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Global Tax Alert

Ireland publishes Finance Bill 2020: A review of international tax provisions

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Executive summary

On 22 October 2020, the Irish Government published Finance Bill 2020 (as initiated). The Bill primarily seeks to implement the tax elements of the Budget 2021 measures announced on 13 October with the addition of some previously unannounced technical changes. Budget 2021 focused mainly on building healthcare capacity and employment/unemployment protection with some taxation measures.

The next stage of the process at which amendments may be tabled is the Committee Stage, which is expected to commence on 17 November. Tax Alerts on selected measures may be issued over the coming weeks as the Finance Bill progresses towards enactment. It is expected that this Finance Bill will be enacted before the end of 2020.

In an international tax context, this Alert summarizes the following Finance Bill measures:

- Irish anti-hybrid rules
- Irish transfer pricing rules
- Balancing allowances/balancing charge rules for newly acquired intellectual property (IP)
- Irish controlled foreign corporate/defensive measures
- Extension of the Knowledge Development Box

Building a better working world

Detailed discussion

Budget 2021 and beyond

In his speech for Budget 2021, Minister Donohoe reiterated Ireland's commitment to the 12.5% corporation tax rate. Minister Donohoe also noted that he will publish an update on Ireland's Corporation Tax Roadmap which "will reflect on the significant action taken to-date on corporation tax reform and outline further areas for consideration, consultation and action over the coming months and years." It is expected that the Roadmap will consider recent reports published by the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) on the tax challenges of the digitalized economy, among other topical items. This clarification from the Minister is welcomed and the practice of issuing Irish Corporation Tax Roadmaps, the last such one being issued in September 2018, should provide investors with confidence and certainty on the future direction of the Irish corporation tax regime.

Transfer pricing changes

Finance Act 2019 extended Ireland's transfer pricing rules to non-trading transactions but added a new exemption for certain domestic transactions with the aim that the rules would not result in deemed income taxable at 25% for which deductions were only available at the 12.5% rate. The wording in *Finance Act 2019* was open to a wide range of interpretations as to its scope.

Irish Revenue have not yet published final guidance with respect to the transfer pricing rules enacted as part of *Finance Act 2019*, albeit there has been extensive consultation with relevant stakeholders as part of the guidance process throughout 2020.

This exemption is completely rewritten in Finance Bill 2020, to include some very prescriptive conditions that must be met for a loan between two Irish parties to be exempt from transfer pricing rules. It is clear that Irish Revenue have acknowledged certain areas of ambiguity in the original law, as highlighted by stakeholders throughout the guidance process, and addressed them in the revised law. These updates provide some welcome clarity, but some important anomalies remain.

The new concept of a "qualifying loan arrangement" has been introduced, which addresses loans between two Irish parties. It outlines that where an Irish company advances a loan, otherwise than in the course of its trade, and the borrower (defined as "acquirer") meets certain conditions, the transaction can be regarded to be a "qualifying loan arrangement" such that the exemption is available. The conditions required to be met by the borrower/acquirer are specific and nuanced:

a) Where the borrower exists to wholly or mainly operate a trade – then the full amount of "any interest chargeable on the loan" must be taken into account in calculating the taxable trading profits, gains or losses (i.e., the borrower/acquirer would be entitled to a deduction for arm's-length interest if charged), or

b) Where the borrower exists to wholly or mainly operate a property rental business – then the full amount of "any interest chargeable on the loan" must be taken into account in calculating the taxable profits, gains or losses of the rental business (i.e., the borrower would be entitled to a deduction for arm's-length interest if charged).

c) Where the borrower is a holding company:
   - Its business must consist wholly or mainly of the holding of shares directly in a company which meets the definition of either a) or b) above, AND
   - With regards to the use of the funds:
     i. Where the borrowings are used by the holding company to on lend to another group company, "the second arrangement," the borrower should be chargeable to tax on an arm's-length amount of interest accruing on the second arrangement, OR
     ii. Where the borrowings are used by the holding company to acquire or subscribe for shares in another group company, the "relevant company," and this group company meets the definition of either a) or b) above, the borrower must receive a dividend or distribution from that relevant company, within the chargeable period or "in any period of three years which includes the chargeable period." A nominal dividend will not suffice.

The "qualifying loan arrangement" exemption also contains an anti-avoidance provision.

It is worth noting that "chargeable period" language has been introduced throughout the section which requires taxpayers to complete an annual assessment as to the availability of the exemption.

Interestingly the revised law is applicable for accounting periods commencing on or after 1 January 2021, so there is one year where the original law applies. The issues with the original wording which allow for differences of opinion as to the breadth of the existing exemption, will continue to apply for accounting periods commencing on or after 1 January 2019 but before the commencement date of the proposed amendment. It will be worth monitoring whether the guidance, if published, provides some clarity here.

Taxpayers should study this legislation closely. Several other nuanced edits are contained throughout the section. While the certainty in some areas is welcome there is still some ambiguity in this law. EY has engaged with Irish Revenue throughout 2020 on this area of law and is well placed to assist with the technical application of this new legislation. EY will continue to engage with all stakeholders on these matters and can raise the concerns of taxpayers.

Extension of balance allowance/charge rules for newly acquired IP

On Budget day, a financial resolution was passed extending the remit of the balancing allowance/balancing charge rules to IP acquired on or after 14 October 2020 (i.e., the amendment should not apply to IP acquired prior to 14 October 2020. This extension will result in adjustments to capital allowance claims on intangible assets (under Ireland's intangible asset provision – section 291A) where balancing events occur such as where there is a disposal or a write off an asset. These adjustments are referred to as balancing allowances/balancing charges and aim to ensure that the taxpayer gets a write-off from tax for the net financial outlay that the taxpayer incurs on an asset. It is noted by Minister Donohoe that this amendment was made to ensure that Ireland's tax regime remains "competitive, legitimate and sustainable". The change has no impact on IP acquired prior to 14 October 2020 and sold after that date.

Controlled foreign corporate (CFC)/defensive measures for European Union (EU) non-cooperative jurisdictions

Finance Bill 2020 has amended Ireland's CFC rules which were implemented with affect from 1 January 2019 in line with the EU Anti-Tax Avoidance Directive (ATAD) to deny certain CFC exemptions to territories listed on the EU's non-cooperative jurisdictions list.

By way of background, Irish CFC rules have many exemptions including situations where the essential purpose of the arrangement(s) is not to secure a tax advantage or where the undistributed income attributable to the relevant Irish activities is a result of arrangement(s) which would have been entered into by persons dealing at arm's length. The ATAD exemptions with respect to effective tax rates, low profit margins and low accounting profits were also transposed into the Irish legislative provisions.

Finance Bill 2020 has amended the CFC exemptions from 1 January 2021 to remove the ability of companies that are resident in EU non-cooperative jurisdictions/"listed territory" to rely on three CFC exemptions, namely:

1. Effective tax rate
2. Low profit margin
3. Low accounting profit

This measure forms part of Ireland's commitment to a "toolbox" of EU defensive measures to apply by 2021.

Interestingly, a "listed territory" is a jurisdiction included by the Code of Conduct Group (Business Taxation) Report to the European Council of 18 February 2020[1] and includes 12 territories (American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands and Vanuatu). The legislation is specifically tied to the list as at 18 February 2020, but countries are frequently added/removed. It remains to be seen if the Government will continuously update the legislation to take account of this.

In most cases this change is unlikely to have a material impact, but a group with an Irish CFC profile should review whether it is relying on any of the exemptions at issue.

Irish anti-hybrid rules

Ireland introduced anti-hybrid rules in Finance Bill 2019, as required by the EU's ATAD, and they apply to payments made from 1 January 2020. The rules are highly technical in nature and are targeted at tax planning through mismatches in the classification of entities or financial instruments according to the tax law of two or more jurisdictions.

Finance Bill 2020 includes some technical amendments to the existing rules, which:

1. Correct a definition in the definition of "associated enterprises" so as to align it more closely with ATAD.
2. Clarify at what point in time the test of "associated enterprise" needs to be applied (e.g., change of ownership situations).
3. Confirm that the special rule for "worldwide taxation" situations extends to CFC rules, not just branches/permanent establishments and hybrid entities.
4. Clarify that the mismatch rule for payments to a hybrid entity does not apply where there is in effect no mismatch because the participator in the hybrid entity is based in a zero-tax jurisdiction.

The inclusion of these clarifications in the Finance Bill are welcomed especially as Irish Revenue's guidance on this complicated matter remains largely incomplete. The Irish tax regime does not necessarily rely on hybrid structures to achieve Irish tax outcomes however common sources of hybridity – such as where companies are disregarded or "checked" for United States (US) tax purposes, where the group contains partnerships, US LLCs or reverse hybrids – are frequently used in organizational structures. Accordingly, businesses need to examine their structures and transactions closely to ensure tax deductions (e.g., COGS or tax amortization in the form of capital allowances) are not denied in the tax computation.

Knowledge Development Box (KDB)

The KDB is an OECD compliant Patent Box which provides for an effective 6.25% rate of corporation tax on income arising from qualifying assets and was due to expire on 31 December 2020. With regard to the proposed future of the KDB, the Tax Group Strategy (TSG) papers – which were released by the Department of Finance on 14 September 2020 – remarked that uptake on the KDB had been low and that a two-year extension of the KDB may provide an opportunity to gather additional data on the relief, including costs and claimants, as well as there being an opportunity to consider the relevance of the KDB against potential outcomes arising from the OECD's Pillar Two.

The Finance Bill 2020 amendment extends the operation of the KDB until 1 January 2023. As part of the reason for the limited uptake in the KDB may have been due to the fact that the KDB had a limited shelf life, this extension is welcome and should provide greater certainty as to the kind of expected cash flows which may arise for taxpayers claiming the relief.

Next steps

EY will be actively monitoring the development of the Finance Bill as it passes through the legislative process towards enactment in the coming weeks. Detailed alerts will follow as matters unfold.

Endnote

1. OJ No. C331, 7.10.2020, p. 3.

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