares) the proposed scope is the preferred approach.
(b)	**In broad terms, relief will apply to distributions in the nature of income, such that "capital distributions" within the meaning of section 583 TCA 1997 would not qualify (e.g. a distribution in the course of dissolving or winding up a company).**
	AC Comment: We do not believe that capital distributions should be outside the scope. As outlined in our previous submission, the UK initially had the distinction, and did not extend their exemption to both, however, removed the distinction to be applicable regardless of whether the distribution is income or capital in nature. The fundamental principles of our tax code and company law have distinguished between capital and profit (traditionally income). From a company law perspective, traditionally, capital was not distributable, however, profit/income was. In the Companies Act 1963, share premium was made non-distributable in Ireland. The theory was that it was part of the capital of the company. All of these capital/income distinctions are rules originating from old trust law concepts. In the intervening centuries (in the case of case law) or decades (in the case of Company Law) the conceptual nature of capital/profit has changed. In accounting standards, the concept of "income" includes both revenue and capital items (as understood for tax purposes). Equity can be accounted for as debt and vice versa. The introduction of capital reduction by way of summary approval procedure has fundamentally changed the nature of the ability of Irish companies to distribute funds. This issue is exacerbated by the fact that many countries permit the distribution of share premium (as Ireland did until several decades ago), have the ability to distribute profit by means of directors' resolution, or simply by applying a solvency test thereby eliminating the capital/profit distinction. We note that the feedback statement continues to address the distinction between capital and income to non-Irish companies, thereby presumably applying Irish tax rules to classifications based on the foreign company and trust law principle (in line with the UK case of *Rae v Lazard Investment Co Ltd*). This is done by way of applying an exemption under section 626B TCA to capital distributions and an exemption under the new participation exemption for foreign dividends to dividends out of profits. This gives rise to several problems, most notably:

- Deciphering what constitutes income and capital? There is a long line of case law in which it is acknowledged that this is an arbitrary distinction with a line to be drawn based on the facts and circumstances of any case. It is unclear why the introduction of such uncertainty into a new Irish tax exemption is necessary. Many other jurisdictions simply do not have a distinction between income and capital (e.g. most civil law jurisdictions) as it is rooted in common law trust concepts which do not apply in those jurisdictions. The result is that we will be asking civil law jurisdictions to give views on an ancient common law concept with which they have no familiarity. This will lead to lack of clarity, and tax uncertainty. An example of the difficulty of applying foreign legal constructs to domestic tax legislation is evident in legal entity classification.

- The conditions for the exemption in section 626B TCA and the new dividend participation exemption will be different. The main difference seems to be the trading test which applies to section 626B TCA. As discussed above, and in our previous submission, the concept of "trading" is an alien notion outside of certain limited number of common law jurisdictions. Its inclusion therefore, only results in complexity and uncertainty.

  In addition, the retention of the trading requirement in section 626B TCA with the lack of a trading requirement in relation to dividend participations will inevitably lead to disputes over which exemption applies. These disputes will consume resources of taxpayers and the revenue commissioners for no benefit. Accordingly, in conjunction with the introduction of the dividend participation exemption we would strongly recommend the removal of the trading concept for Section 626B. If that is not acceptable, we would recommend that the reasons as to policy rationale underpinning the decision be explained. In any event, a halfway house (although not achieving the correct policy objective but going some way there) could be achieved by adding to the trading test in section 626B TCA that the test can be applied at the consolidated level of the UPE under Pillar Two purposes. This would align our participation exemption with Pillar Two concepts.

- The final point on this is that if the dividend participation exemption applies to dividends from profits and the capital gains tax exemption applies to capital distributions what regime applies to income distributions not from profits? This is a fundamental conceptual gap in the framework. The simple solution is, as noted above, to align section 626B TCA with the dividend participation exemption and to apply the full exemption to all forms of distributions/realisations from companies whether of a capital or income nature. This could be achieved simply by removing the reference to profits in the dividend participation exemption and simply refer to income arising from securities (please note this is referred to in paragraph (e) of case III of Schedule D TCA). It would not include interest on debt claims, nor would it include any income from securities that were deductible due to anti-hybrid rules. This would deny the participation exemption with the charged tax and therefore avoid mismatches as mentioned above.

	(c)	**Qualification for the exemption will be established by reference to a minimum level of control over the ordinary shares of the foreign subsidiary. Where that qualification has been established, the exemption may also apply in respect of dividends received from that company on other types of shares, such as preference shares. This may require anti-avoidance provisions against artificial arrangements, similar to section 138 TCA 1997 for example**
		AC Comment: This is a reasonable approach.
	(d)	**Companies must control at least 5% of the ordinary share capital for an un-interrupted period of twelve months up to and including the date of the dividend. Dividends in respect of newly acquired participations may also qualify provided the shares are subsequently held for a period of up to twelve months after the date of the dividend (i.e. a minimum overall holding period of twelve months).**
		AC Comment: The minimum holding interest of 5% is acceptable and in line with the alternate system of Schedule 24 TCA and while we do not believe that section 626B TCA should be the model on which to base this participation exemption, we note that the 5% is in line with it. The criteria for the establishment of this ownership right appears reasonable. However, we question the necessity for the holding period of an uninterrupted period of 12 months. As stated previously, a critical element of this new regime is simplification, particularly for companies within the scope of Pillar 2, it should align with Pillar 2 and not have minimum holding requirements. At the very least, companies within the scope of Pillar 2 should not have to satisfy minimum holding requirements.
	(e)	**The 5% control test will be established by reference to up to four criteria; ownership of ordinary share capital (direct or indirect); holding of voting rights; entitlement to profits available for distribution; and entitlement to assets on a winding-up of the company.**
		AC Comment: This is a reasonable approach, and we have no further comment.
	(f)	**The availability of a participation exemption as set out above is not intended to impact existing provisions relating to portfolio investments in section 21B TCA 1997.**
		AC Comment: This is a reasonable approach, and we have no further comment.

3.	**ANTI-AVOIDANCE**	
	(a)	**The dividend must not be deductible for tax purposes in any other jurisdiction.**
		AC Comment: As outlined in the feedback statement, most respondents to the previous consultation noted that an appropriate anti-avoidance measure would be one that denied the exemption for foreign dividends where a deduction for the dividend is claimed in the payer's jurisdiction. This is therefore a reasonable provision in principle; however, it will need to be aligned with the anti-hybrid rules. The correct order of priority needs to be considered so that in the first instance the payer jurisdiction should be entitled to deny the availability of the deduction, and then essentially this rule would apply when the payer jurisdiction does not have anti-hybrid rules that are in line with the OECD BEPS Action 2 Final Report.
	(b)	**Dividends received from a jurisdiction on the EU list of non-cooperative jurisdictions for tax purposes, as reflected in the TCA 1997 on the date of the dividend, will not qualify for relief.**
		AC Comment: As noted in our previous submission, and above, we believe that rather than being an anti-avoidance measure, this should be the criterion to delineate the territorial scope of the participation exemption, rather than that proposal above to only include dividends received from companies that are resident for tax purposes in the EU/EEA or jurisdictions with which Ireland has a double taxation agreement will qualify.
	(c)	**Relief will apply only in respect of the payment of a dividend where it would be reasonable to consider that the payment is made for bona fide commercial purposes and does not form part of any arrangement or scheme of which the main purpose, or one of the main purposes, is the avoidance of tax.**
		AC Comment: We believe this is a reasonable specific anti-avoidance provision to include, although noting that the existence of the general anti-avoidance contained in section 811C TCA will also provide protection.
4.	**ADMINISTRATION**	
	(a)	**Relief will be available in respect of dividends received in accounting periods commencing on or after 1 January 2025.**
		AC Comment: In line with our position that the exemption should apply on a dividend / distribution basis, it should be applicable for the receipt of any dividend or distribution on or after 1 January 2025, regardless of the accounting year end of the recipient in Ireland.

	(b)	**The election to avail of the participation exemption will be made via the Form CT1 corporation tax return and will apply for a minimum period of 3 years in respect of all qualifying dividends received by the company. An election cannot be revoked once made.**
		AC Comment: As noted above, we do not believe the election should be for 3 years as this is overly restrictive, we believe that the election should be made on a dividend-by-dividend basis.
	(c)	**Companies will be required to report foreign dividends subject to exemption as part of the CT1 return.**
		AC Comment: The participation exemption should be the default position, but the information on the dividends / distribution can be included in the CT1.
	(d)	**The existing Schedule 24 TCA provisions will continue to operate as normal for distributions not in scope of the exemption.**
		AC Comment: The participation exemption should be the default position, however, the company receiving the distribution should be able to elect into the credit system under Schedule 24 TCA 1997 on a distribution by distribution basis similar to the position in the UK which is very flexible so long as the underpinning criterion that the distribution is easily identifiable is satisfied.
	(e)	**A company that elects into the participation exemption may have an amount of the unrelieved foreign tax credit carrying forward at the time of the election. This credit would remain available for offset under Schedule 24 TCA provisions against distributions not in scope of the exemption, or for use in future years if the company ceases to elect into the participation exemption regime.**
		AC Comment: If the approach in (d) is taken this, or any other transitional measures will be less necessary.
5.	**CONSIDERATIONS RELEVANT TO THE STRAWMAN APPROACH**	
	5.1	**Transitional measures**
		AC Comment: As acknowledged in the feedback statement, and noted above, the necessity for transitional measures would be more limited if an election system is imposed.

5.2 Necessary corresponding changes to TCA

AC Comment:

In respect of any specific corresponding changes, we believe these can more accurately be discussed once draft legislation is circulated in the next Feedback Statement.

6. CONSEQUENTIAL IMPACTS AND CONSIDERATIONS

AC Comment:

In addition to the participation exemption, further strengthening of the Irish tax system is necessary. This is an ideal time to modernise and simplify Schedule 24 TCA and section 626B TCA. In terms of the broader tax landscape, the most urgent change is a modernisation and simplification of the archaic, draconian, and complex interest deductibility rules. Ireland now has one of the most restrictive interest regimes in Europe and it is impeding companies investing further in their operation in Ireland, to the detriment of the Irish economy more generally.

The Irish interest deductibility rules are based on Victorian concepts of social class (the trading distinction). They are overly complicated, restrictive, and contain vast sways of anti-avoidance rules which do not interact well with each other. As noted by the Department of Finance around the time of the introduction of the interest limitation rules pursuant to ATAD, the existing suite of Irish anti-avoidance rules are equivalent to an interest limitation rule. In addition, many of the distribution rules are addressed by anti-hybrid rules. At that point, in addition, the Pillar 2 rules were overlaid on top of a complex and out of date system. The Pillar 2 rules also contain anti-hybrid rules, an arms-length test, a dividend participation exemption, a participation exemption on gains and other measures that are functionally equivalent although different in detail to the Irish rules. The failure to simplify the tax legislation has long-term consequences. In order to align and simplify the Irish tax system for large companies (where the complexity largely rests) there is a simple solution. The simple solution is to enable Irish companies within scope of Pillar 2 to dispense with the computation of tax under the Irish domestic tax rules and simply apply the rules applicable when carrying out the QDTT obligations under the Pillar 2 rules, for the domestic tax return. It is difficult to understand how this would negatively impact Ireland as the Pillar 2 rate is 15% whereas the trading rate is 12.5%. We do not believe that State aid would be a concern as this regime would be available to all entities within Pillar 2 and those entities are already treated differently to entities not within Pillar 2 so there is no preferential treatment or tax advantage arising. In order to completely eliminate any State aid concerns, those companies not within scope could be given the opportunity to elect into the regime (which in reality would not happen given the administrative complexity and cost).