Strawman Proposal: a significant move for simplifying Ireland's corporate tax regime

On 5 April, Minister for Finance Michael McGrath TD published a first feedback statement on the development of a participation exemption for foreign dividends to the Irish Corporation Tax system. The feedback statement includes a 'strawman proposal' that sets out a hypothetical example for how a participation exemption for foreign dividends might work in Ireland, writes BDO's ANGELA FLEMING, who says while there are aspects that could be improved upon, the current proposal 'would be a significant step forward in the simplification of the Irish corporate tax system'.

On publication of the feedback statement, Minister McGrath re-iterated Ireland's commitment to ensuring that our Corporation Tax code is competitive and attractive to business investment and aligns with international best practice. In his press release he stated:

"The introduction of a participation exemption will be a very important step towards simplification of the Irish corporate tax system and reflects Ireland's continued efforts to promote a business environment characterised by certainty and clarity. In a time of unprecedented change in international taxation, this move will give confidence and foresight to key stakeholders, maintaining Ireland's reputation as a business-friendly destination and encouraging companies to establish and expand their operations in Ireland."

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Background

Ireland operates a worldwide tax regime meaning all profits, including foreign source profits, are taxable by an Irish resident company with double tax relief for the foreign tax paid, referred to as the "tax and credit" model. Ireland is currently a significant outlier, being the only EU country and one of a very small number of OECD countries that does

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not operate some form of participation exemption for foreign dividends.

On 14 September 2023, the Department of Finance published a roadmap for the introduction of a participation exemption which included a timeline for implementation. As part of this, a consultation period was open until 13 December 2023.

The purpose of the feedback statement is to further progress work to inform the design of key building blocks of the participation exemption for foreign dividends.

The Strawman Proposal

The feedback statement contains a strawman proposal which sets out a potential approach to a participation exemption regime in order to facilitate a focused debate around key design issues. The key features set out are not definitive, and the feedback statement is clear that the final design of the regime may closely resemble the Strawman approach or may deviate significantly from it.

The key features of the Strawman are divided into four sections, as follows:

1. Dividends/distributions in scope

- The exemption would apply to foreign dividends and distributions that are income in nature, and not to capital distributions.
- In order for exemption to apply, companies must control at least 5% of the ordinary share capital for an uninterrupted period of 12 months up to and including the date of the dividend. Dividends in respect of newly acquired participations may also qualify provided the shares are subsequently held for a period of up to twelve months after the date of the dividend.

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- The 5% control test would be established by reference to up to four criteria; ownership of ordinary share capital (direct or indirect); holding of voting rights; entitlement to profits available for distribution; and entitlement to assets on a winding-up of the company.
- Where the control test has been met, the exemption may also apply in respect of dividends received from

the company on other types of shares, such as preference shares.

2. Scope of Relief

- Relief would be provided in the form of an exemption from Corporation Tax. Where the qualifying criteria are satisfied, 100% of the dividend would be in scope.
- The regime would apply to companies within the charge to Irish Corporation Tax – this includes both Irish tax resident companies, and non-resident companies trading in Ireland through a branch or agency.
- Companies would have flexibility to opt into the participation exemption regime, with an election to apply for a minimum period of 3 years. The election would apply in respect of all potentially in-scope foreign dividends received by the company during the period in which the election applies. Where the election is not made, the existing "tax and credit" system would apply.
- The exemption would apply to dividends received from companies that are tax resident in the EU/EEA or tax treaty countries.
- The exemption would not be restricted to dividends derived from trading profits, but would extend to dividends paid out of other income/profits.
- Where the exemption is availed of, a tax credit would not be available in respect of foreign tax paid.

3. Anti-Avoidance

- The dividend should not be deductible for tax purposes in any other jurisdiction.
- Exemption would not be available for dividends received from a jurisdiction on the EU list of non-cooperative jurisdictions for tax purposes.
- The exemption would only apply to dividends paid for bona fide commercial purposes and not for tax avoidance purposes.

"We believe that the scope of the exemption should be extended beyond EU/EEA and treaty countries to all countries, provided the dividends are paid out of taxed income, and excluding countries on the EU blacklist."

4. Administration

- Exemption would be available in respect of dividends received in accounting periods commencing on or after 1 January 2025.
- The election to avail of the participation exemption would be made via the Form CT1 Corporation Tax return and would apply for a minimum period of 3 years in respect of all qualifying dividends received by the company. Once made, an election may not be revoked.
- Companies would be required to report foreign dividends subject to exemption as part of the CT1 return.
- The existing Schedule 24 provisions would continue to operate as normal for distributions not in scope of the exemption.
- A company that elects into the participation exemption may have an amount of unrelieved foreign tax credit carrying forward at the time of the election. This credit would remain available for offset under Schedule 24 provisions against distributions not in scope of the exemption, or for use in future years if the company ceases to elect into the participation exemption regime.

Conclusion

Overall, the key features of the Strawman are welcome developments. In particular, the proposal for a 100% exemption, the elective nature of the regime, and the application of the exemption to dividends from both trading and non-trading profits are all very welcome.

We also feel that there are measures that could be considered further. For example, we believe that the scope of the exemption should be extended beyond EU/EEA and treaty countries to all countries, provided the dividends are paid out of taxed income, and excluding countries on the EU blacklist (as is currently already proposed).

That said, the Strawman proposal, if implemented, would be a significant step forward in the simplification of the Irish corporate tax system, and a welcome development for international businesses operating in Ireland, those using Ireland as a holding company location, and for Irish private equity funds.

The consultation period will run until 8 May and a second Feedback Statement is expected to be published in mid-2024 to contain draft approaches to the legislation required to introduce a participation exemption for foreign dividends in Finance Bill 2024.

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