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Participation Exemption Feedback Statement
Tax Division - Business Tax Policy
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Our ref

5 September 2024

Dear Business Tax Policy Team

Participation Exemption – Second Feedback Statement

Matheson welcomes the opportunity to respond to the paper "*Participation Exemption for Foreign Dividends Second Feedback Statement*" issued by the Department of Finance on 27 August 2024 (the "**Consultation Document**"). This submission is made on our own behalf.

Minister Chambers' stated intention for the development of the participation exemption is to demonstrate *"Ireland's continued desire to promote a business environment that remains best in class*". We fully support that intention. However, we do not believe that the current draft delivers a best in class participation exemption. When compared to existing participation exemptions of other jurisdictions, the proposed design is restrictive, particularly on geographic scope, and includes certain conditions that will make claiming the exemption unnecessarily complicated. We have addressed those concerns and provided suggestions intended to simplify the proposal in line with the general principles that have guided the development of the proposal to date.

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Proposed geographic scope

The decision not to extend the scope of the exemption beyond EU, EEA and treaty partner jurisdictions will be perceived as a missed opportunity by business. We note that *all* of the comments published in response to the feedback statement issued in April (the "**April Feedback Statement**") advocated in favour of extending the geographic scope. Guardrails were suggested to mitigate the risk identified in the April Feedback Statement that a broader geographical scope could result in double non-taxation.

Businesses with whom we have discussed the Consultation Document are disappointed that the proposed geographic scope has not changed at all and articulating the policy reasons for that approach in a post-Pillar Two environment has been challenging.

Some have noted that the distinction between subsidiaries resident in treaty partner jurisdictions and those resident in non-treaty partner jurisdictions is arbitrary. In many cases, the reason that Ireland does not have a double tax treaty with a particular jurisdiction is not because Ireland has reservations about that jurisdiction's tax system but rather reflects the challenges faced by a smaller economy like Ireland in trying to get on the treaty negotiation agenda of that other jurisdiction. Brazil is a good case in point. Restricting the participation exemption to exclude jurisdictions with which Ireland would welcome a double tax treaty is self-limiting.

We strongly urge the Minister to re-examine the policy underpinning the decision to limit the geographical scope of the participation exemption.

Proposed commencement provision

We welcome the revision made to the proposed commencement provision. We agree that the best approach, which reflects the approach taken to previous changes to the taxation of dividends, is to apply the change to dividends received from a particular date rather than the commencement of an accounting period.

We would, however, suggest that the language of the commencement provision be revised to reference *"relevant distributions **received by a parent company** on or after 1 January 2025."* This reflects the receipts basis of taxation, the approach taken to previous changes to the tax treatment of dividends received and obviates the need to identify when a distribution was "*made*" (which is not a concept that is defined in Irish tax law and could point to more than one date).

'Out of profits' requirement

The proposed requirement in the definition of 'relevant distribution' for dividends to be paid, and distributions to be made "*out of profits*" will add unnecessary complexity to the exemption. The definition of profits for the purposes of the participation exemption is based on section 21B of the Taxes Consolidation Act 1997 ("**TCA**"). The purpose of the definition of profits in that section is to provide a baseline against which to measure trading profits. Given the narrow purpose for which this definition was designed, it risks inadequately reflecting the types of income dividends that can be paid by foreign subsidiaries of Irish companies.

For example, in other jurisdictions, capital maintenance rules are different to the Irish rules and it is possible to pay dividends out of amounts that may not be recognised in the entity's profit and loss (e.g., reserves, including revaluation reserves and share premium reserves). Such amounts may not be regarded as 'profits' under section 21B TCA and as such, not capable of qualifying for the participation exemption. However, those amounts may still be treated as income in the hands of the recipient under

Irish law (as this typically depends on how the payment is effected under foreign law). This approach will result in a number of consequences that may be unintended:

- Income dividends from subsidiaries resident in EU, EEA or treaty partner jurisdictions will not always qualify for the participation exemption, thereby creating a category of income dividends from relevant subsidiaries that do not qualify for the exemption. Both taxpayers and the Revenue Commissioners will have to develop systems to differentiate between income dividends from subsidiaries resident in EU, EEA or treaty partner jurisdictions that qualify for the participation exemption and those that do not;

- An element of the tracing associated with the operation of Schedule 24 (i.e., identifying the amounts out of which dividends are paid by foreign subsidiaries and specifying periods and profits) will be retained and foreign legal documentation effecting the payment of foreign law dividends will have to reflect the Irish tracing requirement. The Irish tracing requirement in Schedule 24 is esoteric. It is not a requirement that is ordinarily seen in other shareholding jurisdictions. In practice, it adds to the compliance burden and places an unnecessary demand on resources. Retaining any aspect of that tracing requirement will not be welcomed by businesses with numerous foreign subsidiaries; and

- A similar income distribution made by an Irish unlimited company would be treated as franked investment income. The disparity in treatment may give rise to EU law issues.

The requirement that dividends be paid or distributions be made out of profits is unnecessarily restrictive and should be reconsidered.

'Subject to tax' test

A company will only be a relevant subsidiary if it is "*subject to a tax imposed in a relevant territory which corresponds to corporation tax in the State in respect of profits, without the possibility of being exempt or an option of being exempt*". We understand that the purpose of this language is to ensure that the exemption is restricted to entities that are within the tax charge in their jurisdiction of residence and not eligible for exemption. We further understand that if the entity is entitled to claim exemptions in respect of certain items of income, that should not preclude it from claiming the exemption. For example, if a parent company receives a dividend from its wholly owned subsidiary that is resident in the Netherlands, the exemption should be available even if the only income of the Dutch subsidiary is dividend income which is exempt under Dutch tax law.

It is unclear to us whether the language in sub-paragraph (a) of the definition achieves what is intended and we think it could be read to impose additional restrictions on the subsidiaries that can be treated as 'relevant subsidiaries'. The uncertainty arises from the use of the phrase "*subject to tax*" and the addition of "*in respect of profits*" at the end of the test. 'Subject to tax' tests are typically used in tax law to test the tax treatment of specific items of income, whereas, 'liable to tax' tests are more commonly used when the treatment of the entity itself is being assessed. 'Liable to tax' tests when applied to entities have a widely understood meaning which is reflected in the Commentary to the OECD Model Tax Convention.

The inclusion of the phrase "*in respect of profits*" is not typical in other provisions of Irish tax law that include a 'corresponds to' standard. At best, we think the language is extraneous and, at worst, it could be read as requiring that all profits of the foreign subsidiary must be taxed in order for the subsidiary to be regarded as a 'relevant subsidiary' which we do not believe is intended.

The language in paragraph (a) of the definition of 'relevant subsidiary' should therefore be revised. The 'subject to tax' test should be replaced with a 'liable to tax' test and the phrase "*in respect of profits*" should be deleted.

We also have concerns about the carve-out "*without the possibility of being exempt or an option of being exempt"*. The language is overly-broad and will leave taxpayers in the invidious position of not qualifying for the participation exemption where they receive income dividends from a taxpaying subsidiary in an EU, EEA or double tax treaty jurisdiction simply because the subsidiary could have been exempt. The carve-out should only apply where a full exemption is in fact applied in the paying jurisdiction.

Arguably, any Irish company has "*the possibility of being exempt*" given Irish tax law has exemptions for investment funds which can be established as companies. How close must a foreign company be to the terms of an exemption for the exemption to be regarded as "*possible*"? How would such a provision be audited? How would taxpayers satisfy themselves that an exemption is not "*possible*"?

We recommend that the carve-out be recast as a factual test rather than a hypothetical one.

Meaning of redeemable shares

We note that a company that only holds redeemable shares in a foreign subsidiary cannot qualify as a 'parent company' and cannot claim the exemption. The term 'redeemable shares' is not defined and as a result it is difficult to properly assess this requirement. Any definition should be carefully designed, take account of the fact that the company law of other countries will not mirror Irish law and it may be the case that under the law of other jurisdictions all issued shares are automatically redeemable without the need to follow the types of company law protocols required under Irish law.

Further, if the restriction is to be retained, we note that it too will give rise to a separate category of dividends that are received from subsidiaries located in EU, EEA and tax treaty partner jurisdictions (which would be taxed under the tax and credit system even though they are income in nature). This treatment would differ from the treatment that would be applied to similar income dividends received from an Irish subsidiary. Such a disparity may give rise to EU law issues.

If the restriction is to be retained, we suggest that the 5% ownership thresholds should be adjusted to reflect that redeemable shares should be disregarded when applying those tests. For example, the requirement in sub-paragraph (2)(a)(i) should be adjusted to *"owns not less than 5 per cent of the relevant subsidiary's ordinary share capital* ***that is not redeemable***" with similar adjustments made in sub-paragraphs (2)(a)(ii) and (iii).

We would welcome the opportunity to engage further and to provide additional drafting suggestions if that would be helpful.

Yours sincerely

Sent by email, bears no signature

Shane Hogan | Head of Tax
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