



Pre-Finance Bill Submission

Table of Contents

About the Irish Tax Institute	2
Executive Summary	3
Institute Recommendations	7
1. Enhance Ireland’s position as an attractive place to do business	12
1.1. The need to move to a territorial system of taxation	12
1.1.1 Key elements of a participation exemption and a foreign branch exemption	13
1.1.2 Potential technical issues in adopting a territorial system of taxation	15
1.2. Simplify the corporation tax code	30
1.3. Targeted tax measures to promote the green agenda and sustainability	31
1.3.1 Enhance accelerated capital allowances regime for energy efficient equipment	31
1.3.2 Extend CGT participation exemption to early-stage renewable energy projects	32
1.3.3 Reintroduce Section 486B TCA 1997	32
1.3.4 Extend Section 81C TCA 1997	33
1.3.5 Green enhancements to the EIIS	33
1.3.6 Introduce targeted measures for green or energy related R&D	35
1.3.7 Enhance relief for certain income from leasing of farmland	35
2. Technical issues arising from the implementation of Pillar Two	37
2.1. Issues arising from Finance Act 2022 changes to the R&D Tax Credit	37
2.2. Amendments to existing tax credits to align with Pillar Two Rules	38
2.1.1 Digital Games Tax Credit	38
2.1.2 Knowledge Development Box (KDB)	39
3. Support the growth of the indigenous sector	40
3.1 Improve the EIIS and SURE	41
3.2 Enhance the KEEP	44
3.3 Reduce the CGT rate	50
3.4 Enhance Entrepreneur Relief	50
3.5 Refine the R&D Tax Credit	53
Appendix I – Proposed amendments to interest deductibility provisions	59
Appendix II – Further details on the impact of the Sections 247 and 249 TCA 1997	62

About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 32,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, the Taxation Institute of Hong Kong, and the South African Institute of Taxation. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

Executive Summary

The Irish Tax Institute has set out in this submission a number of legislative amendments for consideration in the drafting of Finance (No. 2) Bill 2023 which we have grouped into the following three key areas:

1. Enhance Ireland's position as an attractive place to do business
2. Technical issues arising from the implementation of Pillar Two
3. Measures to support the growth of the indigenous sector

Enhance Ireland's position as an attractive place to do business

Urgent need to move to a territorial system of taxation

The implementation of the Pillar Two Global Anti-Base Erosion Rules¹ (GloBE Rules) reduces Ireland's scope to compete for foreign direct investment based on its corporation tax rate. Consequently, if Ireland is to continue to compete for such investment, at a minimum, it must align its corporation tax code with other EU Member States. Adopting a participation exemption would help to align the Irish corporation tax code with those operated by other EU Member States and with the GloBE Rules, which is more in line with a territorial system of taxation.

The Institute's response² to the Department of Finance's consultation on moving to a territorial system of taxation in March 2022 and our Pre-Finance Bill 2022 Submission³, highlighted how the absence of a participation exemption for foreign dividends puts Ireland at a disadvantage when competing for foreign direct investment with other OECD and EU countries that operate exemption systems.

The vast majority of OECD and EU countries already operate a territorial system of double tax relief. Indeed, Ireland is the only EU jurisdiction that does not already operate such a territorial system. Feedback the Institute has received confirms that Ireland's status as an outlier in this respect is being used against it by competitor countries bidding for investment.

We have outlined in this submission the key elements of a participation exemption for dividends and a foreign branch exemption which we believe are necessary to ensure that the regimes are competitive and consistent with international standards.

At the inaugural meeting of the Business Tax Stakeholder Forum on 29 March, several potential issues were identified for consideration in the context of the introduction of a participation exemption for dividends and a foreign branch exemption. We have addressed each of these issues in detail in the body of this submission.

¹ OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD Publishing, Paris, <https://doi.org/10.1787/782bac33-en>

² <https://taxinstitute.ie/wp-content/uploads/2022/03/2022-03-07-ITI-Response-to-Consultation-on-a-Territorial-System-of-Taxation-Final.pdf>

³ <https://taxinstitute.ie/wp-content/uploads/2022/06/2022-06-27-ITI-Pre-Finance-Bill-2022-Submission-FINAL.pdf>

Companies are currently evaluating the potential impact of Pillar Two on their businesses and making decisions regarding how to structure their operations going forward. The absence of a participation exemption in the Irish corporation tax code is now acting as a disincentive for such companies when determining where to locate future investment and is already impacting decisions.

We are cognisant that the implementation of the Pillar Two Minimum Tax Directive⁴ in Finance (No.2) Bill 2023 places significant demands on the resources of both the Department of Finance and Revenue. If it is not possible to implement a participation exemption for foreign dividends and foreign branch exemption at the same time given the available resources, we would strongly urge that a participation exemption for foreign dividends is prioritised and legislated for in the Finance Bill this October and a clear timeline is provided for the implementation of a foreign branch exemption at a future date.

If Ireland is to remain an attractive location for foreign direct investment, it is critical that a participation exemption for foreign dividends is introduced in Finance (No.2) Bill 2023 in tandem with the implementation of the Pillar Two Model Rules.

Simplify the Irish corporation tax code

Policymakers must also consider other ways to improve the Irish tax system to ensure Ireland remains a competitive place to do business. An element of the corporation tax code which urgently requires reform is the regime relating to interest deductibility. Following the introduction of the Anti-Tax Avoidance Directive⁵ (ATAD) Interest Limitation Rule in Finance Act 2021, which was layered on top of existing comprehensive interest deductibility provisions, Ireland now has one of the most complicated interest deductibility regimes within the EU.

The Institute strongly urges priority to be given to a review of the interest deductibility provisions, as part of an overall project of simplification, to ensure that Ireland's interest deductibility rules are easier to administer and more in line with the measures contained in the corporate tax systems of our European counterparts.

Targeted tax measures to promote the green agenda and sustainability

The environmental, social and governance (ESG) frameworks of many multinational businesses mean that a key deciding factor when considering whether to invest in a particular jurisdiction is the availability of a range of tax incentives for green energy and sustainability initiatives. Many jurisdictions are using tax incentives to support businesses in reducing their carbon emissions and to encourage investment in green/energy efficient projects. In our view, Ireland's offering in this regard does not compare favourably with competitor jurisdictions.

⁴ Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

⁵ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

We firmly believe that consideration must be given to tax measures which would support businesses in reducing their carbon emissions. The introduction of tax measures targeting the green agenda would also aid Ireland in achieving its climate change targets.

Technical issues arising from the implementation of Pillar Two

At the first meeting of the Business Tax Stakeholder Forum on 29 March, Department officials queried whether any amendments were required to align our domestic legislation with the Pillar Two Rules. Accordingly, we have identified amendments to the Digital Games Tax Credit and the Knowledge Development Box (KDB) which are necessary to ensure they remain competitive and are aligned with the Pillar Two GloBE Rules. We have also identified some technical issues arising from the Finance Act 2022 changes to the R&D Tax Credit.

Support the growth of the indigenous sector

The increasing level of concentration of Ireland's corporation tax receipts among a small number of companies in the multinational sector is widely recognised as a significant risk to the economy. The proportion of income tax receipts from these companies also represents a significant risk for the Exchequer.

The most sustainable strategy for mitigating the risk of over-reliance on the multinational sector is to broaden the economic base by building an innovative, productive, and competitive indigenous sector. Effective tax measures have a significant role to play in this endeavour. Therefore, we welcomed the commitment by the Minister for Finance, Michael McGrath T.D., at the Institute's Annual Dinner in February, to take *"a fresh look at all the enterprise tax measures on the table to assess whether they are working properly, and fulfilling the potential that we know our economy can deliver."*

It is our firm belief that changes to existing measures are required to encourage investment in SMEs and make them more accessible to start-ups. These include:

- **Improve the Employment Investment Incentive Scheme (EIS)**

EIS is aimed at incentivising investment in early stage and small businesses whose funding options are limited. However, there are inherent complexities in the scheme which are impacting its overall effectiveness. Whilst the changes introduced in recent Finance Acts have, for the most part, enhanced the scheme, the EIS continues to be complex and further amendments are necessary to ensure its effectiveness for start-ups and smaller businesses.

- **Enhance the Key Employee Engagement Programme (KEEP)**

Recruiting and retaining skilled workers is central to building a successful company and is crucial to the future growth and export potential of the business. Irish SMEs and start-ups in many instances cannot match the salaries paid by large multinationals. While we welcome the Finance Act 2022 changes to the KEEP, there continues to be a number

of limitations with its design which need to be addressed if it is to achieve its policy objective of incentivising talent to take up employment in SMEs and start-ups.

- **Reduce the CGT rate**

The tax that matters most to investors is capital gains tax (CGT) and the Irish CGT headline rate, at 33%, is one of the highest in Europe. This rate has remained unchanged since it was increased during the financial crisis. In our view, a reduction in the rate to 25% for active business assets would encourage innovation and productivity in our domestic sector as well as increasing the yield.

- **Enhance CGT Entrepreneur Relief**

Ireland's high rate of CGT lends added importance to measures such as Entrepreneur Relief.⁶ This relief allows for a lower 10% CGT rate on business gains, subject to a lifetime limit of €1 million.

The restrictions on Entrepreneur Relief do not allow external investors to benefit from the 10% rate which creates a real barrier to investment in Ireland. If the conditions attaching to CGT Entrepreneur Relief were altered, it could make the difference between angel investors, venture capital investors and others deciding to take the risk of investing in an Irish company or not.

- **Refine the R&D Tax Credit**

The R&D Tax Credit has a critical role to play in supporting innovation in our indigenous enterprises. However, both legislative and administrative changes are needed to the R&D Tax Credit if it is to encourage increased investment in innovation by Irish SMEs.

We have set out the Institute Recommendations in further detail on pages 7 – 12 and we have also provided further detailed analysis of each technical matter in the body of this submission.

Please contact Anne Gunnell at agunnell@taxinstitute.ie or (01) 6631750 if you require any further information regarding the matters raised in this submission.

⁶ Section 597AA TCA 1997

Institute Recommendations

Our recommendations for Finance (No. 2) Bill 2023 are grouped into three broad areas below. We have provided further detailed analysis on each technical matter in the body of this submission.

Enhance Ireland's position as an attractive place to do business

Move to a territorial system of taxation

1. A participation exemption for foreign dividends and a foreign branch exemption should be adopted into Irish tax legislation to help simplify the Irish corporation tax code, to protect the country's ability to attract foreign direct investment and to encourage international growth and development by Irish headquartered multinationals.
2. Given the extensive base erosion protections which exist in the Irish corporation tax code, we believe that the rules governing a participation exemption for foreign dividends and a foreign branch exemption should be clear and simple with limited exceptions.
3. In adopting a participation exemption for foreign source dividends and a foreign branch exemption in Ireland, it would be important that companies have the option to elect to apply both exemptions.
4. Ireland should adopt a participation exemption which would apply to all foreign source dividends irrespective of whether they are derived from treaty or non-treaty jurisdictions. Designing the participation exemption in this manner would increase the attractiveness of Ireland as a location for foreign direct investment compared with other competitor countries, such as the Netherlands and the UK.
5. The participation exemption should not be limited to dividends paid out of trading profits of companies as this would add unnecessary complexity and uncertainty for investors regarding the availability of the exemption.
6. The branch exemption should apply to profits arising in a foreign branch in any jurisdiction outside Ireland and should extend to profits in the nature of income or capital gains arising to the branch. If policymakers believe the foreign branch exemption should apply to a definitive category of jurisdictions, consideration could be given to restricting the branch exemption to jurisdictions to which Section 21B Taxes Consolidation Act (TCA) 1997 applies.
7. As the automatic application of a branch exemption could result in the denial of relief for branch losses, in our view, a company should have the option to apply the foreign branch exemption on a branch-by-branch basis at the election of the company, with appropriate safeguards put in place.
8. If it is not possible to implement a participation exemption for foreign dividends and foreign branch exemption at the same time due to resource constraints, we would strongly urge that a participation exemption for foreign dividends is prioritised and

legislated for in the Finance Bill this October and a clear timeline is provided for the implementation of a foreign branch exemption at a future date.

Simplify the Irish corporation tax code

9. We urge the Department of Finance to carry out a review of the interest deductibility provisions in the Irish tax code to reduce the inherent complexity and ensure the rules compare favourably with regimes in other jurisdictions competing with Ireland for foreign direct investment.

Targeted tax measures to promote the green agenda and sustainability

10. Enhancements to existing tax measures and incentives are necessary to improve Ireland's offering to businesses seeking to reduce their carbon emissions and to enhance Ireland's position as a location for sustainable investment. These include:
 - Enhancements to the existing Accelerated Capital Allowances regime for energy efficient equipment.
 - An extension of CGT participation exemption to early-stage renewable energy projects.
 - The reintroduction and refining of Section 486B TCA 1997 to encourage investment into sustainable projects and build on Ireland's reputation as a hub for sustainable innovation.
 - An extension of Section 81C TCA 1997 (emissions allowances) to cover carbon offsets in the voluntary sector.
 - Adopting a territorial system of taxation to further enhance Ireland's attractiveness as a location for sustainable assets and promote Ireland as a hub for global green/sustainable financing activities.
 - Enhancing the EIS to encourage investment in high-risk ventures which support green or energy efficient projects.
 - Introducing targeted measures for green or energy related R&D activities.
11. Consideration should be given to enhancing the relief available under Section 664 TCA 1997 by extending the scope of the relief to include solar panel activity. In our view, this would incentivise the leasing of farmland for solar panels which would expand the generation of renewable energy and assist Ireland in achieving its climate change targets.

Technical issues arising from the implementation of Pillar Two

Issues arising from Finance Act 2022 changes to the R&D Tax Credit

12. Sections 766C(13) and 766D(12) TCA 1997 provide that where a company specifies that the first instalment of the R&D Tax Credit is to be offset against the company's corporation tax liability for the accounting period, then this amount may be taken into account for the purposes of calculating preliminary corporation tax. We believe that these provisions should be reviewed as a company may wish to claim all three

instalments of the refundable R&D Tax Credit as an overpayment of tax which may be taken into account for the purposes of their preliminary corporation tax calculation.

Amendments to existing tax credits to align with Pillar Two

13. Similar to the Finance Act 2022 changes to the R&D Tax Credit rules, we believe it is necessary to amend the mechanism for granting relief under the Digital Games Tax Credit to ensure it falls within the definition of a “qualified refundable tax credit” for the purpose of Pillar Two.
14. The Institute has received feedback that onerous clawback provisions for the Digital Games Tax Credit are negatively impacting decisions by business on whether to locate digital games development companies in Ireland. In our view, legislative amendments are necessary if the Digital Games Tax Credit is to achieve its policy objective of incentivising increased investment by digital games development companies in Ireland.
15. The Pillar Two rules will impact the value of the KDB regime for in-scope multinational companies. In our view, consideration should be given to redesigning the mechanism for granting relief under the KDB regime so that it is a tax credit which falls within the definition of a ‘qualified refundable tax credit’ under Pillar Two rules.

Measures to support the growth of the indigenous sector

Improve the EIS and the Start-Up Refunds for Entrepreneurs (SURE)

16. The EIS continues to be a complex scheme to administer despite changes introduced in recent Finance Acts. We believe the following further amendments are necessary to ensure the EIS can fulfil its policy objective of supporting the growth of indigenous business:
 - A streamlined EIS administrative process for small and micro companies.
 - Allowing the offset of capital losses.
 - Removing the exclusion of holding company structures.
 - Amending the employment conditions.
 - Applying more proportionate monetary sanctions for administrative errors or the late filing of a return.
 - A carve-out from the connected party rule linked with a control test.
 - Committing appropriate and adequate resourcing to the administration of EIS applications.
 - Providing a 4-year holding period for all EIS investments.
 - Recognising additional exit strategies for EIS investors.
17. The SURE income tax refund scheme for those who start their own business is restricted to former PAYE workers. In our view, the SURE scheme should be extended to include new business founders who were previously self-employed and starting up a new business.

Enhance the KEEP

18. Several amendments were made to KEEP in Finance Act 2022 which continue to be subject to a Ministerial commencement order as State aid approval is required. We believe further legislative amendments are needed to improve KEEP to achieve its policy intention to help SMEs attract and retain key employees. These include:

- Amending the definition of a ‘qualifying holding company’ to permit the group as a whole to be considered, rather than in isolation.
- Developing an agreed ‘safe harbour’ approach to share valuation and impose an appropriate sanction where there is an undervalue.
- Removing the annual emoluments cap from the qualifying share option limits.
- Allowing the continuing availability of the relief should the SME (e.g., holding company and its subsidiaries) undergo a corporate reorganisation during the period in which the KEEP share option rights are outstanding.
- Providing ‘roll over relief’ of KEEP share options.

The above reforms are particularly relevant now when redundancies are occurring in large multinational tech companies and some of the employees laid off are taking up job opportunities with Irish tech start-ups. These Irish SMEs are unlikely to be able to compete on salaries to retain such valued workers when future job vacancies arise in the larger tech companies, meaning a well functioning KEEP scheme will be critical in the longer-term.

Reduce the CGT rate

19. Ireland’s headline rate of CGT, at 33%, is high by international standards. In our view, a reduction in the rate to 25% for active business assets would encourage innovation and productivity in our domestic sector as well as increasing the yield.

Enhance CGT Entrepreneur Relief

20. In our view, the conditions of Entrepreneur Relief should be amended to permit much-needed external ‘angel investors’ benefit from the reduced CGT rate of 10%, which would encourage such investors to take the risk to invest in Irish SMEs and start-ups.

21. There are a number of technical issues with the current legislation⁷ (as interpreted in Revenue’s Operational Manual)⁸ which are limiting the availability of Entrepreneur Relief in the following five significant situations:

- Where there is a dormant company in a group.
- Where a group is party to a joint venture.
- Where a company/group holds investments or leases trading premises.
- Where a company is liquidated.

⁷ Section 597AA Taxes Consolidation Act 1997.

⁸ Revenue Operational Manual 19.06.02B – Capital Gains Tax Revised Entrepreneur Relief.

- Where EIS funds are raised by a company.

Refine the R&D Tax Credit

22. We believe the following legislative and administrative changes are needed to encourage increased investment in R&D and innovation by SMEs in Ireland:

Legislative:

- Condense the 3-year R&D Tax Credit payment schedule to one year for SMEs.
- Allow rent to qualify as R&D expenditure.
- Increase the limits for outsourcing.

Administrative:

- Simplified documentation requirements for R&D Tax Credit claims by SMEs.
- SME-friendly Revenue guidance on sector specific R&D issues.
- A Revenue pre-approval process for first-time R&D Tax Credit claims by small and micro companies.
- Access to Revenue's R&D technical experts.
- Ensure Revenue Compliance Interventions are proportionate and conducted in a timely and efficient manner.
- Consultation with stakeholders in advance of updates to Revenue guidance.

1. Enhance Ireland's position as an attractive place to do business

1.1. The need to move to a territorial system of taxation

Currently, the rules concerning relief from double taxation on foreign earnings are set out in Schedule 24 TCA 1997. The provisions are complex which result in an onerous administrative burden being placed on companies to claim double taxation relief, even though it has been recognised⁹ that the application of Schedule 24 often results in limited amounts of incremental tax payable in Ireland on foreign earnings.

In the past, the policy rationale for Ireland not having a territorial tax system was because the country's corporation tax code did not contain controlled foreign company (CFC) rules to prevent the artificial diversion of profits to other jurisdictions. In 2017, the Coffey Report¹⁰ recommended that in the context of the introduction of CFC rules, Ireland should consider moving to a territorial system of taxation. ATAD compliant CFC rules were subsequently introduced into Irish law by Finance Act 2018.

In addition to CFC rules, extended transfer pricing rules, the ATAD Interest Limitation Rule (ILR) and anti-hybrid rules have been introduced since the 2017 Coffey Report. All of these measures operate to further protect Ireland's domestic tax base from any artificial diversion of profits and base erosion.

Previously, Ireland could rely on its low rate of corporation tax of 12.5% as a key part of the country's offering to multinational groups to locate their operations here but that is no longer the case. The implementation of the Pillar Two Minimum Tax Directive means that if Ireland is to compete for foreign direct investment, at a minimum it must strive for a level playing field and align its corporation tax code with other EU Member States.

Adopting a participation exemption and a foreign branch exemption would help to align the Irish corporation tax code with those operated by other EU Member States and with the Pillar Two GloBE Rules, which have been conceived in line with a territorial system of taxation.

The Institute's response¹¹ to the Department of Finance's consultation on moving to a territorial system of taxation in March 2022 and its Pre-Finance Bill 2022 Submission,¹² highlighted how the absence of a participation exemption for foreign dividends puts Ireland at a disadvantage when competing for foreign direct investment with other OECD and EU countries that operate exemption systems.

We outlined in those submissions the key elements of a participation exemption for dividends and a foreign branch exemption which we believe are necessary to ensure that the regimes would be competitive and consistent with international standards.

⁹ Department of Finance, Consultation on a Territorial System of Taxation, December 2021.

¹⁰ The Review of Ireland's Corporation Tax Code, Seamus Coffey, Department of Finance, 2017.

¹¹ <https://taxinstitute.ie/wp-content/uploads/2022/03/2022-03-07-ITI-Response-to-Consultation-on-a-Territorial-System-of-Taxation-Final.pdf>

¹² <https://taxinstitute.ie/wp-content/uploads/2022/06/2022-06-27-ITI-Pre-Finance-Bill-2022-Submission-FINAL.pdf>

At present, multinational groups located in Ireland are evaluating the potential impact of Pillar Two on their businesses and making decisions regarding how to structure their operations going forward. The absence of a participation exemption in the Irish corporation tax code is now acting as a disincentive for such companies when determining where to locate future investment and is already impacting decisions.

If Ireland is to remain an attractive location for foreign direct investment, it is critical that a participation exemption for dividends is introduced in Finance (No.2) Bill 2023 in tandem with the implementation of the Pillar Two Model Rules.

1.1.1 Key elements of a participation exemption and a foreign branch exemption

Given the extensive base erosion protections which exist in the Irish corporation tax code, we believe that the rules governing a participation exemption and a foreign branch exemption should be clear and simple with limited exceptions.

In adopting a participation exemption for foreign source dividends and a foreign branch exemption in Ireland, it would be important for companies to be given the option to elect to apply both exemptions.

Irish-based companies have structured their businesses to permit the repatriation of profits to Ireland and avail of credit, deduction, pooling and carry-forward entitlements as set out in Schedule 24 TCA 1997 in circumstances where there is a double taxation treaty in place and also where unilateral relief provisions apply. Depending on the countries in which a business may be located, the benefit of credit pooling could be diminished following a move to a territorial system of taxation if the option to elect out of the regime is not provided.

We have outlined below other key elements of a participation exemption for dividends and a foreign branch exemption which we believe are necessary to ensure that the regimes would be competitive and consistent with international standards.

Key elements of a participation exemption for foreign dividends

Ireland should adopt a participation exemption which would apply to all foreign source dividends irrespective of whether they are derived from treaty or non-treaty jurisdictions. Designing the participation exemption in this manner would increase the attractiveness of Ireland as a location for investment compared with other competitor countries, such as the Netherlands and the UK. Notably, under the Pillar Two GloBE Rules, when adjusting an entity's financial accounting income to exclude dividends in order to arrive at the entity's GloBE income figure, no distinction needs to be made between dividends received from treaty and non-treaty countries.

The participation exemption should not be limited to dividends paid out of trading profits of companies as this would add unnecessary complexity and uncertainty for investors regarding the availability of the exemption.

In designing a participation exemption for dividends, we believe it would be reasonable to impose a minimum ownership requirement. For example, policymakers could consider imposing a condition similar to that which applies to the participation exemption for gains in Section 626B TCA 1997. This would limit the availability of the participation exemption to dividends where the Irish resident company has a direct or indirect interest of at least 5% in the company from which the dividend is ultimately sourced.

In the event that the participation exemption for dividends is restricted to companies resident in a defined category of jurisdictions, in order to determine if the dividend is paid by a company in such a jurisdiction, it would be important that the dividend should be capable of being tracked through any number of intermediary layers to determine that it is paid by a company located for tax purposes in a qualifying jurisdiction.

Policymakers may wish to consider imposing a condition which would deny the participation exemption in circumstances where the payer has received a tax deduction for the dividend. This approach would align with Ireland's existing anti-hybrid mismatch rules.

Key elements of a foreign branch exemption

Ireland should adopt a foreign branch exemption which applies at the election of the taxpayer on a branch-by-branch basis. The exemption should apply to profits arising in a foreign branch in any jurisdiction outside Ireland.

We consider that the branch exemption should extend to profits in the nature of income or capital gains arising to the branch. For example, capital gains arising on the disposal of assets held by the branch or upon a sale or cessation of the branch business should come within the scope of the exemption. Post-cessation trading receipts should also come within the scope of the exemption.

Notably, under the UK foreign branch exemption, UK resident companies can elect for profits of their foreign branches to be exempt from UK taxation and the exemption applies to the branch's trading profits, investment income connected with the branch and chargeable gains. There is no requirement for the foreign branch of the UK company to be located in a treaty jurisdiction.

If policymakers believe that the foreign branch exemption should apply to a definitive category of jurisdictions, consideration could be given to restricting the branch exemption to the jurisdictions to which Section 21B TCA 1997 applies. This would include EU Member States, countries with which Ireland has a double taxation treaty in force or with which Ireland has signed a double taxation treaty which has yet to come into force, and countries which have ratified the Joint Council of Europe/ OECD Convention on Mutual Assistance in Tax Matters.

As the automatic application of a branch exemption could result in the denial of relief for branch losses, in our view, a company should have the option to apply the foreign

branch exemption on a branch-by-branch basis at the election of the company and that there would be the possibility to revoke the election.

Policymakers could consider restricting the availability of the branch exemption to circumstances where the profits of the branch are considered to be subject to tax in the foreign jurisdiction (i.e., the exemption would not be available if the branch is not recognised as a taxable presence in the branch jurisdiction). This approach could be aligned with the anti-hybrid mismatch measures that apply in respect of branches.

1.1.2 Potential technical issues in adopting a territorial system of taxation

At the meeting of the Business Tax Stakeholder Forum on 29 March, in the context of considering the introduction of a foreign dividend participation exemption and/or a branch exemption, stakeholders were invited to consider potential issues arising in each of the following areas:

- CFC Rules
- Transfer Pricing
- Anti-hybrid Rules
- Interest Limitation Rule
- Exit Tax
- Tax Treaties
- Transitional Provisions
- Interaction with existing domestic rules and reliefs

1.1.2.1 CFC Rules

ATAD compliant CFC rules were introduced in Ireland by Finance Act 2018, which prevent the artificial diversion of profits from controlling companies to CFCs. The rules operate by attributing undistributed income of a CFC to a controlling company or a connected company in Ireland.

Participation Exemption

Under the current CFC rules, if a company opted to apply a participation exemption to a dividend which it receives from its CFC, this could result in a CFC charge not applying to that income on the basis that the CFC has distributed that income. Therefore, policymakers may wish to consider amending the CFC rules to ensure a CFC charge cannot be averted solely on the basis that the CFC has no undistributed income in such circumstances.

For example, an amendment could be made to Section 835Q TCA 1997 to ensure that, to the extent that the Irish company avails of a participation exemption in respect of a dividend from a CFC, the dividend income which was covered by the participation exemption in Ireland would be treated as undistributed income for the purposes of the CFC rules.

Foreign Branch Exemption

As the income of a foreign branch of an Irish company is treated as the income of the company for Irish tax purposes under the worldwide tax system, the Irish CFC rules do not currently apply to foreign branches. However, ATAD recognises that a permanent establishment (PE) can be a CFC and notes that it is necessary for CFC rules to extend to the profits of PEs where those profits are not subject to tax or are tax exempt in the Member State of the taxpayer.

Therefore, in adopting a foreign branch exemption, Irish CFC rules would need to be extended, in line with ATAD, to ensure they apply to the undistributed income of foreign branches where the relevant conditions are satisfied and the Irish resident company has opted to apply the foreign branch exemption. There are two possible approaches to this, as noted in the OECD's 2015 Report on Designing Effective CFC Rules¹³:

“...where a parent jurisdiction exempts the income of a PE, the income of that PE could potentially raise the same concerns as income arising in a foreign subsidiary. Where this is the case, the parent jurisdiction could address this either by denying the exemption or by applying CFC rules to the PE.”

Should the Irish CFC rules be applied to a PE of an Irish resident company that has opted to apply the foreign branch exemption, it would be necessary to consider what constitutes undistributed income of a PE for the purposes of the CFC rules given a PE cannot issue dividends.

An alternative approach which policymakers could consider would be to restrict the profits that are within the scope of the foreign branch exemption. Such a restriction would operate to exclude any profits of a foreign branch which would have been subject to a CFC charge, had the branch been a subsidiary resident in the territory in which the branch is established, from the scope of the foreign branch exemption and would remain chargeable to Irish tax.

Interestingly, the UK adopted the approach of denying the exemption, i.e., the UK foreign branch exemption itself includes an 'anti-diversion rule' which effectively applies the CFC tests to the branch profits. In short, this means that any 'diverted profits', being profits that pass through the CFC and to which none of the CFC exemptions apply, are excluded from the branch exemption regime and remain chargeable to corporation tax in the UK.

HMRC guidance notes that where a UK enterprise has a PE in another country, the profits attributed to it should be such profits as it might be expected to make if it were a separate enterprise dealing at arm's length with the UK enterprise.¹⁴

¹³ OECD (2015), Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264241152-en>, at paragraph 28.

¹⁴ INTM163050 - UK residents with foreign income or gains: income arising abroad: Branch profits - arm's length principle, HMRC International Manual.

1.1.2.2 Transfer Pricing

The Authorised OECD Approach (AOA) mechanism for the determination of profits attributable to a PE is contained in Article 7(2) of the OECD Model Tax Convention. Guidance on the application of the AOA is set out in the OECD's Report on the Attribution of Profits to Permanent Establishments published in July 2010.

The AOA seeks to attribute to a branch the profits that it would have earned at arm's length if it were a legally distinct and separate enterprise performing the same or similar functions under the same or similar conditions. Therefore, it incorporates separate entity and arm's length principles. The aim of the AOA is to apply the transfer pricing principles that apply to inter-company transactions to intra-company 'dealings'.¹⁵

From a transfer pricing perspective, the AOA is a long-established practice for taxpayers and advisers in Ireland and other OECD Member States. Section 25A TCA 1997, which was introduced in Finance Act 2021, provides for the application of the AOA to the attribution of income to a branch of non-resident companies carrying on a trade in Ireland.

In considering the attribution of profit to the foreign branch of an Irish company for the purpose of the foreign branch exemption, a similar approach could be taken to that in Section 25A. Such an approach would also be consistent with the approach adopted in the UK.

1.1.2.3 Anti-hybrid Rules

ATAD anti-hybrid rules were introduced in Ireland in Finance Act 2019 and apply to payments made after 1 January 2020. The rules are intended to counteract tax mismatches, such as double deductions and deductions with no corresponding income inclusion, by denying a deduction for the payer or bringing a receipt into charge for the recipient.

Although the anti-hybrid rules were introduced against the background of a worldwide system of taxation, the rules address a number of mismatch situations which may arise in a head office branch scenario which will be relevant in moving to a territorial tax system, including:

- Section 835AG TCA 1997 applies where there is a deduction non-inclusion outcome which is attributable to differences in the allocation of payments between the Irish head office and the PE or between two or more PEs of the Irish entity.
- Section 835AJ TCA 1997 addresses deduction without inclusion mismatch outcomes which arise to the extent a payment, or part of a payment, is tax deductible in one jurisdiction without a corresponding amount being included in

¹⁵ Revenue Commissioners, Notes for Guidance, Taxes Consolidation Act 1997, Finance Act 2022 Edition, Part 2 at Section 25A.

another jurisdiction. Therefore, as noted earlier in this submission, a participation exemption for dividends should not be available where the payer is entitled to a tax deduction in respect of the distribution.

- Section 835AC TCA 1997 deals with double deduction situations on payments between an Irish company and its PE or between two or more PEs of the Irish company. Where the foreign branch exemption applies, there will be no tax expense deduction available in Ireland and therefore, the entity will not be in scope of the double deduction provisions.
- Section 835AB TCA 1997 addresses the application of Ireland's anti-hybrid rules in the context of worldwide tax systems to ensure that the rules only operate to neutralise actual economic hybrid mismatches and not technical hybrid mismatches. This provision can apply where there is an Irish company with a foreign branch or where there is a foreign company with an Irish branch.

In adopting a participation exemption for dividends and/or a foreign branch exemption in Ireland, it would be important for Section 835AB TCA 1997 to be retained, as the application of the provisions would continue to be required in certain circumstances to ensure that the anti-hybrid rules are confined to actual economic hybrid mismatches. For example, if a company does not avail of a foreign branch exemption, the provisions of Section 835AB would still be relevant. In addition, Section 835AB would have application where another jurisdiction operates a worldwide system of taxation.

In moving to a territorial regime, some additional measures which policymakers may need to consider include:

- Payments that are disregarded, exempt or excluded from tax under the laws of the branch jurisdiction could be treated as if they had been received directly by the Irish head office (and therefore, outside any foreign branch exemption).
- Payments or deemed payments from the branch to head office which are tax deductible in the branch location against non-dual inclusion income could be treated as taxable in Ireland. This change would be required to remain ATAD compliant.
- Third-party interest and other deductions which are offset against non-dual inclusion income in the branch location could be treated as non deductible against Irish head office profits.
- The existing imported mismatch rules which carve out payments to EU jurisdictions could be amended to include situations involving tax exempt branches in such locations.

1.1.2.4 Interest Limitation Rule (ILR)

Article 4 of ATAD required Member States to impose a restriction on the interest deductibility of corporate entities up to a limit of 30% of a taxpayer's taxable earnings before interest, tax, depreciation, and amortisation ("EBITDA"). The ATAD ILR was transposed in Irish law by Finance Act 2021 and applies for accounting periods commencing on or after 1 January 2022.

At the Business Tax Stakeholder Forum, it was queried whether any changes would be required to the ATAD ILR in the event of the introduction of a territorial tax system. In particular, it was noted that head office to branch transactions are not currently in scope and the potential impact, if any, on the earnings calculation, or the 'single company worldwide group' provisions was questioned.

(i) Potential impact on the earnings calculation

Where the conditions for a participation exemption or a foreign branch exemption and the appropriate elections are made, we would anticipate that foreign dividends and foreign branch profits would be exempt from Irish tax while relief for branch losses would be denied.

Any interest expense attributable to an exempted foreign branch or allocated by the head office to the branch would not be deductible for tax purposes in Ireland, and would be excluded from the calculation of Net Interest Equivalent in Section 835AAB TCA 1997.

The relevant profit or relevant loss of an entity is a component of the formula used to calculate EBITDA (as set out in Section 835AAB TCA 1997) on which the 30% ATAD ILR restriction is based. Section 835AZ defines 'relevant profit' as the amount of profits on which corporation tax falls finally to be borne.

Therefore, relevant profit would not include exempt branch profits or exempt dividend income. 'Relevant loss', which is defined in Section 835AZ as including "*deductions and reliefs which under any provision are treated as reducing profits for those purposes*", will similarly not include branch losses which have been denied relief.

A further component in the EBITDA formula is the amount of foreign tax deducted in calculating the relevant entity's relevant profit or relevant loss for the accounting period. In our view, the definition of this component would not require amendment as the foreign tax deducted would be nil in the case of exempt dividend income or exempt branch profits.

(ii) Potential impact on the 'single company worldwide group' provisions

A 'single company worldwide group' is subject to the ILR but may be able to avail of group reliefs (i.e., the Group Ratio or Equity Ratio) subject to certain anti-avoidance rules.

The objective of the Group Ratio or Equity Ratio is to allow deduction of third-party debt provided it is not disproportionately allocated to the relevant taxpayer. The operation of the Group Ratio and Equity Ratio tests for a relevant entity, an ILR group and a single company worldwide group are based on figures disclosed in the relevant financial statements rather than tax adjusted figures.

Such financial statements will include the results of an exempt foreign branch and may also include the results of a company from which an exempt dividend has been, or could be, received. Therefore, in our view, no amendments to these provisions would be required in adopting a territorial system of taxation.

1.1.2.5 Exit Tax

At the Business Tax Stakeholder Forum, it was queried whether any changes would be required to the existing exit tax provisions if a participation exemption and a foreign branch exemption were introduced into Irish law.

As Ireland currently has a worldwide tax system, the exit tax rules contained in Section 627 TCA 1997 do not apply to foreign branches. However, ATAD envisages that exit tax should apply in circumstances where a taxpayer transfers assets from its head office to a PE in another Member State or in a third country insofar as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer. Therefore, in adopting a foreign branch exemption, it would be necessary to amend the exit tax provisions contained in Section 627 TCA 1997 to ensure they are fully aligned with the ATAD provisions.

As set out in our response to the Public Consultation on a Territorial System of Taxation,¹⁶ the transfer of assets by a head office to a foreign branch could result in a charge to exit tax arising in circumstances where the underlying capital gain has not been realised by the branch.

The option to elect on a branch-by-branch basis to not be within scope of the foreign branch exemption will be important for companies that would not be in a position to pay an exit tax liability. As branches that do not avail of the foreign branch exemption will continue to be taxable in Ireland, the exit tax charge should not apply on the transfer of assets by head office to these branches.

In adopting a foreign branch exemption, it would be essential that chargeable gains arising to the foreign branch in respect of assets that are used for the purposes of the trade or business of the branch would be within scope of the exemption. Policymakers could consider adopting the following approach to the legislation:

- The assets that are within the scope of the foreign branch exemption could be restricted such that they do not include any assets that remain chargeable to

¹⁶ Consultation on a Territorial System of Taxation, Department of Finance, December 2021, at page 7.

Irish tax in the hands of non-residents under Section 29 TCA 1997. A similar approach has been taken in the UK foreign branch exemption.

- Section 627(2) TCA 1997 would need to be amended to comply with the requirements of ATAD. This could be achieved by inserting a new paragraph (d) into Section 627(2) to impose an exit tax charge where a company transfers assets from its head office in Ireland to a PE of that company in another Member State or in a third country. It would be necessary to confirm that this new paragraph (d) would apply only in cases where the foreign branch exemption is claimed.
- Any exit tax charge should continue to be subject to the provisions of Section 627(3) TCA which provides for an exclusion from an exit tax charge where Ireland retains taxing rights on a subsequent disposal of assets.

In our view, the making of the election for the foreign branch exemption should not in itself be considered an event which comes within the scope of Section 627 TCA 1997 as it would not involve a transfer either of assets or of place of residence.

We understand that on the introduction of the UK foreign branch exemption, a policy decision was taken that the making of the election would not be considered an exit event in its own right. Consequently, branch assets which had built in gains at the time of making the election would be exempt on future disposal by the branch if those assets were always used by the branch.

1.1.2.6 Tax Treaties

At the Business Tax Stakeholder Forum, it was noted that Ireland had reserved positions under the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI) due to the existing worldwide tax system. The potential impact, if any, of a move to territoriality on Ireland's Double Taxation Agreements (DTAs) was also queried.

We do not believe that implementing a participation exemption and/or a branch exemption into Ireland's domestic legislation would directly impact Ireland's tax treaty network as the intended purpose of such exemptions would be to avoid the incidence of double taxation. Hence, the introduction of a participation exemption for dividends and a foreign branch exemption should not require the renegotiation of individual tax treaties.

Exemption regimes are commonplace and would be familiar to the vast majority of our tax treaty partners. However, going forward, as Ireland re-negotiates its double taxation treaties in the normal course, it would be appropriate for such treaties to reflect the existence of a participation exemption and/or branch exemption in Irish tax law.

Participation Exemption

The Dividends article in Ireland's tax treaties generally provides that dividends may be taxed in the payee jurisdiction and also taxed in the payer jurisdiction in the form of a withholding tax.

The Elimination of Double Taxation article provides for a credit against Irish taxes in respect of taxes paid in the payer jurisdiction where the double taxation of dividends arises. However, if a participation exemption in respect of foreign dividends applied under Ireland's domestic legislation, there would be no double taxation as the dividends would be exempt in Ireland meaning the Elimination of Double Taxation article should not apply in this regard. Where the conditions for a participation exemption for foreign dividends are not met, foreign tax credits should be available in line with the current system.

Foreign Branch Exemption

The Business Profits article of Ireland's tax treaties generally allocates taxing rights in respect of profits of a PE to the jurisdiction where the PE is located. However, under Ireland's worldwide system of taxation, the profits of the PE are taxed in Ireland with a credit available for the tax paid in the jurisdiction of the PE, up to the Irish measure, as calculated under Schedule 24 TCA 1997. Therefore, the double taxation of branch profits arises as a result of Ireland's worldwide system of taxation as provided under domestic legislation.

Some tax treaties provide that treaty benefits on certain types of income are only available if the income is subject to tax in Ireland. This could mean that the automatic application of a foreign branch exemption could give rise to unintended consequences in terms of accessing treaty benefits. Consequently, where there is uncertainty over the availability of treaty benefits on certain income, it would be important that the taxpayer could elect not to opt for the branch exemption.

We understand that when the UK transitioned from a credit regime to an exemption regime, there was no requirement for immediate renegotiation of their tax treaty network on the basis that the UK adopted an elective regime, where companies could elect for the exemption not to apply.

Article 10 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI) provides anti-abuse rules for PEs situated in third countries that are not taxed in the state of residence and that are taxed at a low rate in the third country. As Ireland does not currently have a branch exemption it reserved its position under Article 10.

Article 10 seeks to deny double taxation treaty benefits where branch income benefits from an exemption from tax in the state of the head office but the branch tax rate would be less than 60% of the tax rate in the state of the head office. This could arise if Ireland introduces a foreign branch exemption and the branch profits are taxed at a rate of less than 60% of the relevant Irish rate.

Notably, Article 10 of the MLI does not apply where the income of the branch *“is derived in connection with or is incidental to the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise’s own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively).”*

If the Irish foreign branch exemption is only available to trading branches this would avoid having to potentially adopt Article 10. Such an approach would also be consistent with the approach taken in the UK.

1.1.2.7 Transitional Provisions

In adopting a participation exemption for dividends and a foreign branch exemption, consideration would need to be given to what relief should be provided to taxpayers with unrelieved foreign tax credits carried forward from prior years whether in respect of foreign dividends or foreign branches.

Foreign Branch Exemption

Transitional rules may be required to allow for circumstances where a branch has incurred losses for a number of years prior to electing into the branch exemption where these losses were set off against other profits. It may be appropriate to restrict the exemption for future branch profits in such circumstances.

In the UK, transitional rules apply to losses accruing prior to entry into the branch exemption regime. In addition, losses incurred after entry into the exemption regime are not relieviable.

1.1.2.8 Interaction with other existing domestic rules and reliefs

At the Business Tax Stakeholder Forum, stakeholders were asked to consider the interaction of a participation exemption for dividends and a branch exemption with existing domestic rules and reliefs (in addition to the rules addressed in paragraphs 1.1.2.1 to 1.1.2.5).

Participation Exemption

If a participation exemption is to achieve the objective of ensuring Ireland remains an attractive location for foreign direct investment, it would be critical for the regime to be easily understood to provide certainty to investors.

Section 129 TCA 1997 provides that where a dividend or distribution is received by an Irish resident company from an Irish resident company, the company is not chargeable to corporation tax on the receipt of the distribution. Section 156 TCA 1997 defines franked investment income as being the amount or value of a distribution which is

received by an Irish resident company from another resident company. Franked investment income is not within the charge to corporation tax.

In our view, one relatively straightforward approach to legislating for a participation exemption for dividends could be to facilitate Section 129 treatment for certain dividends/ distributions from shares in foreign resident companies. At the same time, the definition of franked investment income could be extended to include certain dividends/ distributions from shares in foreign resident companies.

If such an approach were adopted, consideration would need to be given to amending certain other provisions of the TCA 1997. We have summarised these suggested legislative amendments in the table below.

Summary of the provisions of the TCA 1997 which may need to be amended if a participation exemption is adopted		
Provision	Purpose	Potential Amendment
Section 110	Section 110 deals with the taxation of securitisation and other structured finance transactions.	Confirmation that the exemption of foreign dividends, if introduced on an optional basis, will be accessible to Section 110 entities on the same optional basis as other Irish resident companies.
Section 129A	Section 129A disapplies section 129 treatment to certain dividends of formerly non-Irish resident companies which became Irish resident.	With the possible exception of companies resident in territories on the EU list of non-cooperative jurisdictions, the rationale for Section 129A post the introduction of a participation exemption for dividends would need to be reviewed.
Section 138	Section 138 TCA 1997 is an anti-avoidance measure that aims to remove certain tax advantages attaching to 'artificial' preference share arrangements.	<p>If policymakers wish to exclude certain distributions (e.g. fixed rate distributions on 'debt-like' shares) from the participation exemption, we believe this could be achieved with minimal amendments to Section 138.</p> <p>Given the scope of Section 138 can often be ambiguous, policymakers may wish to take the opportunity to refine Section 138 to give clarity regarding the type of distributions (both domestic and foreign) for which Section 129 treatment is to be disapplied.</p>
Section 697A	Part 24A TCA 1997 provides an alternative method (called "tonnage tax") for calculating the shipping related profits of a company for corporation tax purposes. The definition of 'relevant shipping	The definition of 'relevant shipping income' may need to be reviewed if a participation exemption via Section 129 is implemented.

	income' in Section 697A includes dividends from overseas companies.	
Section 816	Section 816 charges foreign scrip issues to tax under Schedule D Case III.	<p>If a participation exemption via Section 129 is implemented, it would be expected that foreign scrip issues would fall outside the charge and therefore, an amendment to Section 816 may be required.</p> <p>In cases where an election not to apply a participation exemption is made, then it is expected that Section 816 would continue to apply as normal for companies to any scrip issues in such cases.</p>
Section 831	Section 831 transposes Council Directive No. 90/435/EEC concerning the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. The Directive seeks to relieve double taxation in the case of cross-border dividend flows within the EU from a subsidiary to its parent company (generally referred to as the Parent/ Subsidiaries Directive).	<p>Consideration would need to be given to whether it is necessary to amend Section 831 to reflect the fact the existence of a participation exemption in Irish legislation.</p> <p>The Directive provides for both an exemption and credit relief approach to its implementation. Therefore, if optionality exists regarding the application of the participation exemption for dividends, Section 831 could be amended to reflect that effect could be given to the Directive via the exemption or the credit regime, as relevant. Exemption via Section 831 might apply instead of via the Section 129 type approach in relation to income distributions from EU/ EEA resident entities.</p> <p>Alternatively, policymakers could take the view that Section 831 in itself does not require amendment and that implementing the participation exemption via Section 129 gives effect to the Directive.</p>
Schedule 24	Schedule 24 contains the rules for computing a foreign tax credit available on foreign source income where there is a double taxation treaty in force. It also includes unilateral relief provisions which apply where there is no double taxation treaty.	It may be necessary to amend the credit relief measures within Schedule 24 to confirm that a credit would not apply to foreign taxes payable in respect of an exempt dividend. The provisions of Schedule 24 will remain applicable to dividends in respect of which an election out of the dividend exemption regime is made.

Branch Exemption

It would be important that a foreign branch exemption would operate at the election of the taxpayer on a branch-by-branch basis. Companies could elect to have the profits (including capital gains attributable to the branch) attributed to a relevant PE under the AOA to be disregarded for Irish corporation tax purposes. Where an election is not made, the branch would remain taxable under the current system.

If such an approach is adopted, we anticipate that consideration would need to be given to amending certain provisions of the TCA 1997. We have summarised these suggested legislative amendments in the table below.

Summary of the provisions of the TCA 1997 which may need to be amended if a branch exemption is adopted		
Provision	Purpose	Potential Amendment
Section 4	Section 4(1) defines a “branch or agency” for the purposes of the Corporation Tax Acts.	<p>Consideration may need to be given to including a definition of ‘permanent establishment’ within Section 4 TCA 1997. The definition could then be used to assist in defining what is considered to be a qualifying PE for the purposes of the foreign branch exemption.</p> <p>An alternative approach could be for the definition of a PE to be included as part of a standalone Part of the TCA introducing the regime.</p> <p>Regardless of which approach is taken, we would anticipate that a company would have a PE in a territory only if it has a fixed place of business there through which the company carries on its business, or an agent, acting on behalf of the company, has and habitually exercises there authority to do business on behalf of the company (i.e., a dependent agent).</p>
Section 5	Section 5(1) defines a “branch or agency” for the purposes of the Capital Gains Tax Acts.	Similar to Section 4 above, it may be necessary to define ‘permanent establishment’ for the purpose of the Capital Gains Tax Act.
Section 25A	This section provides for the application of the AOA mechanism for the attribution of income to a branch or agency of non-resident companies carrying on a trade in the State through such a branch or agency.	<p>Section 25A could be amended to allow a similar approach in respect of foreign branches to be taken as that which is taken for Irish branches. This would be consistent with the approach taken in the UK.</p> <p>From a capital gains perspective, as a starting point, where a double tax treaty is</p>

	<p>The AOA seeks to attribute to a branch (or agency), the profits that it would have earned at arm's length if it was a legally distinct and separate enterprise performing the same or similar functions under the same or similar conditions.</p> <p>Therefore, it incorporates separate entity and arm's length principles. The aim of the AOA is to apply the transfer pricing principles that apply to inter-company transactions to intra-company 'dealings'.</p>	<p>in force, it is expected that the attribution of profits and gains for these purposes is done in accordance with the relevant tax treaty.</p> <p>We would anticipate gains attributed to a PE based on the AOA approach would fall within the scope of the exemption, notwithstanding that a double tax treaty may not necessarily allocate taxing rights over assets solely by reference to attribution to a PE.</p> <p>For instance, gains on immovable assets may not be attributed under a tax treaty to a branch but such property may nonetheless be used by the branch and should therefore be eligible for the branch exemption.</p>
Capital Allowances		<p>An amendment in relation to capital allowances would be necessary on the introduction of a foreign branch exemption. For example, on electing into the regime, a deemed disposal event for capital allowances purposes may need to arise to ensure it does not give rise to either a balancing allowance or balancing charge (i.e., it could be a deemed disposal at tax written down value).</p> <p>Where a company has elected into the branch exemption regime, any trade carried on through an exempt permanent establishment could be treated as a separate, non-chargeable activity for capital allowance purposes, so that it may not claim capital allowances in respect of an asset which is being used for a PE activity.</p> <p>This would mean that the existing capital allowances provisions should operate as normal thereafter in respect of the assets which are in use for the purposes of the part of the trade that is within the charge and the part of the trade which is not within the charge (i.e. the branch).</p>
Losses		<p>Once a company elects to apply a foreign branch exemption, losses attributable to a PE would not generally be expected to be relievable.</p>

		<p>Transitional rules may be required to allow for circumstances where a branch has made losses for a number of years prior to electing into the branch exemption where these losses were set off against other profits. It may be appropriate to restrict the exemption for future branch profits in such circumstances.</p> <p>In the UK, the loss transitional rules only apply to losses accruing prior to entry into the branch exemption regime. Losses which are incurred after entry into the exemption regime are not relievable.</p> <p>In our view, a similar approach to that adopted in the UK could be considered in Ireland.</p>
Section 617 & Section 623	<p>Section 617 provides that the disposal of a chargeable asset (other than trading stock) within a group of companies is treated as having been for a consideration of such an amount that neither a gain nor a loss accrues to the company making the disposal.</p> <p>Section 623 sets out the charge to tax on one or more group members leaving a group of companies in respect of assets the company leaving the group acquired from the other group companies within a period of 10 years immediately preceding the time the company leaves the group.</p>	<p>On the transfer by a company of a chargeable asset attributable to an exempt foreign branch to another Irish resident group company, the usual no gain/no loss provisions in Section 617 may need to be amended to ensure the consideration is treated as market value.</p> <p>In line with the policy rationale underlying the branch exemption, the amendment would need to ensure that the element of the gain accruing during the period of ownership by the exempt foreign branch is not taxed on the eventual disposal of the asset.</p> <p>It would be expected that assets transferred intra-group to the exempt foreign branch of a group company for use in its branch trade which were used otherwise than for the business of an exempt PE would be eligible for group relief under Section 617. However, on the ultimate disposal of any such assets by an exempt foreign branch, it would likely be necessary to apportion part of the gain to the branch, as exempt and part as being taxable. A similar approach can be taken to the de-grouping provisions in Section 623.</p>
Section 626B	Section 626B provides for an exemption from tax in the case of certain capital gains from the	Once a branch exemption is introduced, it would make sense to amend Section 626B so that the treatment of gains on the

	disposal of holdings in subsidiaries.	<p>disposal of foreign trading subsidiaries are on a par with the treatment of gains in respect of foreign PEs.</p> <p>This could be achieved by the removal of the requirement for investee companies to be resident in a treaty country.</p> <p>Policymakers may wish to retain some restrictions that the exemption would not be available in respect of investee companies resident in territories on the EU list of non-cooperative jurisdictions at the time of the disposal.</p> <p>Such a change would bring the Irish regime in line with other countries, such as the UK.</p>
Patent Rights		For consistency, policymakers may wish to consider extending the foreign branch exemption to capital sums received for the sale of patent rights where those patent rights are attributed to a branch for use in its branch business.
R&D Tax Credit		We would not anticipate that R&D activities carried on by an exempt foreign branch would be eligible for the R&D Tax Credit on the basis that the costs are not deductible in computing profits within the charge to corporation tax. If this is the case, consequential technical amendments to the R&D Tax Credit may be necessary.
Schedule 24	Schedule 24 sets out the rules concerning relief from double taxation on foreign earnings.	For the avoidance of doubt, it may be necessary to amend credit relief measures within Schedule 24 to confirm that credit would not apply to foreign taxes payable in respect of an exempt foreign branch.

1.2. Simplify the corporation tax code

The ATAD ILR which was introduced in Finance Act 2021 was layered on top of existing comprehensive interest deductibility provisions making the operation of the rules onerous and overly complex. This makes it difficult and costly for businesses to operate in Ireland and comply with their tax obligations and has resulted in Ireland having one of the most complicated interest deductibility regimes within the EU.

We strongly urge the Department of Finance to carry out a review of Ireland's interest deductibility provisions to ensure the rules governing interest deductibility are less complicated and compare more favourably with competitor jurisdictions. We recommend that reformed interest deductibility provisions should reflect a broad base for interest deduction against both trading and non-trading income, using the protection of the ATAD ILR 30% EBITDA ratio rule against base erosion risks and remove the existing interest restrictions within Sections 247 and 249 TCA 1997.

In our view, retaining two separate interest limitation regimes on a permanent basis will increase the cost of borrowing for Irish businesses. By comparison, both Germany and the UK operate straightforward EBITDA-based interest limitation regimes.

As Ireland has different rules for trading and non-trading activities, a legislative basis for claiming a tax deduction for interest arising in a non-trading context would need to be established within the Irish corporation tax code, in conjunction with a full removal of Section 247 TCA 1997, by incorporating a general test for permitting a deduction for interest expense that is incurred for a business or commercial purpose, similar to the German tax system.

In the Institute's response to the Department of Finance's consultations on the implementation of the ATAD ILR in 2021 and in our Pre-Finance Bill 2022 Submission, we identified the interest deductibility provisions which we believe, following the enactment of the ATAD ILR into domestic legislation, are either no longer required or should be amended. We have included a summary of these provisions in Appendix I to this submission for completeness.

1.3. Targeted tax measures to promote the green agenda and sustainability

In line with the European Commission's *European Green Deal* and the 'Fit for 55 Package', Ireland's *Programme for Government: Our Shared Future*¹⁷ commits to achieving a 51% reduction in Ireland's overall green-house gas emissions from 2021 to 2030 (based on 2018 levels), and to achieving net zero emissions no later than 2050. These legally binding objectives are set out in the Climate Action and Low Carbon Development (Amendment) Act 2021.

At the same time, the environmental, social and governance (ESG) frameworks of many multinational groups mean that a key deciding factor when considering whether to invest in a particular jurisdiction is the range of available green energy and sustainability tax incentives on offer. Many jurisdictions are using tax incentives to support businesses in reducing their carbon emissions and to encourage investment in green/energy efficient projects. In our view, Ireland's current offering in this regard does not compare favourably with competitor jurisdictions.

We firmly believe that consideration must be given to tax measures which would support businesses in reducing their carbon emissions. The introduction of tax measures targeting the green agenda would also help the country to achieve its climate change targets.

We have set out below a number of enhancements to existing tax measures and new tax measures which we believe would improve Ireland's offering to businesses on their journey to decarbonisation and enhance the country's position as a location for sustainable investment.

1.3.1 Enhance accelerated capital allowances regime for energy efficient equipment

The cost incurred by a business in investing in energy efficient equipment (EEE) can be relieved for tax purposes through accelerated capital allowances (ACAs). ACAs provide a tax deduction equal to 100% of the costs incurred on qualifying EEE in the year the expenditure was incurred.

In our view, the ACA scheme is administratively difficult and is limited in scope. The scheme could be enhanced by:

- Widening the scope of the relief beyond EEE to whole buildings that receive a recognised accreditation for overall energy performance.
- Adding new product categories and removing the condition for products to be registered with the Sustainable Energy Authority of Ireland. Instead, the eligibility of products could be based on meeting performance criteria for their particular product category.
- Removing the condition that the equipment must not be leased, let or hired, as this precludes landlords and lessors from availing of the relief.

¹⁷ Programme for Government: Our Shared Future, Department of the Taoiseach, June 2020.

- Introducing a tax credit for companies which can be monetised where the company is loss-making for the element of the loss generated by the ACAs claim.
- Introducing an enhanced rate of relief above the current 100% first-year allowance.

1.3.2 Extend CGT participation exemption to early-stage renewable energy projects

In order to ensure that Ireland maximises the opportunity to become a centre for green financing activities, it is important that Ireland's holding company regime is on a par with other competitor countries in the EU.

To qualify for the participation exemption for capital gains on disposals of substantial shareholdings, Section 626B(2)(c) TCA 1997 states that at the time of the disposal:

- i. the activities of the investee company must consist "*wholly or mainly of the carrying on of a trade or trades*"; or
- ii. the business of the investor company and its subsidiaries and the investee company and its subsidiaries when taken as a whole "*consists wholly or mainly of the carrying on of a trade or trades*".

Many early-stage renewable energy companies may not meet this trading requirement, particularly at the very early stage of development of projects. However, given the capital commitments required to develop these assets, often these companies will seek to obtain funding from private investors by selling a portion of their equity interest resulting in a substantial CGT impact on the seller.

Consideration could be given to amending the requirement for the investee company to be considered 'trading' where the economic activity undertaken by the company qualifies as environmentally sustainable in line with the criteria set out in Article 3 of EU Taxonomy Regulation¹⁸. This would bring Ireland into line with other competitor jurisdictions such as the Netherlands and Luxembourg.

1.3.3 Reintroduce Section 486B TCA 1997

Section 486B TCA 1997 came into operation with effect from 18 March 1999 and provided tax relief to encourage corporate investment in certain renewable energy projects. The scheme ran until 31 December 2014. The relief was given in the form of a deduction from a company's profits for its direct investment in new ordinary shares in a "qualifying renewable energy company".

¹⁸ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

A qualifying renewable energy company included companies operating in the solar, wind, hydro or biomass technology categories. The relief was capped at the lesser of 50% of all capital expenditure or €9,250,000 for a single project. Further, investment by a company or group was capped at €12,700,000 per 12 month period. Unless the shares were held for at least 5 years by the investor company, the relief was withdrawn.

The reintroduction of this tax relief could encourage investment in sustainable projects and build on Ireland's reputation as a centre for sustainable innovation. Consideration could be given to expanding the technology categories to which the original scheme applied to include start-ups and SMEs undertaking decarbonisation activities, such as the development of carbon capture technology, hydrogen storage solutions or sustainable aviation fuel solutions.

1.3.4 Extend Section 81C TCA 1997

The net zero agenda is driving demand for high quality verified carbon offsets in the voluntary carbon market. Regulators, investors and lenders frequently request companies to measure their carbon footprint and put decarbonisation strategies in place. For many companies, the road to decarbonisation will take time and the purchase of carbon credits may be part of the interim solution for the transition period.

Section 81C TCA 1997 confirms that a corporate tax deduction for expenditure incurred for the purposes of the trade on the purchase of EU Emissions Trading Scheme (EU ETS) allowances is available and that amounts received or receivable for the disposal of purchased allowances are deemed to be trading receipts of the trade.

Consideration could be given to expanding the scope of the deduction for corporation tax in Section 81C to include carbon offsets in the voluntary sector. The definition of carbon offsets for this purpose could be aligned with the definition contained in Section 110 TCA 1997. This would limit the relief for the purchase of voluntary carbon credits to those issued under an approved scheme by a Government, inter-governmental, or supra-national institution which is subject to independent monitoring and reporting.

To promote a change in behaviour, the deduction could be linked to a requirement to report greenhouse gas emissions and prescribe pre-defined reductions over a transition period.

1.3.5 Green enhancements to the EIIS

Enhancements to the EIIS could assist Ireland in achieving its climate change commitments by helping to ensure businesses become energy neutral. The EIIS could be used as a policy lever to encourage investment in high-risk ventures which support green or energy efficient projects. However, a number of amendments to the EIIS would be required to achieve this objective.

Amend the definition of a qualifying company for EIS to include Relevant Renewable Energy Community (REC)

The Renewable Energy Support Scheme (RESS) provides support to renewable electricity projects in Ireland and aims to encourage growth of the green economy, generate sustainable employment, and ultimately benefit the consumer, as renewables become more cost effective.

For Community-Led Projects to participate in the RESS, they must meet certain requirements under the RESS 1: 2020 Terms and Conditions¹⁹ which require that the Community-Led Project must *“at all relevant times be at least 51% owned by a Renewable Energy Community (the “Relevant REC”)*”. In most Community-Led Projects, the Relevant REC is structured as a Company Limited by Guarantee without a share capital (CLG). The CLG is regarded as a company for the purposes of EIS.

An unintended consequence of these terms and conditions means where the Relevant REC of a Community-Led Project is structured as a company (which under RESS must hold 51% of the shares in the renewable energy project company), it will be precluded from raising funds under the EIS. This is because the “qualifying company” for the purposes of EIS cannot be controlled by another person/company.

We recommend a technical amendment to Section 490(3)(a)(ii) TCA 1997 to ensure that a “qualifying company” for the purposes of EIS includes a Relevant REC for Community-Led Projects under the RESS.

Carve out for green or energy efficient specific projects in the definition of “qualifying trading activities”

To promote investment in green or energy efficient specific projects by companies, we believe there should be a carve out in “qualifying trading activities” for green or energy efficient specific projects that would permit companies that would not normally qualify for EIS, to raise EIS finance for investment in such products and help their business to become energy neutral.

Consideration could be given to permitting companies that do not carry on “relevant trading activities” *per se* for the purposes of EIS, to avail of EIS finance to invest in ringfenced green energy efficient products to improve their carbon footprint.

For example, many commercial retail centres may wish to install PV solar panels on the rooftops of premises to source power for the building and become energy neutral. While capital allowances are available for energy efficient equipment, this does not solve the funding issue for many companies that wish to invest in such energy efficient specific projects.

¹⁹ Terms and Conditions for the First Competition Under the Renewable Electricity Support Scheme , RESS 1: 2020, Government of Ireland, February 2020.

If a carve-out in “qualifying trading activities” was permitted for investment in ringfenced green or energy efficient projects, consideration could be given to restrict the capital allowances available on the equipment to the extent of the amount of EIS relief obtained, similar to the treatment for normal grants.

1.3.6 Introduce targeted measures for green or energy related R&D

When considering the main design features of the R&D Tax Credit, noticeable comparisons can be drawn with other EU countries that have introduced targeted measures for green or energy related R&D. In order for Ireland to maintain and improve its competitiveness, consideration should be given to enhancing the R&D Tax Credit to encourage research, development and innovation which would facilitate emissions reductions and the development of new low carbon and carbon neutral products.

Some EU countries already have targeted measures in place for green or energy related R&D. For example:

- **Italy:** Special provision of a tax credit for technological innovation aimed at new or substantially improved manufacturing processes for ecological transition or digital innovation 4.0.
- **Portugal:** Expenses related to the making of eco-design products are increased by 10% upon submission and approval of the project by the Portuguese Environment Agency.
- **Spain:** A higher tax credit rate currently applies to expenses in technological innovation activities aiming at new or relevant improvements in the production processes in the value chain of the automotive industry.

1.3.7 Enhance relief for certain income from leasing of farmland

Section 664 TCA 1997 exempts from income tax certain income arising from leasing of farmland. To qualify for the relief, the farmland must be let under a qualifying lease by a qualifying lessor to a qualifying lessee. The definition of qualifying lessee ensures that relief is available only if the leased land is used by the lessee for the purposes of a trade of farming.

Revenue guidance²⁰ confirms that income received by a lessor from a solar energy company is not income received relating to farmland used for the purpose of a trade of farming, notwithstanding that the solar energy company may agree to occupy some of the land around the solar panels for the purposes of husbandry.

Therefore, unless the solar energy company can demonstrate that they are carrying on two distinct commercial activities (i.e., the solar panel activity and a farming activity) and that the farmland is wholly or mainly occupied for the purpose of husbandry, a lessor

²⁰ Revenue Tax and Duty Manual [Part 23-01-23 – Relief for certain income from leasing of farmland](#)

who leases out land to a solar energy company would not be entitled to Section 664 TCA 1997 relief.

The *Report on the Tax Treatment of Solar Panels on Farmland*²¹ notes that farmers unwilling to lease land for solar developments means reduced availability of suitable sites for development unless the solar developers can acquire such sites themselves, which may be difficult and costly. It further notes that restrictions on the supply of land used for solar projects will ultimately feed through to the costs of financing solar projects.

Notably, Finance Act 2017 amended Section 598 TCA 1997 to permit farmers whose land is leased to solar energy developers to qualify for retirement relief on a disposal of that land provided less than 50% of the land is so leased.

We believe consideration should be given to enhancing the relief available under Section 664 by extending the scope of the relief to include solar panel activity. In our view, this would incentivise the leasing of farmland for solar panels which would expand the generation of renewable energy and assist Ireland in achieving its climate change targets.

²¹ Report on the Tax Treatment of Solar Panels on Farmland, Department of Finance, 13 September 2017.

2. Technical issues arising from the implementation of Pillar Two

2.1. Issues arising from Finance Act 2022 changes to the R&D Tax Credit

Preliminary Tax Provision

The changes introduced in Finance Act 2022 to align the R&D Tax Credit with new international definitions of refundable tax credits provide for a new three-year fixed payment schedule. Under the new provisions the R&D Tax Credit is to be paid in full within 48 months from when a valid claim under Section 766C or Section 766D TCA 1997 is made, as follows:

- The first payable instalment in year one equals the greater of:
 - €25,000, or if lower, the amount of the R&D Tax Credit, or
 - 50% of the amount of the R&D Tax Credit
- The second payable instalment in year two equals three-fifths of the remaining balance of the R&D Tax Credit.
- The last payment in year three shall be the remaining balance of the R&D Tax Credit in respect of the accounting period, less the sum of the first and second instalment amounts.

Sections 766C(13) and 766D(12) TCA 1997 provide that where a company specifies that the first instalment of the R&D Tax Credit is to be offset against the company's corporation tax liability for the accounting period, then this amount may be taken into account for the purposes of calculating its preliminary corporation tax.

It is possible that a company may wish to claim all three instalments of the refundable credit as an overpayment of tax, for the purposes of Section 960H TCA 1997. However, it appears that under the legislation a company can take into account the first instalment only.

We believe that Sections 766C(13) and 766D(12) should be reviewed to consider facilitating companies that wish to claim all three instalments of the refundable R&D Tax Credit as an overpayment of tax that may be taken into account for the purposes of calculating its preliminary corporation tax. However, care should be taken to ensure any change does not result in any unintended consequences arising from the operation of the US Foreign Tax Credit Regulations.

2.2. Amendments to existing tax credits to align with Pillar Two Rules

2.1.1 Digital Games Tax Credit

Align with the definition of a 'qualified refundable tax credit'

Finance Act 2021 introduced Section 481A TCA 1997 which provides for the Digital Games Tax Credit. The relief is a refundable corporation tax credit for digital games development companies.

There is a concern that the method for granting relief for the Digital Games Tax Credit does not fall within the definition of a 'qualified refundable tax credit' for Pillar Two, given that it is firstly set against the corporation tax liability and is then refundable.

Similar to the Finance Act 2022 changes to the R&D Tax Credit rules, we believe it is necessary to amend the mechanism for granting relief for the Digital Games Tax Credit, as outlined in Sections 481A(22), 481A(23) and 481A(24) TCA 1997, to ensure that it falls within the definition of a 'qualified refundable tax credit' for the purpose of Pillar Two. As most of the large digital gaming companies are US based, the impact of the US Foreign Tax Credit Regulations must also be considered.

In amending the relief to align with the definition of a 'qualified refundable tax credit', we believe that the credit should be made fully refundable in one year. This would be in line with the current provisions where the digital games development company receives the full benefit in year one.

Amend the clawback provisions

The Institute has received feedback that the onerous clawback provisions which apply for the Digital Games Tax Credit are negatively impacting decisions by companies on whether to locate digital games development companies in Ireland.

Section 481A(26) TCA 1997 provides for a clawback where it is found that the payment of all or some of the Digital Games Tax Credit was not authorised. In such cases, the clawback may be assessed on the company, any director of the company, or any person referred to in Section 481A(13)(c) TCA97 (which includes each person who is either the beneficial owner of, or able directly or indirectly to control, more than 15% of the ordinary share capital of the digital games development company).

For the globally significant digital gaming companies to invest in Ireland, holding directors and shareholders personally liable is not workable. As the companies cannot allocate that risk to these parties, it is currently not possible for them to claim the credit. It would appear that the clawback provisions are based on those which apply for the Film Tax Credit even though the film industry significantly differs to the digital games industry in terms of how companies are structured.

We believe legislative amendment of the clawback provisions is needed if the Digital Games Tax Credit is to achieve its policy objective of incentivising increased investment by digital games development companies in Ireland.

2.1.2 Knowledge Development Box (KDB)

The KDB provides for a 6.25% effective rate of corporation tax on profits generated from exploiting certain assets, such as patents and software developed through R&D activities carried out in Ireland.

Pillar Two provides that members of the Inclusive Framework on BEPS which apply nominal corporate income tax rates below the Subject to Tax Rule (STTR) minimum rate of 9% to interest, royalties and a defined set of other payments should adopt the STTR into their bilateral treaties with developing Inclusive Framework members when requested to do so.

In preparation of the implementation of Pillar Two, Finance Act 2022 increased the effective rate of the KDB to 10%. The amendment is subject to Ministerial commencement order, by reference to international progress on the implementation of the STTR.

In order to achieve the 6.25%/10% effective rate, the KDB gives a downward adjustment to taxable profits. In a Pillar Two context, for the purpose of the effective tax rate calculation, this reduces the 'covered taxes', but the 'GloBE income' taken from the financial statements stays the same. As top up tax will be paid on the difference between the GloBE minimum rate of 15% rate and the KDB rate, this means the benefit of the KDB will be negated.

To preserve the benefit of the KDB, in our view, consideration should be given to redesigning the mechanism for granting relief under the KDB so that it is a tax credit which falls within the definition of a 'qualified refundable tax credit' under Pillar Two rules. This would help ensure that the KDB can continue to incentivise the commercial exploitation of patents and software developed through R&D activities in Ireland, following the implementation of Pillar Two.

3. Support the growth of the indigenous sector

Ireland's overdependence on corporation tax receipts from a small number of companies in the multinational sector is widely recognised as a significant risk to the economy. The proportion of income tax receipts from these companies also represents a significant concentration and risk for the Exchequer.

The most sustainable strategy for mitigating the risk of over-reliance on the multinational sector is to broaden the economic base by building an innovative, productive, and competitive indigenous sector. Effective tax measures such as the EIIS, the KEEP, the R&D Tax Credit and CGT Entrepreneurial Relief have a significant role to play in this endeavour. We welcome the commitment given by the Minister for Finance, Michael McGrath T.D., at the Institute's Annual Dinner in February, that he intends to take "*a fresh look at all the enterprise tax measures on the table to assess whether they are working properly, and fulfilling the potential that we know our economy can deliver.*"

Although there have been some welcome changes to the key tax measures targeted at small enterprises in recent Finance Bills, we believe that further improvements to existing measures are required if they are to achieve their policy objectives. Notably the White Paper on Enterprise 2022 – 2030²² acknowledged that there is scope to develop the tax measures, which are targeted at small enterprises, to increase take-up and improve impact by ensuring that schemes are not too restrictive or costly and to address the severity of penalties applied, even for small transgressions.

In addition to considering the necessary legislative amendments, a key focus of any review of the tax incentives aimed at SMEs must be to ensure that the administration of the tax measures does not act as a barrier to access for early stage and small businesses.

In this regard, the Institute endorses the recommendation of the Commission on Taxation and Welfare that Revenue, the Department of Enterprise Trade and Employment and the enterprise agencies develop a mechanism which can provide the necessary assurance and comfort for small enterprises that they are eligible for tax incentives, particularly in respect of the R&D Tax Credit, the KEEP and the EIIS. In our view, such an assurance mechanism could help alleviate the risk for smaller businesses in availing of these incentives which can often act as a deterrent.

We have outlined below the reforms we believe are necessary to maximise existing reliefs to encourage investment in SMEs and make them more accessible to start-ups. We also believe that the Government should consider the case for reducing the rate of CGT which can be a deciding factor for potential investors in SMEs.

²² White Paper on Enterprise 2022 – 2030, Department of Enterprise, Trade and Employment.

3.1 Improve the EIS and SURE

The Commission on Taxation and Welfare recognised the role of appropriately targeted taxation measures, such as the EIS, to support SMEs in raising equity investment, and thereby supporting such firms to establish, grow and sustain employment. The Institute endorses the Commission's recommendation that the EIS should be extended and enhanced to support early-stage, high-risk and R&D intensive businesses in attracting stable financial investment.

For early stage and small businesses that have limited financing options, the EIS should be an essential source of funding to help them grow and develop. However, contrary to the objective of the scheme, the feedback we continue to receive is that as the rules of the EIS do not reflect commercial investment norms, the scheme can hamper a company's ability to grow and expand.

Our members have in-depth experience of the operation of the EIS and their input informed the Institute's response to various public consultations carried out by the Department of Finance on the EIS, most recently in February 2021.²³ Whilst the changes introduced in recent Finance Acts have, for the most part, enhanced the scheme, the EIS continues to be very complex and burdensome to administer.

Further amendments are necessary to ensure the EIS and SURE can fulfil their policy objective of supporting the growth of indigenous business. These reforms are outlined below and are listed in order of importance, based on recent feedback the Institute obtained directly from SMEs/ entrepreneurs.²⁴

EIS – Recommendations for Legislative Amendment

i. Allow the offset of capital losses

Capital losses, net of tax relief already received, incurred on EIS investments should be allowable, in line with the recommendation made by Indecon in their 2018 evaluation of the scheme.

ii. Permit holding company structures

The exclusion of holding company structures is causing genuine businesses to be precluded from EIS finance. Typically, founder holding companies are established before raising EIS finance is even a consideration. These structures are inadvertently borne out of genuine commercial arrangements, sometimes as a result of partnerships or Joint Ventures (JVs) arising from incubator programmes or due to the understanding of founders as to market norms and investor expectations on certain structures. In some cases, the structure can be a legacy from a previous failed venture.

²³ <https://taxinstitute.ie/wp-content/uploads/2021/02/2021-02-12-ITI-Response-to-the-Public-Consultation-on-EIS.pdf>

²⁴ Feedback provided as part of the Enterprise Ireland Tax Stakeholder Event, 26 April 2023.

The exclusion of founder holding companies from the EIS is in stark contrast to other funding sources (including Enterprise Ireland and other Government funding) where founder holding company structures are permitted and in fact, are encouraged in certain sectors. Furthermore, the General Block Exemption Regulations (GBER)²⁵ which sets out the conditions which the EIS, as a State aid, must satisfy, does not prohibit holding companies.

iii. Amend the employment conditions

Section 26(b) Finance Act 2021 reintroduced a condition in Section 502(5) TCA 1997 regarding increases in employment or expenditure on R&D. The condition must be satisfied three years after the year in which the eligible shares are issued. Failure to satisfy the condition will result in a partial withdrawal of the tax under the scheme.

This condition was removed in 2019 following the removal of second stage relief for shares issued after 8 October 2019. The removal of the condition was in line with the stated objective at that time, to increase the efficiency and effectiveness of the scheme. The reintroduction of the condition further adds to the administrative burden and does not take account of the fact that businesses may pivot and change their business models during the interim period.

Section 502(5) TCA 1997 requires an increase in (a) both the number of employees and the total remuneration of employees, or (b) the expenditure on R&D. The requirement to increase both the number of employees and the total remuneration of employees can be problematic and would appear to be contrary to Section 496(2)(a) TCA 1997, which states that EIS is for the creation or maintenance of employment.

In our view, it would be more appropriate for a company to be deemed to have fulfilled the employment condition if they satisfy either of the tests i.e., an increase in the number of employees under Section 502(5)(a) or an increase in total remuneration under Section 502(5)(b)) TCA 1997.

iv. Impact of non-compliance

Under existing rules, administrative errors or delays in the certification and reporting process can result in a full clawback of the relief on the fundraising company²⁶ which is disproportionate to the error in our view. These penal sanctions can act as a disincentive for companies considering using the EIS.

We believe it would be more proportionate for a monetary penalty to be imposed,

²⁵ Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty

²⁶ For example, where eligible shares are held by a nominee, a failure to file a nominee return (Form 21R) may result in such shares ceasing to be eligible shares and consequently, there will no longer be a qualifying investment for the purposes of the relief (see section 494(2) and section 496 TCA 1997). This means that there is a clawback of the relief on the company under section 508U TCA 1997.

rather than a clawback of the entire EIS relief, as a sanction for an administrative error or the late filing of a return.

v. Amend the connected party rules

We welcomed the amendment to the connected party rules in Finance Act 2022 where the EIS investment in a company is made via an investment fund. However, we believe a further amendment to the connected party rules is necessary where the EIS investment is made directly in the qualifying company.

The connected party rule limits the ability of early-stage companies to attract strong board membership because shares and share options granted to non-executive directors or other key employees to incentivise them to join the board, are curtailed. Investment by such individuals can be key to developing a business as it means they are committed to its future.

In our view, there should be a carve-out from the connected party rule linked with a control test, so that shares and share options granted to non-executive directors or other key employees will not automatically result in ineligibility as a qualifying investor.

vi. Provide a 4-year holding period for all EIS investments

Consideration should be given to having a 4-year holding period for all EIS investments. If the 7-year rule for investments up to €500,000 is retained, we believe only a partial clawback should occur between years 5 to 7. At the very least, the first €250,000 beyond year 4 should not suffer a clawback, instead of the entire EIS relief claimed.

vii. Exit strategies for EIS investors

Normal commercial investment decisions are always made with exit strategies being provided to investors. Investors will always ask about what the company will do with their money and how and when they will receive a return on their investment.

The EIS only allows investors to exit by way of share redemption or a trade sale. The former attracts income tax treatment and requires the company to have accumulated distributable reserves, and the latter only materialises for a small number of companies. Investee companies also need to be able to tidy up their share capital tables in advance of a potential exit or for other commercial reasons without the fear of contravening the EIS rules.

The EIS imposes a clawback of relief for investors still within their relevant period if other EIS investors are taken out. In the event a company raises several rounds of EIS funds, it is not reasonable to expect the investors in Round 1, who took on the highest levels of risk, to have to wait until the 4-year period of the final round has expired to receive a return on their investment. The redemption windows set

out in Section 508R (9) TCA 1997 are not sufficient.

We believe the EIS should recognise exit strategies for investors beyond what is provided by way of a share redemption under Section 508R(9) TCA 1997 or trade sale, given the high commercial risks investors assume.

EIS – Tax Administration Recommendations

i. Resourcing

Appropriate and adequate resourcing of the processing of EIS applications is essential. To ensure consistency in dealing with applications in a timely manner, it is important that there are dedicated full-time staff who understand the complicated rules of the scheme, together with staff who have commercial knowledge and experience in dealing with businesses.

ii. Enhanced support for start-ups through EIS

The introduction of a streamlined administrative process for small and micro companies to help them avail of EIS finance, by adopting non-mandatory template forms (for business plans, cash flows etc.) which would ease the extensive administrative burden for them.

SURE – Recommendation for Legislative Amendment

Under the SURE scheme, an individual needs to have paid sufficient income tax through the PAYE system in the previous four years. This means that a previously self-employed person, who has paid equivalent levels of income tax through the self-assessment system, does not qualify for relief. Apart from discriminating against self-employed workers, this restriction acts as a significant barrier to the effectiveness and applicability of SURE. In our view, the SURE scheme should be extended to self-employed workers who set up a new business.

3.2 Enhance the KEEP

The KEEP was introduced by Finance Act 2017 to assist SMEs²⁷ to attract and retain skilled workers through the provision of share-based awards. It provides for an exemption from income tax, USC and PRSI for any gain arising on the exercise of a share option by a qualifying individual in a qualifying company. Irish SMEs continue to experience difficulties recruiting and retaining skilled workers. Attracting the best talent is central to building a successful company and is crucial to the future growth and export potential of the business.

Several amendments were made to KEEP in Finance Act 2019 which related to companies operating through a group structure qualifying for the scheme; extending the

²⁷ A company will be considered a micro, small or medium sized enterprise (SME) where the company employs fewer than 250 employees and its annual turnover/annual balance sheet does not exceed €50 million and €43 million respectively.

definition of a 'qualifying individual' to include certain part-time employees and permitting the grant of KEEP options over existing shares, as opposed to newly issued shares. The Finance Act 2019 provisions were brought into effect in Finance Act 2022.

The Institute welcomes the Finance Act 2022 amendments to the KEEP, including extending the scheme to 1 January 2026, doubling the lifetime company limit for the KEEP shares from €3 million to €6 million, and enabling CGT treatment to apply to the buyback of KEEP shares by a company from a relevant employee. However, as these changes are subject to a Ministerial commencement order while State aid approval is obtained, the impact of the Finance Act 2022 amendments on the uptake of the KEEP remains to be seen.

Notwithstanding these amendments, we believe further legislative reforms are needed to improve the feasibility of the KEEP. In our view, the policy intention of KEEP, to help SMEs attract and retain key employees, can only be achieved if these limitations are addressed.

In our response to the Department of Finance consultation on the KEEP in June 2022,²⁸ we outlined the limitations of the scheme in detail together with our recommendations for reforms to the existing legislation. In summary, we recommended the following legislative amendments, listed in order of importance based on recent feedback we have received from SMEs/entrepreneurs.²⁹

i. Amend the definition of a 'qualifying holding company'

While the amendments introduced by Finance Act 2019 (and brought into effect in Finance Act 2022) are welcome and are likely to go some way to increasing the number of groups that can now qualify for the KEEP, there are certain conditions attaching to the new definitions of 'qualifying holding company' and 'qualifying group' which will continue to hinder certain groups availing of the scheme.

For example, it is common for a new business to start up as a single trading entity, then, as the business grows and expands into new territories or delivers new products, it can become necessary for commercial reasons to incorporate another entity. Often, such new entities are established as subsidiaries of the original trading company. As the business activities expand, the original company often continues to carry on the existing trade but also evolves into a holder of the shares in the new trading subsidiary.

Generally, such businesses would not put a company in place whose sole or main business is that of holding shares, as the stage of development of the business may not warrant it or it may not be commercially necessary to do so, particularly given the complexity and cost that can be involved in undertaking a group restructure to put a holding company in place.

²⁸ <https://taxinstitute.ie/wp-content/uploads/2022/06/2022-06-17-Irish-Tax-Institute-Response-to-Key-Employee-Engagement-Programme-KEEP-Questionnaire-2022-FINAL.pdf>

²⁹ Feedback provided as part of the Enterprise Ireland Tax Stakeholder Event, 26 April 2023.

Many businesses that wish to set up a KEEP scheme are prevented from doing so because of the restrictive definition of a 'qualifying holding company' under the legislation.

The following conditions for a 'qualifying holding company' are particularly problematic:

- A 'qualifying holding company' for KEEP purposes cannot be a trading company. If it is trading, it is not a 'qualifying holding company', even if it is wholly or mainly holding shares in trading subsidiaries.
- Company structures with an intermediate holding company may not be regarded as a qualifying company if there is no qualifying subsidiary held directly by the ultimate holding company. By way of comparison, Revenue guidance for Revised Entrepreneur Relief (Section 597AA TCA 1997) acknowledges that structures with a double holding company are not precluded from that relief.
- A holding company can only hold shares in a qualifying subsidiary and a 'relevant subsidiary' and no other companies. A 'relevant subsidiary' is one in which the 'qualifying holding company' holds more than a 50% interest in the ordinary share capital. Therefore, if the holding company had a 50% joint venture interest in another company it cannot be a 'qualifying holding company', even if it had a qualifying subsidiary that was a qualifying company.

We believe that the definition of 'qualifying holding company' in Section 128F(1) TCA 1997 should be amended to permit the group as a whole to be considered, rather than simply considering the holding company in isolation.

This could be achieved by amending the wording of the definition of a 'qualifying holding company' at subsection (c) to state that it means a company where *"the business of the company, its qualifying subsidiary or subsidiaries, and as the case may be, its relevant subsidiary or subsidiaries, taken together consists wholly or mainly of the carrying on of a trade or trades."* This approach would be similar to the approach taken for the CGT holding company exemption in Section 626B TCA 1997.

In addition, the legislation is unclear as to whether it is possible to issue the KEEP options in a single company within a group that meets the 'qualifying company' tests or whether it is necessary for the group, of which the qualifying company is part, to be a 'qualifying group'. This should be clarified in the legislation.

ii. A Revenue agreed 'safe harbour' for share valuations

In our responses to the 2019 and 2022 consultations on KEEP, we highlighted that one of the most significant practical issues that SMEs face when implementing KEEP is the ability to achieve as much certainty as possible that the valuation conditions have been met. For example, that the share option price is not less than the market value of the shares at the date of grant.

Currently, there is no guidance on how to determine what market value is for the purposes of the KEEP. If qualifying options are not granted for market value or the market value is subsequently determined by Revenue to be higher than originally projected, the options would not qualify as KEEP options under Section 128F TCA 1997, resulting in no exemption from income tax, USC and PRSI on exercise.

Comprehensive guidance on share valuations is required to support companies adopting the scheme. This would make the process more accessible, easily understood, and capable of implementation without undue duplication of effort and cost.

This could be achieved by developing templates or safe harbour approaches for valuing shares in a SME. This would mean that a taxpayer would have assurance from Revenue that the share valuation is not less than market value for tax purposes, where the taxpayer had adopted the safe harbour approach to valuing the KEEP shares.

It is worth noting that it is possible to agree a valuation of a company with HMRC for the purposes of the Enterprise Management Incentive (EMI), a share scheme in the UK which is similar to the KEEP. The valuations from HMRC are valid for 90 days from the date of the agreement. An application request for a share valuation in connection with the EMI can be made online by the SME and are given priority by HMRC.

In addition, where options are granted at an undervalue, we believe that a more proportionate sanction would be for a charge to income tax to arise on the exercise of the options on the difference between the market value at the date of grant and the option price. This would allow the options to remain qualifying share options, but it would also enable Revenue to collect income tax on the portion of the gain attributable to the undervalue.

The income tax arising on exercise could be collected under the same mechanism as Section 128 TCA 1997 (i.e., a charge to income tax under Schedule E is imposed on any gain realised by a director or employee from a right granted to him/her, by reason of his/her office or employment, to acquire shares or other assets in a company).

iii. Remove the annual emoluments cap from the qualifying share option limits

Currently, the total market value of all shares, in respect of which qualifying share options have been granted by the qualifying company to an employee or director, must not exceed €100,000 in any year of assessment, €300,000 in all years of assessment or 100% of the annual emoluments of the qualifying individual in the year of assessment in which the qualifying share option is granted.

In our response to the 2019 and 2022 consultations, we outlined that linking the amount of share options that can be awarded under the KEEP to the employee's annual emoluments restricts high growth companies in start-up mode availing of the scheme. Often in start-up businesses, employees and directors have lower salaries, compared with larger multinationals, which can prohibit such companies under the KEEP offering equity as an incentive for these individuals to stay in the business.

We suggest that rather than discriminating in practice against the remuneration strategies of these companies and the mix of cash-based and equity-based remuneration that they offer employees, the KEEP measures should simply set absolute values, such as those included in subparagraph (i) and (ii) of part (d) of the definition of a qualifying share option in Section 128F (1) TCA 1997. It should be left to companies to determine the proportionate mix of cash and share-based remuneration as a commercial matter and to follow market driven pay awards.

We believe that such an amendment to the qualifying limit of 100% of the annual emoluments of the qualifying individual would take account of situations where an employee's salary has reduced because of reduced working hours or a temporary layoff. It would also address situations where employees, who are temporarily absent from work due to maternity or paternity leave, are limited in terms of the relief which may apply, as often their salary levels would be reduced during this time.

In addition, we have received feedback from members that the lifetime limit of €300,000 can act as a barrier to claiming relief under the scheme where shares have increased in value. In our view, consideration should also be given to applying the limit on a rolling basis. It is noteworthy that in the UK scheme, the cap is on the value of the share options as opposed to the value of the shares, which can be rolled over every three years.

iv. Allow for the continuation of the relief where a SME undergoes a reorganisation

The current KEEP legislation does not provide for the continuing availability of the relief in the event of the SME (e.g., holding company and its subsidiaries) undergoing a corporate reorganisation during the period in which the KEEP share option rights are outstanding.

We would suggest amending the KEEP legislation to include similar provisions to those contained within the Revised Entrepreneur Relief legislation, which seeks to address reorganisations³⁰ that might affect the entitlement of a qualifying individual and a qualifying company to meet the scheme requirements.

v. Provide for 'roll over relief' of the KEEP share options

We believe that Section 128F TCA 1997 should be amended to provide 'roll over relief' of KEEP share options, similar to that provided in Section 128(8)(a) TCA 1997. Where share rights are exchanged between directors and employees or a company grants a new right in exchange for the surrender of an original right, the new right and the original right are looked at as one for the purpose of the charge to tax under Section 128. This 'roll over relief' effectively means that the tax charge arises at the point of exercise of the new right, with the history of the original share right taken over in respect of a future exercise of the new right. A similar relief is not included in the KEEP legislation.

For example:

- Company A grants share options that meet the conditions of the KEEP under Section 128F TCA 1997 and would qualify for an exemption from income tax on exercise.
- During the exercise period, a transaction is entered into which results in the share capital of Company A being acquired, and unexercised share options are exchanged or assigned for new options in the acquiring company.

In our view, Section 128F should be amended to provide 'roll over relief' in respect of KEEP share options. This would apply where during the exercise period, a transaction is entered into which results in the share capital of a company being acquired, and unexercised KEEP share options are exchanged or assigned for new options in the acquiring company.

In such circumstances, we believe that if the acquiring company meets the qualifying company/ group criteria set out in the legislation, the future exercise of the new replacement options should qualify for relief, with the history of the original share option being taken over for the purposes of determining the charge to tax.

³⁰ Corporate reorganisations under section 586 and 587 TCA 1997.

3.3 Reduce the CGT rate

Ireland's headline rate of CGT, at 33%, is high by international standards. A high CGT rate can result in delays in selling investments that have large unrealised gains. In our view, Ireland's high CGT rate is restricting external investment in Irish business. It is also creating reluctant business owners who may hold onto businesses beyond the point where they have capacity to grow them to the scale required to expand into export markets.

Given the low level of receipts in recent years it is reasonable to ask if the high rate is having a dampening effect on productivity and growth in the SME sector. We know from previous experience that reducing the CGT rate can stimulate activity and increase the yield to the Exchequer.

Feedback we have received directly from SMEs/ entrepreneurs³¹ confirms that a reduced CGT rate of 25% applying to business assets would help stimulate activity and attract more investment in indigenous business.

3.4 Enhance Entrepreneur Relief

Ireland's high rate of CGT makes reliefs such as Entrepreneur Relief³² even more important as the relief can reduce the high CGT burden on the sale of a business albeit to a limited extent. The relief allows for a lower 10% CGT rate on business gains which is subject to a lifetime limit of €1 million.

Feedback we have received from members and directly from entrepreneurs is that the current design of the relief is one of the key contributing factors to holding back the indigenous entrepreneurial ecosystem.

Entrepreneur Relief requires that an individual must spend at least 50% of his/her time working for the company continuously for a period of three years at any time prior to the disposal to qualify for the relief. Feedback the Institute has received directly from entrepreneurs suggests more angel/venture capital investors would invest in SMEs if the working time condition for Entrepreneur Relief (i.e., 50% of their working time) was reduced.³³ Typically, 'angel investors' mentor and support several companies at the same time and therefore, they cannot possibly satisfy this working time requirement.

Consequently, the relief locks out important external investors, who not only invest money but provide experience and industry expertise, which are vital factors when considering the deficit in managerial capability in Irish businesses as has been highlighted by the OECD.³⁴ In 2020, Ireland's enterprise birth rate of 6.7% was lower than the European average of 8.9%.³⁵

³¹ Feedback provided as part of the Enterprise Ireland Tax Stakeholder Event, 26 April 2023.

³² Section 597AA TCA 1997

³³ Feedback provided as part of the Enterprise Ireland Tax Stakeholder Event, 26 April 2023.

³⁴ OECD Ireland Country Report, OECD, March 2018.

³⁵ OECD Economic Surveys: Ireland 2022, December 2022.

The current conditions of Entrepreneur Relief rule out the possibility of external investors benefiting from the lower 10% rate. Therefore, any investor who makes a gain must pay one third of that gain in CGT, and this is a real barrier to investment in Ireland. If the conditions attaching to CGT Entrepreneur Relief were reformed, it would encourage such investors to take the risk to invest in Irish SMEs and start-ups.

In our view, the legislation should be amended to permit much-needed external 'angel investors' avail of Entrepreneur Relief. This would be in line with the OECD's recommendation that Entrepreneur Relief should be broadened by making third party equity investors eligible.³⁶ We also believe the existing €1 million lifetime threshold needs to be increased to compete effectively with other countries for international capital.

There are also technical issues with the current Entrepreneur Relief legislation³⁷ (as interpreted in Revenue's Operational Manual)³⁸ which are limiting the availability of the relief in the following five significant situations:

i. Where there is a dormant company in a group

According to Revenue's Operational Manual, Entrepreneur Relief is not available in situations where a dormant company is present in the group. This is a very significant limitation to the relief because a subsidiary company can commonly become dormant over time.

This might happen where the company has ceased to trade or where the trade has been transferred to another group company and the company cannot be wound up or liquidated due to company law legislation for the protection of creditors. A group company could have dozens of trading subsidiaries, out of which only one is dormant, yet the relief is completely denied to the entrepreneur in this situation. We recommend that the legislation is amended to remove restrictions to Entrepreneur Relief in situations where a group holds a dormant company.

ii. Where a group is party to a joint venture

One of the conditions of Entrepreneur Relief is that all subsidiaries must be minimum 51% subsidiaries for the relief to apply. If a group is party to a joint venture and holds less than 51% of the joint venture company, this again can result in full denial of the relief.

We recommend that the legislation is amended to remove restrictions to Entrepreneur Relief in situations where a group has a shareholding in a joint venture company of less than 51%.

³⁶ OECD (2019), *SME and Entrepreneurship Policy in Ireland*, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris, <https://doi.org/10.1787/e726f46d-en>

³⁷ Section 597AA Taxes Consolidation Act 1997.

³⁸ Revenue Operational Manual 19.06.02B – Capital Gains Tax Revised Entrepreneur Relief.

iii. Where a company/ group holds investments or leases trading premises

When either the holding of investments or the leasing of trading premises takes place within a group company, this can exclude an entrepreneur from claiming Entrepreneur Relief. It is common for businesses to invest cash generated from trading activities rather than leaving it on deposit. This results in them holding investments.

Similarly, many companies who expect high growth in the short-term will often buy or lease premises that exceed their current needs but will meet their future expectations. These businesses will occasionally rent the excess space out to a third party until they need to expand into the space.

Both these activities are efficient from a commercial perspective. They improve cash flow, while utilising the companies' assets to their full potential. Yet they can impact on this important tax relief.

We would ask that consideration be given to either apportioning the relief in circumstances where there is a mix of investments and qualifying activities (similar to the Retirement Relief provisions³⁹) or to allow the relief in full where non-trading activities are below a certain *de minimus* level.

This is the approach adopted in the UK, where Business Asset Disposal Relief (formerly known as Entrepreneurs' Relief) is available on the sale of shares in a holding company, provided non-trading activities in the group do not comprise of more than 20% of the group's overall activities.

iv. Where a holding company of a trading company is liquidated

The legislation does not specify whether Entrepreneur Relief is available on a liquidation. Revenue's guidance on Entrepreneur Relief only refers to situations where the liquidated company is carrying on a qualifying business up to the time the liquidator is appointed. However, it is unclear whether Entrepreneur Relief can apply on the liquidation of a qualifying holding company, for example;

- (a) where the trading company has been sold and a holding company is being liquidated to access the sales proceeds; or
- (b) the trading company continues to trade and the holding company is being liquidated for administrative / commercial purposes.

We recommend that the legislation is amended to ensure that the existence of a holding company does not prevent a claim for Entrepreneur Relief in a liquidation scenario.

³⁹ Section 598 TCA 1997

v. Where EIS funds are raised by a company

A founder of a company which was financed using shares issued under the EIS may be denied Entrepreneur Relief on disposal of their shares in certain circumstances. This issue arises because Entrepreneur Relief requires the vendor to own 5% of the ordinary share capital of a company.

Often, EIS shares do not have voting rights and have limited dividend and winding up entitlements. However, such EIS shares may be considered to be ordinary share capital for tax purposes, as Section 2 TCA 1997 defines ordinary share capital as “*all the issued share capital (by whatever named called) of a company, other than capital the holders of which have a right to a dividend at a fixed rate, but have no other right to share in the profits of the company*”.

This means, for example, if a founder shareholder owned 100 €1 ordinary shares but the company also had 500,000 €1A ordinary shares in issue from a previous EIS, a disposal of the founder’s shares may not qualify for Entrepreneur Relief, as the legislation is silent on whether to consider the number of shares in issue or the nominal value of the shares in issue, when applying the 5% shareholding test.

We recommend that the legislation be amended to confirm that shares which qualified for relief under Part 16 TCA 1997, with the exception of shares qualifying for SURE, should be ignored for the purposes of meeting the 5% shareholding test for CGT Entrepreneur Relief. Clarification would also be welcome on whether it is the number of shares or the nominal value of shares that is relevant when determining the 5% test.

3.5 Refine the R&D Tax Credit

The Institute welcomes the Finance Act 2022 changes to the R&D Tax Credit to align the credit with new international definitions of refundable tax credits. Recent feedback we have received from companies suggests the new three-year fixed payment system will help improve the uptake of the R&D Tax Credit for SMEs.

With the implementation of Pillar Two, many countries are currently improving or introducing new incentives for R&D with a view to attracting investment. Given the mobility of R&D investment, it is critical that the R&D Tax Credit is continually benchmarked against key competitor jurisdictions to ensure that Ireland can continue to attract additional R&D investment.

We believe further legislative amendments are needed to incentivise increased investment in innovation by SMEs in Ireland. We agree with the recommendations of the Commission on Taxation and Welfare in relation to the R&D Tax Credit that:

- enhanced relief measures be introduced which are targeted at small and micro-sized enterprises;
- guidance and supports should be introduced to facilitate greater uptake by SMEs more generally; and
- consideration be given to a limited acceleration of the refundable element of the R&D Tax Credit from three years to one in order to support early-stage and research and development-intensive businesses.

The Institute's response to the Department of Finance consultation on the R&D Tax Credit and KDB in May 2022⁴⁰ outlined how the R&D Tax Credit can play a critical role in supporting innovation in Ireland's indigenous businesses together with recommendations for reform of the existing legislation and administration of the R&D Tax Credit. In summary, we recommended the following legislative and administrative changes.

R&D Tax Credit - Recommendations for Legislative Amendment

i. Condense the 3-year R&D Tax Credit payment schedule to one year for SMEs

The changes introduced in Finance Act 2022 to align the R&D Tax Credit with new international definitions of refundable tax credits provides for a new three-year fixed payment schedule. We believe condensing the 3-year R&D Tax Credit payment schedule to one year for SMEs would provide valuable assistance to smaller companies that tend to be cash constrained and accelerating the refund for them would be very beneficial, with only a timing cost for the Exchequer.

ii. Allow rent to qualify as R&D expenditure

The R&D Tax Credit plays a critical role in supporting innovation in our indigenous businesses. The *Report of the SME Taskforce: National SME and Entrepreneurship Growth Plan*⁴¹ identifies enhancements needed to the R&D tax credit to incentivise increased investment in innovation by Irish SMEs. However, Revenue's guidance,⁴² updated in July 2020, significantly impacted the attractiveness of the R&D Tax Credit for SMEs.

In July 2020, Revenue updated their guidance on Section 766(1) TCA 1997 on the circumstances in which rental costs can be considered qualifying expenditure for the purpose of the R&D Tax Credit. Notwithstanding representations from tax advisers through TALC⁴³, Revenue confirmed their view that in most cases rent does not qualify as R&D expenditure but there may be scenarios where rent can qualify where the expenditure is incurred wholly and exclusively in the carrying on of the R&D activities.

⁴⁰ <https://taxinstitute.ie/wp-content/uploads/2022/05/ITI-Response-to-the-Public-Consultation-on-the-RD-Tax-Credit-and-KDB-May-2022-FINAL.pdf>

⁴¹ Report of the SME Taskforce: National SME and Entrepreneurship Growth Plan

⁴² <https://www.revenue.ie/en/tax-professionals/tadm/income-tax-capital-gains-tax-corporation-tax/part-29/29-02-03.pdf>

⁴³ <https://taxinstitute.ie/wp-content/uploads/2021/06/2020-11-16-ITI-Submission-to-Revenue-on-treatment-of-rent-in-Research-and-Development-TDM.pdf>

The guidance provides examples of rent incurred on a specialised laboratory or a clean room in order to advance R&D activities which it states may be qualifying expenditure but the rent of an office space in which R&D activities are carried on is not qualifying expenditure as the office is *“the setting in which R&D happens and does not itself perform a key function in relation to the R&D process”*. We believe that Revenue’s guidance significantly narrows the circumstances where rent may be included as qualifying expenditure on R&D and in our view, is contrary to the policy intention of the R&D Tax Credit.

We consider that Revenue’s interpretation also creates a clear inequity in favour of companies that have the available resources to incur expenditure on the construction or refurbishment of a building or structure for R&D purposes rather than incur a rental cost.

Section 766A TCA 1997 provides that where a company acquires a building and incurs expenditure on the refurbishment of the building for R&D purposes, these costs, subject to meeting specific conditions, qualify for the R&D Tax Credit. However, based on Revenue’s most recent guidance, renting the same refurbished R&D building may not qualify for the R&D Tax Credit even if the same R&D activity is being undertaken in the building.

As rental costs are a substantial cost for most small and micro sized companies, the disallowance of rent as qualifying expenditure on R&D significantly diminishes the attractiveness of the R&D Tax Credit for such companies.

Feedback the Institute has received directly from entrepreneurs confirms that legislative clarification is necessary to ensure rent is a qualifying cost for the purpose of the R&D Tax Credit so that the tax incentive can continue to encourage investment in R&D and innovation by Irish business.⁴⁴

iii. Increase the limits for outsourcing

We believe the level of qualifying expenditure incurred by a company when R&D is sub-contracted or outsourced to a third-party or university or Institute of Higher Education should be increased, above the current limits of 15% of in-house R&D expenditure or €100,000 (whichever is greater). This would be in keeping with Government policy to foster collaboration between academia and private business.

Consideration should also be given to amending Revenue guidance on the conditions for agency staff to be disregarded as outsourcing, to reflect the new hybrid working environment.

⁴⁴ Feedback provided as part of the Enterprise Ireland Tax Stakeholder Event, 26 April 2023.

iv. Incentivise green or energy related R&D

As detailed in paragraph 1.3.6 of this submission, in our view consideration should be given to new targeted measures for R&D in specific priority areas, such as green or energy related R&D. The introduction of such targeted measures could help the Government to deliver its ambitious carbon emission targets.

R&D Tax Credit - Tax Administration Recommendations

i. A Revenue pre-approval process for first-time R&D Tax Credit claims by small and micro companies

In an effort to reduce the administrative burden, Revenue does not seek to challenge the 'science test' as part of any validation checks on a R&D Tax Credit claim made by a small or micro company that has already been approved for an Enterprise Ireland, Horizon 2020 or IDA grant for the R&D project, provided the credit claim is no more than €50,000 for any accounting year and the R&D project is undertaken in a qualifying field of science or technology. While this is a welcome simplification measure for small/micro companies, we would recommend that consideration be given to increasing the amount that can be claimed from €50,000 to make the credit more accessible for small/micro companies and start-ups.

We believe a pre-approval process for first time R&D Tax Credit claims by small/micro companies would help to alleviate the uncertainty over Revenue subsequently challenging the claim on the 'accounting test' (i.e., the record-keeping requirements).

Notably, the OECD has recommended the introduction of such a pre-approval process to help reduce uncertainty for SMEs.⁴⁵ In the UK, SMEs making their first R&D claim can qualify for 'Advance Assurance'. If 'Advance Assurance' is granted, HMRC will accept any R&D claims in the first three accounting periods without the need for HMRC to carry out further checks on the claim.

ii. Simplified documentation requirements for R&D Tax Credit claims by SMEs

The 'accounting test' must be passed by small and micro companies. Only those revenue expenses that are incurred by the business wholly and exclusively in the carrying on of R&D activities can qualify for the R&D Tax Credit. This includes salaries and wages of staff directly involved in the R&D activity, cost of raw materials used in the R&D activity and fuel, power, water, etc. used in the R&D process.

⁴⁵ OECD (2019), *SME and Entrepreneurship Policy in Ireland*, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris, <https://doi.org/10.1787/e726f46d-en>

The time and resources required to prepare this documentation can deter some taxpayers, and particularly SMEs, from claiming the credit. For them, the compliance cost for the business is greater than the potential benefit of the tax credit.

Having a 'one size fits all' approach, regardless of the size of the company is not fit for purpose and does not encourage engagement from the SME sector. In our view, simplified documentation requirements for claims by SMEs would help improve the uptake of the R&D Tax Credit among start-up and SMEs.

We also recommend that Revenue guidance relating to overhead costs should be simplified as it has become increasingly complex to navigate, particularly for SMEs. This could be achieved, for example, by providing for a set percentage of labour overheads in guidance to simplify R&D expense claims and provide more certainty to taxpayers.

iii. SME-friendly Revenue guidance on sector specific R&D issues

The processes and documentation needed to support a R&D Tax Credit claim can be daunting. This is a particular challenge for business sectors such as food, software and IT, which traditionally do not document their processes and costs to the extent done in highly regulated sectors, such as pharma and financial services. We believe providing SME-friendly guidance, with step-by-step instructions on the claims process and practical studies, together with tips on how to avoid common errors in claims is essential, similar to the approach adopted by HMRC in the UK.

Industry specific guidance, with detailed practical instances of what qualifies and what does not qualify would be welcome. For example, starting with sector-specific guidance for food production, software and med-tech industries, all of which engage in very different R&D processes. Uncertainty surrounding what can qualify and how to document such processes, continues to persist in these sectors.

iv. Ensure Revenue Compliance Interventions are proportionate and conducted in a timely and efficient manner

There is a certain level of anxiety amongst companies over the potential for Revenue to subsequently challenge R&D Tax Credit claims. While verification of claims by taxpayers is an intrinsic part of a self-assessment system, it is important that Revenue Compliance Interventions are proportionate and conducted in a timely and efficient manner, in the interest of all parties. In addition, it is important that there is recognition of the appropriateness of 'technical adjustment' treatment for R&D Tax Credit claims, given the subjective nature of R&D.

v. Access to Revenue's R&D technical experts

Revenue appoints and agrees the terms of engagement with R&D technical experts who are tasked with opining on the science element of R&D Tax Credit claims. We understand that Revenue informs such technical experts of the R&D legislation and current Revenue guidance in advance of their review.

At the end of the review, the R&D technical experts provide Revenue with a copy of their report and discuss their findings with Revenue. Revenue then provides a copy of the R&D expert's opinion to the taxpayer. Taxpayers and their advisers do not participate in any briefings between Revenue and the appointed R&D technical expert reviewing the relevant claim.

Providing access to Revenue's R&D technical experts is a way in which R&D Tax Credit claims could be dealt with more smoothly. We firmly believe that taxpayers and their advisers should be given the opportunity to participate in briefings with R&D technical experts during the review process, which would reinforce the independence of the expert and increase the overall transparency of the review process.

It is also vital that the R&D technical experts tasked with opining on the science element of R&D Tax Credit claims have the experience of the application of science in a business environment. Feedback from companies and tax advisers indicates that the technical experts used by Revenue to opine on the 'science test' tend to be from academic backgrounds, which can often result in knowledge gaps, as the technical expert is applying science theory to commercial practices.

Revenue should explore ways to expand the pool of experts undertaking this work to ensure it adequately reflects the necessary expertise. We understand that Revenue has agreed at the R&D Discussion Group (a subgroup of the Tax Administration Liaison Committee (TALC) Direct/Capital Taxes Sub-Committee), to work with practitioners to develop training for the R&D technical experts, however, progress has been slow to date.

vi. Stakeholder consultation in advance of updates to Revenue guidance

Revenue guidance on the R&D Tax Credit has changed 18 times since the introduction of the credit. While many of the updates have provided more clarity on various aspects of the credit, the combination of the volume of iterations and the change in emphasis to the extent to which a company may rely on the guidance, has added to the uncertainty in particular where the legislation underpinning the guidance has not been amended but Revenue's interpretation of it has altered. Consultation with stakeholders in advance of updates to Revenue's guidance would help to provide more tax certainty for claimants.

Appendix I – Proposed amendments to interest deductibility provisions

Summary of the interest deductibility provisions, which following the enactment of ATAD ILR, are either no longer required or should be amended in the TCA 1997		
Provision	Purpose	Proposed Amendment
Section 81	Section 81 sets out the general rules regarding deductions in computing the profits of a trade.	Broaden the scope of section 81 so that a taxpayer is entitled to deduct interest and 'interest equivalent' expenses that is incurred for a business or commercial purpose.
Section 97(2)(e)	Section 97 sets out the computation rules for Case V rental profits. Section 97(2)(e) provides for a deduction for interest expense related to the purchase, repair or improvement of rental property.	In our view, section 97(2)(e) should be replaced with a broad business purpose test.
Section 130 (2)(d)(iv) (and related Sections 130 (2B), 452, 452A and 845A) and Section 130 (2)(d)(iii)(II)	<p>Interest on debt without any 'equity' characteristics where it is payable to a non-resident 75% group member is automatically treated as a distribution under section 130(2)(d)(iv).</p> <p>This treatment is disapplied for EU and UK residents by section 130(2B).</p> <p>Sections 452, 452A and 845A also provide for elections to override this distribution treatment.</p>	<p>In our view, the automatic treatment as a distribution for interest paid to a non-resident 75% group member which is not otherwise within the scope of Section 130 measures targeted at interest on debt with equity characteristics should be removed.</p> <p>It would follow that Sections 130(2B), 452, 452A and 845A should also be removed, as they would no longer be relevant where distribution treatment no longer applies.</p> <p>We believe that Section 130(2)(d)(iii)(II) should also be removed as it is a measure that addresses the quantum of interest akin to thin capitalisation rules (rather than the purpose of the interest) which is now also the purpose of the 30% EBITDA cap under the ATAD ILR.</p>
Section 247 (interest as a charge) and Section 249 (recovery of capital)	<p>Section 247 TCA 1997 provides relief under interest as a charge provisions for qualifying borrowings which are used to acquire shareholdings in trading companies.</p> <p>Disposals of any shareholdings or intra group debt trigger 'recovery of capital' measures which deny a deduction for 'interest as a charge' by deeming borrowings to be repaid (even if the financing is unrelated to the recovery event).</p>	<p>Section 247 rules (and the recovery of capital rules contained in section 249) are extremely complex.</p> <p>Given the protection already afforded by the introduction of the ILR, in our view, these provisions should be simplified to enable groups to restructure debt without falling within the scope of onerous recovery of capital provisions.</p> <p>We firmly believe that a general test for permitting a deduction for interest expense that is incurred for a business or commercial purpose should be introduced in conjunction with the removal of Section 247 TCA 1997.</p>

		<p>However, if it is the intention of policymakers to retain section 247, then at a minimum, the following provisions should be modified:</p> <ul style="list-style-type: none"> • Consideration should be given to removing the requirement for a common director under Section 247(3)(b) TCA 1997, given this requirement poses an administrative burden without any obvious policy rationale. • Section 247(4E) TCA 1997 denies interest relief as a charge in respect of interest on an intra-group loan used to finance the purchase of certain assets from another group company. Consideration should be given to simplifying or removing this measure (similar to the proposed removal of Section 840A below) as the ATAD ILR applies the limitation to both group and third-party borrowings. • The very broad scope of the application of the deemed recovery of capital rules in Section 249 TCA 1997 can mean common steps taken by companies to tidy up balance sheets of group companies and to simplify forecasting and monitoring compliance with the ILR or similar interest limitation rules in other jurisdictions, can trigger the deemed recovery of capital provisions in circumstances which are wholly unrelated to the borrowing in question. We believe that the impact of the recovery of capital rules are disproportionate and need to be reconsidered. We have set out further analysis of these issues in Appendix II to this submission.
Section 291A	Section 291A caps relief for interest expense and capital allowances in a given period at 80% of the tax adjusted income from specified intangible assets.	As interest is already subject to the 30% of EBITDA limit under the ILR, in our view the 80% cap under Section 291A should be disapplied.
Section 817C	Section 817C is an anti-avoidance provision which denies a deduction for interest expense accrued by a borrower until such time as it is taxed in hands of connected party lender.	<p>In our view, in a reformed regime for interest deductibility which allows for a broad business purpose test for interest, this provision should be removed for corporation tax purposes.</p> <p>However, it would be important to ensure that where the section has previously resulted in an expense being denied, relief should be</p>

		preserved with it being treated as an interest expense subject to ILR in the claim period.
Section 840A	Section 840A is an anti-avoidance provision that denies a trading deduction for interest payable on intra-group borrowings to purchase assets from a connected company.	<p>We consider that Section 840A TCA 1997 should be removed as it can impact <i>bona fide</i> transactions and the ILR 30% EBITDA limit will in any event apply to both group and third-party borrowings.</p> <p>However, relief for unused and carried forward expense which may be offset under Section 840A against profits from an acquired trade should be preserved.</p>

Appendix II – Further details on the impact of the Sections 247 and 249 TCA 1997

Section 247 TCA 1997 provides relief under interest as a charge provisions for qualifying borrowings which are used to acquire shareholdings in trading companies.

Several limitations apply to these measures and they are also subject to the extensive recovery of capital provisions that apply under Section 249 TCA 1997 and corresponding anti-avoidance measures.

The qualifying loan conditions under Section 247(3) TCA 1997 which must be satisfied, not only at the time of drawdown of the borrowing but throughout the period that interest is paid on the loan are:

- a) when the interest is paid, the investing company must have a material interest in the company, or where the loan is on-lent and used by a company connected with the company, in the company and the connected company,
- b) during the period taken as a whole, from applying the loan to the time when the interest was paid, at least one director of the investing company was also a director of the company or, where the loan is on-lent and used by a company connected with the other company, in the company and the connected company,
- c) during that period the investing company did not recover any capital from the company or from a connected company, apart from any amount taken into account under Section 249.

The Section 249 measures are essentially anti-avoidance measures which disallow or restrict interest relief available to a borrower company under Section 247 where the borrower company has, or is deemed to have, recovered capital from the company in which the borrowings are invested or a connected company, without using the capital recovered to reduce the loan in respect of which relief is claimed.

If the borrower company recovers or is deemed to recover an amount of capital which is not used to repay the qualifying Section 247 borrowing, the borrower company is deemed to have repaid an amount of the qualifying borrowing which is equivalent to the recovered capital amount. This means that a corresponding amount of otherwise deductible interest expense paid is restricted on the borrowing and a deduction is denied for the restricted interest paid.

The measures apply not just to actual recoveries of capital by the borrower company from the investee company but also to several deemed recovery of capital events which can include:

- The assignment of connected party debt (even if the debt is wholly unrelated to the qualifying borrowing of the borrowing company or the investment made because of the deployment of the proceeds of the qualifying loan).
- The settlement of debt amounts.
- Recovery of capital arising to subsidiaries in an underlying holding chain of companies, apart from certain circumstances where permitted exclusions are

available for capital recoveries resulting from the liquidation or unwinding of intermediate companies in the holding chain which have been undertaken for bona fide commercial purposes.

In general, the way corporate groups comply with earnings stripping measures in other countries is to ensure that the largest borrowers in their group manage their debt levels and forecasted interest costs during the taxable period so as not to exceed 30% of EBITDA. It is normal for groups to endeavour to reduce the risk of exceeding the 30% of EBITDA ceiling where the group overall has debt levels and interest expense within that ceiling. It is typical for these groups to attempt to mitigate any excess interest limitation amount in the period in order to minimise the uncertainties arising from potential reliance on reliefs.

The ATAD ILR permits the carry forward of interest spare capacity which is similar to the design of measures enacted in other EU Member States and internationally which include provisions to carry forward excess disallowed expenses in one period to future periods.

However, as there is always uncertainty surrounding the capacity of the group to use these reliefs in the future, failure to deduct the disallowed expense can mean an unexpected increase in the effective tax rate of the group for the period. This effect could be immediate on the key performance metrics of a company if there is sufficient uncertainty over the probable use of the interest credit thus preventing the recording of a deferred tax asset. A deviation from expected results for the period can affect the perceived performance of the company from the perspective of its shareholders, debt investors and the markets.

In practice, and for bona fide commercial reasons, groups will focus on minimising the risks arising from unforeseen excess interest amounts by restructuring existing debt flows. To do this, the debt is consolidated into and may need to be centred on companies which have the highest capacity to absorb the expense. The group ratio rule is of course helpful here.

Irish groups are impacted by the broad scope of the deemed recovery of capital rules in Section 249 where they take common steps (which are taken by companies subject to equivalent measures in other jurisdictions) to tidy up balance sheets of group companies and to simplify forecasting and monitoring compliance with ILR.

To illustrate this, we have outlined a couple of scenarios below whereby a group which wishes to take steps to simplify forecasting and monitoring compliance with ILR will be penalised by triggering the disallowance of an existing relief.

Impact for Irish groups that centralise cash and intra group debtor holdings

In this example, a company ("TopCo") has borrowed from a third-party bank and used the proceeds for a qualifying purpose under Section 247, such as lending to a group member that is engaged in carrying on a trade ("TradeCo") who in turn uses the loan proceeds for a qualifying purpose. Separately, TopCo has advanced loans funded from its equity capital in the past to TradeCo who in turn used these loans to fund general working capital requirements as part of its trade.

The group decides it will focus its efforts to centralise cash balances and to monitor net borrowing costs in compliance with ILR in TopCo (which has significant third-party expense) and TradeCo (which is one of the biggest trading companies in the group). The group forecasts that its net borrowing costs will fall below the 30% of EBITDA ILR.

TradeCo holds balances of trade debtors owed by another group member, SubsidiaryCo, which does not have the liquidity to repay the sums due and TradeCo decides to assign these debtors to TopCo in settlement of the prior working capital borrowings. No part of the Section 247 loan advance is repaid by TradeCo and TopCo has not realised any cash from the assigned debtor amounts owed by SubsidiaryCo. This assignment of intragroup balances relates to a completely separate loan advanced by TopCo to TradeCo but gives rise to a deemed recovery of capital by the borrower, TopCo, equal to the amount of the debtors assigned/loan repaid by TradeCo. This results in a restriction of TopCo's deductible interest expense.

The effect of these assignments is to deem TopCo to have repaid an amount of its debt to the third-party bank. There is no difference in the amount of interest expense borne by the group. This straightforward tidy up exercise has triggered a disallowance of expense.

It may be technically possible to avoid triggering a deemed recovery of capital in the above scenario, however, to do this it would involve entering into transactions which are not required from a commercial perspective and which potentially give rise to significant additional costs for the group. Therefore, careful consideration needs to be given to simplify our existing legislation to remove the barrier/penalties for groups that need to take certain steps to comply with the new ILR regime.

Impact for Irish Outbound Companies

Where an Irish parent company ("Irish TopCo") uses funds borrowed from a third party bank for a qualifying purpose to invest in the share capital of its direct subsidiary, which is a holding company ("Irish HoldCo"), then the debt borrowed by Irish TopCo may be deductible as interest as a charge under Section 247.

In this scenario, Irish HoldCo is indirectly holding shares in trading companies through Irish and foreign subsidiary holding companies and uses the funds borrowed to finance the investment in a new foreign group. The deemed recovery of capital provisions may apply in this group structure to Irish HoldCo as it is a holding company which holds other holding companies (Section 249 (2)(ac) TCA 1997). The repayments of loans, share capital sales and loan assignments between the subsidiary holding companies and trading companies in the group must be monitored, as well as any capital recovered (or deemed to be recovered) by Irish HoldCo or by Irish TopCo.

Following the implementation of the ILR into Irish law, the above group may wish to tidy up some of its intra-group debt but this may trigger the recovery of capital rules. For example, where any subsidiary holding companies in the group decides to repay any loans in existence between them and yet there is no actual or commercial changes or impact on the bank borrowings the interest on which is being tested for ILR.

Even though the business intention would be to restructure the level of interest bearing debt and related net borrowing costs of the Irish group members to be better aligned with EBITDA, the repayments of loans between the subsidiary holding companies may trigger a deemed recovery of capital by Irish HoldCo. This is notwithstanding there is no actual capital recovered from the group's investments and there are no funds received by Irish HoldCo.

The recovery of capital provisions would deem Irish TopCo, the borrower and investing company, to have recovered any capital recovered by "an intermediate holding company" from another company where the company concerned owns directly or indirectly 50% of the share capital of the intermediate holding company or both companies are under the control of the same person. The result of the application of the deemed recovery of capital provisions is that the receipt of the loan repayment proceeds by a subsidiary holding company triggers a deemed recovery of capital by TopCo such that it is treated as though it had repaid the corresponding amount of its qualifying borrowing to the bank when in fact this did not happen nor would it be possible for this to happen in a commercial environment.

This results in a disallowance of a portion of the interest expense deduction otherwise available to Irish TopCo. The outcome applies notwithstanding that the investment in the Irish and foreign operating groups is held through a parallel ownership chain and is in no way linked to the original borrowing used to finance the investment in the foreign group. International groups will continually refinance debt to fund growth rather than repay because it is the cheaper and more flexible component of its weighted average cost of capital or there are significant breakage costs. The ability for a group to actually repay debt when there is a deemed or actual recovery (in tax terms) is quite limited in reality.

We believe it is now appropriate to modify the provisions in Sections 247 and 249 TCA 1997. It is clear that the deemed recovery provisions in particular can have unintended consequences of impacting wholly commercial financing transactions in an international group that are unrelated to the original debt and not connected with any base erosion, profit shifting or avoidance motivations.