Public Consultation on the introduction of a participation exemption(s) to the Irish corporation tax system

Submission from the American Chamber of Commerce Ireland (AmCham) to the Department of Finance

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The American Chamber of Commerce Ireland
The Voice of US-Ireland Business

The American Chamber of Commerce Ireland (AmCham) is the collective voice of US companies in Ireland and the leading international business organisation supporting the Transatlantic business relationship. Our members are the Irish operations of all the major US companies in every sector present here, Irish companies with operations in the United States and organisations with close linkages to US-Ireland trade and investment.

Executive Summary

AmCham welcomes the firm commitment by the Minister to introduce a participation exemption for both dividends and branch profits. As noted by the Minister, Ireland is an international outlier with regards to the taxation of foreign dividends, and as such the introduction of a participation exemption is overdue. It is essential that the regime is best in class, and it should not be seen as a revenue raiser for Ireland. As the Irish and UK tax codes have broad similarities, AmCham recommends that Ireland should adopt a regime comparable to that of the UK, which was introduced in 2009. In addition, given the complexities of the Irish tax regime, AmCham recommends that the existing mechanism for the taxation of foreign sourced dividends and branch profits is retained on an electable basis, to ensure there are no unintended consequences with the introduction of a territorial system of taxation.

Significant feedback has already been provided in respect of the introduction of a territorial regime of taxation to the Department of Finance. As such, the vast majority of the questions posed in the current consultation have already been answered. AmCham therefore does not believe it is necessary to have two further consultations on this matter in 2024. In place of these consultations, AmCham recommends that a more robust review of the overall tax code should be undertaken, with a particular emphasis on the interest deductibility rules and the multiple tax rates (i.e., 12.5%, 15%, 25%, 33%).

Introduction

AmCham welcomes the Minister's commitment to the introduction of a participation exemption on foreign source dividends in Finance Bill 2024 and a review of Ireland's interest deductibility rules.

AmCham acknowledges Minister McGrath's comments on the roadmap to introducing a participation exemption in Ireland. Minister McGrath said:

"…this change has been a consistent ask of the foreign direct investment community because Ireland is currently an outlier in the European Union and even among OECD member countries in not having a dividend exemption in those circumstances."

"So, we will now be providing that, and I think it does offer certainty and predictability in relation to our corporate tax offering into the future for people who are investing a lot of money in Ireland."

It is critical that Ireland retains its competitive advantage and continues to attract foreign investment into Ireland.

Benefits of a Participation Exemption

One of the primary advantages of a territorial system of taxation is that it allows Irish companies to repatriate their earnings from foreign subsidiaries without triggering excessive tax obligations. This empowers businesses to reinvest profits in Ireland, facilitating innovation, expansion, and job creation. Additionally, companies can distribute dividends to shareholders without the burden of double taxation which incentivises investment. A territorial system of taxation aligns Ireland with international best practices and puts the country on a level playing field with other competitive jurisdictions. As businesses increasingly seek global opportunities, this alignment ensures that Ireland remains a relevant and attractive hub for international trade and investment.

Ireland stands to resolve a competitive disadvantage by implementing a participation exemption and transitioning to a territorial system of taxation. This policy change would ensure that Ireland is still considered as an excellent location for US MNCs and Irish headquartered companies to do business. The introduction of a territorial system of taxation would simplify administrative procedures for both companies and for Revenue. By exempting certain types of foreign income from taxation, it reduces the compliance burden on businesses, streamlines financial reporting, and tax filing processes. This efficiency is conducive to maintaining Ireland's reputation as a business-friendly destination and encourages companies to establish and expand their operations in Ireland.

AmCham is of the view that a move to a territorial system of taxation will be beneficial in reducing the complexity of the Irish tax code, and in removing a disincentive for using Ireland as a holding company jurisdiction. As several European jurisdictions (e.g. the Netherlands and Switzerland) demonstrate, there is a natural synergy between balanced tax rules dealing with investment and repatriation on the one hand, and high-skilled employment in related functions, including treasury and group IT, on the other.

A territorial regime of taxation would benefit taxpayers by ensuring certainty of treatment. The current credit system, that operates under Ireland’s worldwide taxation system, gives rise to considerable difficulties for both US MNCs operating out of Ireland and for Irish headquartered groups. The consequential record-keeping and computational requirements are burdensome, with little corresponding incremental tax yield for the Irish Exchequer.

Furthermore, the shift towards a territorial system of taxation is in closer alignment with OECD Pillar Two rules. By adhering to these international standards, Ireland would demonstrate its commitment to responsible and transparent tax practices, reinforcing its status as a trustworthy and stable location to do business. The introduction of Pillar Two rules is likely to prompt some re-evaluation of holding, financing and operational activities. This will likely result in a consolidation of activities to substance-based locations. Ireland has not historically been viewed as an attractive location for holding company activities due to the absence of a participation exemption, however, in order to continue to attract substance to Ireland, the opportunity now exists for Ireland to broaden its offering and it has the opportunity to become a 'go-to' location for holding, financing and operational structures.

The cost to the exchequer is expected to be minimal, if not zero. The introduction of an exemption system should encourage companies to reinvest their profits back into their operations, promoting investment in Ireland.

The Impact of Pillar Two Rules

The following interaction of the Pillar Two rules with the Irish domestic rules should be considered with respect to the design of the territorial system of taxation:

1. Most countries operate a participation exemption and, consequently, the Pillar Two rules effectively contain a participation exemption, i.e., the rules specifically provide that 'excluded dividends' and 'excluded equity gains or losses' should not form part of the constituent entity's GLoBE income.

   On this basis, income or gains or losses falling within the definition of an 'excluded dividend' or 'excluded equity gain or loss' that do not also fall within the scope of a domestic territorial regime, may give rise to a distortion in the effective tax rate of the relevant constituent entity.

2. Where Ireland continues to operate a worldwide system of taxation and imposes tax on dividend income, this tax will not be treated as a covered tax in computing GloBE ETR for Ireland, but for the jurisdiction in which the dividend paying entity is resident.

In this regard, the rules specifically provide that the covered taxes of a constituent entity should be reduced by the amount of current tax expense arising on income excluded from the computation of qualifying income or loss of that constituent entity (i.e., income or gains or losses falling within the definition of an ‘excluded dividend’ or ‘excluded equity gain or loss’). Given the operation of Schedule 24 TCA 1997, it may not be straightforward to identify how much of an Irish company’s tax liability is attributable to dividend income.

On the basis of the above, the preference would be for the Irish territorial regime to align with, and not to deviate far from, the definitions of ’excluded dividends’ and ‘excluded equity gains or losses’ as per Pillar Two, such that the Irish domestic provisions do not create volatility or anomalies and drive unusual results relative to Pillar Two computations of ETR.

In slightly simplified terms, the main requirement is that the dividend/distribution should not be from a Short-Term Portfolio Investment, defined as an Ownership Interest of at least 10% of the equity held for a period of at least one year. Pillar Two contains no conditions as to trading status, or income or capital treatment.

AmCham Recommendations

In moving to a territorial taxation system, AmCham is of the view it is essential that the transition is to a model which fits with the shape of Ireland’s economy, its stance on international tax generally and the existing protections now contained in the Irish tax code. It is important that the territorial system adopted by Ireland is fit for purpose.

AmCham is of the view that there will be a need for a simple process of working out if a company will qualify for an exemption. The UK's participation exemption system serves as a pertinent model for us to consider, given its long-standing and well-established approach that has proven to work for businesses and government alike. The UK transitioned from a credit system for dividends in 2009 to a broad-based participation exemption system where, subject to targeted anti-avoidance rules, companies can qualify for an exemption under a broad number of categories. The UK’s rules are designed for the particular circumstances of the UK tax system, and as such, in the context of Ireland, AmCham believes that a simpler framework of anti-avoidance rules would be appropriate.

AmCham believes that Ireland should adopt a broad-based exemption regime and one which is broader than the current Irish participation exemption rules applicable to chargeable gains. In this context, there is no reason to limit the exemption to the EU, or countries with which Ireland has a tax treaty. For commercial and business reasons, multinational groups operate in an extensive number of territories, including non-treaty and non-EU jurisdictions. The exemption should effectively recognise that Ireland does not have primary taxing rights over profits earned outside Ireland. The current international tax environment means that there is no longer any need for a worldwide tax system as a backstop, and especially not one which makes such a distinction. Accordingly, any new regime should not disregard the importance multinational groups place on the ability to repatriate profits from such territories by excluding same from scope.

For similar reasons, AmCham believes it would be unwise to use the Irish domestic tax concept of ‘trading’ to frame access to the exemption. ‘Trading’ is a concept which is largely unique to the Irish tax code relative to Ireland’s OECD counterparts. Under the current rules, the application of a ‘trading’ clause requires businesses to assess the foreign operations through an Irish lens. As the analysis is based on archaic caselaw which does not always reflect how modern business operates, and makes broad based assumptions in respect of same, the inclusion of a ‘trading’ requirement would complicate any new regime, leading to uncertainty for businesses. Building on the points above, AmCham believes that the participation exemption in Section 626B TCA 1997 should also be assessed as part of wider revisions to the Irish corporate tax code. In this respect, AmCham would like to see the participation exemption widened to align with the anticipated dividend exemption regime.

AmCham does not believe the exemption should be limited to distributions from any one class of shares. There are a number of different mechanisms through which an interest in an entity can be held and through which the holder of that interest can become entitled to receive a distribution, e.g., ordinary shares, preference shares, redeemable share capital, profit sharing certificates, etc. To ensure Ireland adopts a broad-based regime and does not differentiate one holding from another, income from all classes of shares should be eligible for the exemption.

The exemption should not distinguish between 'income' and ‘capital' distributions. The need to apply this largely case law driven distinction is a complicated exercise which overlooks business reality and applying a distinction would disregard the policy rationale for the exemption.

The regime should allow for a degree of optionality by providing an ‘opt in’ election to taxpayers. The existing rules in Schedule 24 should therefore be amended to provide greater simplification and certainty to businesses who choose this option. Ireland already has extensive anti-avoidance rules and therefore additional provisions, if any, introduced as part of the new regime should be drafted so as to narrowly target the specific abuse or risk to the Irish exchequer.

Appendix

AmCham aims to provide the context of the path leading to this point, underscore the advantages of expeditious implementation of this legislation, and highlight the critical technical issues that should be reflected in the legislation.

The recommendations from the Coffey Report have played a pivotal role in shaping the discussion on Ireland's corporate tax code. Seamus Coffey's 2017 review highlighted the need to consider introducing a participation exemption for foreign dividends and foreign branch profits in the Irish tax code. This proposal was a response to a broader government initiative that sought an independent expert's insights into Ireland's corporate taxation system. Mr. Seamus Coffey's appointment in October 2016, led to a comprehensive six-week consultation period, which concluded in April 2017.

The European Union's Anti-Tax Avoidance Directive (EU ATAD) had already imposed requirements on Ireland, including the introduction of a Controlled Foreign Company (CFC) regime by 1 January 2019. In response, the Coffey Report recommended a shift from a worldwide system of taxation to a territorial system, alongside the introduction of a participation exemption on foreign dividends and branch profits or amendments to the double tax relief provisions. These changes were viewed as essential to maintain Ireland's competitiveness and adapt to international tax standards.

In 2018, the Department of Finance published "Ireland's Corporation Tax Roadmap" outlining Ireland's commitment to implementing EU Directives, OECD BEPS reports, and recommendations from the Coffey Report. While this marked significant progress, the roadmap also created expectations for future reforms in the country's tax framework, building a foundation for forthcoming changes.

In a consultation conducted by the Department of Finance in March 2022, technical concerns were raised by AmCham and tax firms. AmCham outlined the need for adequate resources to be allocated for a transition to a territorial system of tax.

"AmCham is aware that Pillar Two, and its associated timeframe, requires the focus of Department of Finance resources, however, it is AmCham's view that there is an urgent need for a transition to a territorial system of taxation... As such, it should be a priority for the Department to make resources available to advance the required changes to support the transition."

In 2023, AmCham advocated in a number of consultations to the Department of Finance that the introduction of a territorial system of taxation should be prioritised. For example, in June 2023, in advance of the Finance Bill, AmCham stated:

"AmCham strongly advocates for Ireland to transition to a territorial tax regime... AmCham recommends increasing resourcing in relevant government departments, especially the Department of Finance, to effectively support the implementation of international tax changes and facilitate a transition to a territorial system of taxation."

AmCham acknowledges that the current roadmap outlined by the Department will aim for a transition to a territorial tax system on 1 January 2025. AmCham believes that a lengthy roadmap is not required at this point as the change is not particularly complicated. AmCham welcomes the introduction of the participation exemption and looks forward to working with the Department of Finance going forward with a view to enhancing and improving Ireland's corporate tax code in the future.