Feedback Statement on New Taxation Measures to apply to Outbound Payments

Department of Finance

3 August 2023

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1. Introduction

1.1 The Law Society of Ireland (Society), as the educational, representative, and co-regulatory body for the solicitors' profession in Ireland, welcomes the opportunity to make observations in relation to the draft legislative approaches included in section 2 of the Department of Finance Feedback Statement of July 2023.

The observations are drawn from the Law Society Taxation Committee and, as ever, the Society remains available to meet with the Department of Finance to clarify any of the matters raised and to support additional initiatives in the area.

2. General Comments

2.1 We are concerned that the overall approach as set out in the proposed draft legislation is too broad and is not in line with what Ireland committed to do in the National Recovery plan. It appears to us that the approach to drafting the proposed legislation was to base it on the Irish enactment of the Interest and Royalties Directive ("**IRD**") and the Parent Subsidiary Directive ("**PSD**") and seek to apply withholding tax to all payments to which those directives could apply where the recipient is an 'Associated Enterprise' in a 'Specified Territory'. We believe that this goes beyond Ireland's commitments under the Recovery and Resilience Facility Operation Arrangements which requires Ireland to introduce legislation to apply to outbound payments to prevent double non-taxation.

The scope of the IRD and PSD were deliberately broad so as to ensure that a wide range of potential payments were within the scope of the directives. However, it is not the case that withholding taxes on all payments contemplated by the directives were actually imposed by all Member States. In reality, some Member States impose withholding taxes on certain payments and other Member States impose withholding taxes on other payments, rather than a particular Member State applying withholding taxes on all types of payment.

Therefore, we think that a more targeted anti-avoidance provision would be more appropriate. One such alternative would be for the rules to apply only to payments which are already subject to a withholding tax (i.e., they are the type of payment to which withholding tax already applies – for example, yearly interest only) and where those payments qualify for relief from withholding tax. Relief could then be disapplied in respect of payments to certain categories of recipient.

2.2 As drafted, the proposed legislation does not make any distinction between blacklisted jurisdictions and zero-tax jurisdictions. If they are treated in the same way, there is little incentive for a blacklisted country to get off the list. The consequences for both under the legislation will be the same if the proposed legislation is introduced in its current form.

2.3 Cayman and other zero tax jurisdictions are often used as intermediate investment jurisdictions where underlying profits flow through to residents of double tax treaty jurisdictions. Under the proposed legislation it appears that the ability to use vehicles in zero tax jurisdictions as intermediaries could no longer be possible. It is crucial to Ireland, as an investment centre, that this ability be retained where there is no risk of double non-taxation by reason of the ultimate investors not being in “specified territories”.

2.4 We are concerned about the impact of the proposed legislation on quoted Eurobonds. From a practical perspective, if there is a possibility of withholding arising on quoted Eurobonds, it may be difficult to get quoted Eurobonds into clearing systems.

2.5 The extension of withholding tax to short interest would upset treasury/cash pooling structures.

2.6 In relation to royalties, Ireland has only ever levied withholding tax on patent royalties. We see no reason to impose withholding tax on a much wider category of royalties.

2.7 The proposed legislation in its current form may make plant/machine rental payments subject to withholding. This would be problematic for the aircraft leasing industry.

2.8 As dividends are not tax deductible, we do not understand why they are seen to be in scope. We do not consider payments of dividends to zero tax jurisdictions to be more problematic than payments of dividends to participation exemption jurisdictions. In both cases the dividends are not taxed. We do not see a problem with either scenario.

2.9 Rather than implement the proposed legislation as drafted, we suggest that a test similar to that used in the Section 110 regime be used. Where profit participating notes, which are quoted Eurobonds, are held by “specified persons” under Section 110 Tax Consolidation Act 1997 (“**TCA”**), the qualifying Section 110 Company must assess, at the date of issuance of the quoted Eurobonds, where or not it is in possession, or aware, of information which could reasonably be taken to indicate that the interest or distribution concerned would not be subject to tax in an EU or treaty county. For outbound payments, the Irish company concerned could be required to assess whether it is in possession of information which could reasonably be taken to indicate that the payments concerned would either ultimately end up with “associated entities” which are resident in a “specified territory”.

3. Response to Feedback Question 1

3.1 <u>**Question 1**</u>

Comments are invited on these possible definitions, and in particular on the definitions of specified zero-tax territory and the meaning of ‘definite influence’.

<u>Zero-tax territory</u>

As currently drafted, the proposed definition of 'Zero-Tax Territory' would appear to include a territory that imposes tax on one or two of interest, dividends or royalties but not on all three. In our view, this is unnecessarily broad. For example, a territory that applies tax on interest and royalties but not on dividends would appear to be a 'Zero-Tax Territory' for the purposes of the rules. An alternative approach might be to replace the 'or' with an 'and'. This would ensure that only territories which do not tax all types of payments would be in scope.

The draft legislation does not make any distinction between blacklisted jurisdictions and zero tax jurisdictions and the consequences are the same for payments to blacklisted and zero tax jurisdictions based on the current form of the legislation. This may result in certain blacklisted countries being less encouraged to take steps to be removed from the list (which we understand is one of the intentions of having a blacklist, i.e., to encourage cooperation with respect to tax). Therefore, we think this should be clarified and the rules should apply differently to payments to blacklisted countries. From a practical perspective, given that the list of blacklisted countries is constantly evolving, clarity is needed on when presence on the list should be checked. For example, the legislation could be framed as applying to payments to associated entities in jurisdictions on the blacklist at the time of the payment. It could also be considered whether the list could be updated periodically and circulated by an official source in Ireland.

Entity (including fiscally transparent entities)

The definition of 'entity' in the proposed legislation is very broad and, in particular, includes tax transparent entities such as partnerships. The result of this is disproportionate in that a partnership which is not subject to tax simply because it is fiscally transparent appears to be within the scope of the rules, notwithstanding that the partners are themselves subject to tax in their jurisdictions. For this reason, in our view, the definition should be narrowed to apply to opaque entities only.

At the very least, we suggest that consideration needs to be given to including a provision to address payments which are made through transparent entities in Specified Territories to ultimate investors which are not in Specified Territories. A potential way of legislating for this would be to include a 'reasonable awareness' test (similar to that included in section110 TCA in respect of 'quoted Eurobonds'). In other words, the payment would only be within the scope of the rules if the payer could reasonably be considered to have knowledge that the payment would not ultimately be received by persons who are not in Specified Territories. Overall, we believe this would be appropriate and a 'reasonable to consider' test already applies in the anti-hybrid rules. In practice, a payer could seek representations from investors to the effect that payments are ultimately being received by persons in non-Specified Territories such that it is not reasonable to consider that the payment is not ultimately being received by persons in non-Specified Territories. We would suggest that the rules should not apply to a payment in those circumstances.

In addition, where a payment is made to a transparent entity, there may be circumstances under Irish tax rules where a deduction for such payments would be denied. For example, the anti-hybrid rules could deny a deduction in circumstances where a payment is made to a transparent entity which is a hybrid entity (e.g., because it is checked closed for US tax purposes) and there is no 'inclusion' by the participators with respect to the payment. We would suggest that the proposed rules should not apply to an interest payment in these circumstances because a deduction would be denied for such payment so imposing withholding tax could lead to double taxation.

Definite Influence

The definition of 'Definite Influence' appears to be largely the same as the definition of 'Control' in section 11 TCA. We would suggest that it may be more straightforward to use the existing definition of control rather than introducing a new term.

Definition of royalty

As currently drafted, the definition of 'Relevant Royalty' appears to potentially be broad enough to capture rental payments in respect of plant/machinery/equipment (which would include an aircraft). We would welcome clarification that this is not intended to capture payments of rent in respect of aircraft, helicopters, engines or other plant and machinery. Any other outcome would be problematic for the aircraft leasing industry and would fundamentally alter the current position with respect to withholding tax on payments of rent in Ireland.

Anti-avoidance test

The anti-avoidance test which provides that an arrangement which is entered into to avoid the application of the rules would be ignored and considered not to have occurred is too broad, in our view. We would suggest that this should be clarified to provide that a 'good' reorganisation is excluded from this anti-avoidance test (which does not currently appear to be the case and we assume is due to an oversight in the drafting). For example, a move from a zero-tax jurisdiction to an onshore jurisdiction where payments would be subject to tax should be excluded from this anti-avoidance test.

4. Response to Feedback Question 2 and Question 3

4.1 Question 2 and Question 3

Comments are invited on this possible approach with regard to outbound payments of interest

Interest specific considerations

The proposed legislation appears to disapply all domestic law exemptions from interest withholding tax where relevant distributions are made to “associated entities” in non-cooperative jurisdictions or no-tax or zero-tax jurisdictions. We note that the quoted Eurobond, the wholesale debt instrument and all of Section 246(3) TCA will all be limited. In particular, in our view, the scope of the draft legislation under which a withholding tax charge is imposed on 'short interest' is too broad. As mentioned above, we believe that the rules should only apply in circumstances where withholding tax already applies under Irish law.

We consider that the new legislation should be limited to payments which are tax deductible for the payer of the interest. Otherwise taxpayers who are not entitled to a deduction of the payments of interest could become subject to double taxation. This could potentially arise under the Interest Limitation Rules or the Anti-Hybrid Rules where interest deductions are denied.

We have some concerns about the impact of the proposed legislation on quoted Eurobonds. From a practical perspective, if withholding tax applies in respect of quoted Eurobonds, it may be difficult to get quoted Eurobonds admitted into clearing systems. For that reason and in light of the importance of the capital markets industry in Ireland, consideration should be given to excluding quoted Eurobonds from the scope of the rules. If that is not possible, consideration should be given to ensuring that intermediaries such as paying agents and clearing systems are exempted for the obligation to withhold tax from payments.

Royalty specific considerations

The proposed legislation appears to disapply all domestic law exemptions from royalties withholding tax where relevant distributions are made to “associated entities” in non-cooperative jurisdictions or no-tax or zero-tax jurisdictions.

We consider that the new legislation should be limited to payments which are tax deductible for the payer of the royalties. Otherwise taxpayers who are not entitled to a deduction of the payments of royalties could become subject to double taxation.

We also consider that the scope of royalty payments which are currently subject to withholding tax (i.e., on patent royalties) should not be broadened. We see no good policy reason, or any obligation in the context of Ireland's commitment with respect to these rules, to impose withholding tax on a much wider category of royalties.

General considerations

The proposed legislation's inclusion of “Supplemental Tax” helpfully treats payments as having been subject to tax where it is subject to a Controlled Foreign Company ("**CFC**") charge or other taxes under Global Anti-Base Erosion Model Rules (“**GloBE rules**”) / EU minimum tax directive. However, while the proposed legislation does acknowledge situations where a CFC charge may apply to payments made to 'Associated Entities' in Specified Territories, we recommend that the legislation goes a step further and provides for situations where a CFC charge would have been applied was it not for a specific exemption from the CFC charge. Additionally, the legislation does not appear to contemplate other instances where a payment may be subject to some form of tax (e.g., under GILTI rules). We would welcome clarification that all such taxes be taken in to account as 'Supplemental Tax'.

More generally, as mentioned above, we would also suggest that a test similar to that used in Section 110 (with respect to quoted Eurobonds and specified persons) whereby the payer would need to assess whether, at the date of the payment, it is or is not in possession, or aware, of information which could reasonably be taken to indicate that the interest or distribution concerned would be paid to an associated entity in a Specified Territory.

5. Response to Feedback Question 4

5.1 Question 4

Comments are invited on this possible approach with regard to outbound distributions.

The proposed legislation appears to disapply all domestic law exemptions from dividend withholding tax (“**DWT**”) where relevant distributions are made to Associated Entities in non-cooperative jurisdictions or no-tax or zero-tax jurisdictions.

We think imposing withholding tax on dividend payments to Associated Entities in Zero-Tax Territories has potentially far-reaching consequences and goes over and above Ireland’s commitment with respect to these rules.

Dividends and distributions are not deductible under Irish law so there is no base erosion by permitting dividends to be paid without deducting withholding tax (where the conditions for one of our exemptions to apply are satisfied). As such, our legislation already protects against double non-taxation in the context of dividends paid to jurisdictions on the EU list of non-cooperative jurisdictions.

There are three types of non-resident company which currently qualify for exemption from dividend withholding tax ("**DWT**"):

- A company resident for the purposes of tax in an EU Member State or tax treaty country and not controlled directly or indirectly by Irish residents;
- A company controlled directly or indirectly by a person or persons resident for the purposes of tax in an EU Member State or tax treaty country who are themselves not controlled by persons not so resident; and
- A company whose main shares, or the main shares of its parent company or companies, are substantially and regularly traded on a recognised stock exchange.

We currently apply an exemption from DWT where the ultimate beneficial owners of the dividends are in the EU or treaty jurisdictions whether or not the dividends pass through intermediary entities, which could be resident either in treaty or non-treaty jurisdictions. We must keep the ability to look through non-treaty intermediary entities to the ultimate beneficial owners of the dividends. To do otherwise would have huge implications, particularly in the multinational, aircraft leasing and insurance industries. It would severely damage Ireland's attractiveness as an investment centre.

In our view, dividends should be excluded from the proposed rules. If this is not possible, an exception could be made for dividends qualifying for participation exemptions or exemptions under GLobE. The concept of Excluded Dividends under GLoBE Rules could be very helpful – these are defined as *"dividends or other distributions paid on shares or other equity interests where (i) the MNE Group holds 10% or more of the Ownership Interests in the issuer or (ii) the Constituent Entity has held full economic ownership of the Ownership Interest for a period of 12 months or more."* We recommend that such Excluded Dividends would be excluded from the anti-avoidance rules.

6. Response to Feedback Question 5

6.1 Question 5

Comments are invited on these possible consequential amendments to the Taxes Consolidation Act 1997. Are there other possible consequential amendments which may be necessary to achieve the objective of these measures?

We have included our comments on other possible consequential amendments in the above responses to questions 1 – 4 above.

7. Conclusion

We appreciate the opportunity to provide observations and recommendations in this regard and we will be glad to engage further if that would assist in your consideration of these issues.

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