**International Bar Association Annual Conference 2024**

# Recent Developments in International Taxation

## Ireland

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## Introduction

Changes to Ireland's tax regime are announced as part of the budget for each year, with announced measures typically taking effect from 1 January of the following year. Budget 2024 was announced in October 2023.

While the effects of significant inflation and the ongoing cost of living crisis were given much airtime in the Budget 2024 speech, and there were a number of measures brought in to address those matters, the more substantial tax changes were in relation to corporation tax.

## Income tax changes

The threshold at which taxpayers move from the 20 per cent standard income tax rate to the higher 40 per cent rate was increased by €2,000 to €42,000.

The rate of Universal Social Charge (which is a charge on income) was decreased from 4.5 per cent to four per cent for income over €25,760 (this lower threshold was also increased by €2,840) and below €70,044.

A new tax credit to offset the costs of those renting their homes was introduced in 2022. For 2024, the credit was increased from €500 to €750. A temporary credit has also been introduced for homeowners who suffered increases in their mortgage interest charge in 2023.

## Introduction of Pillar Two rules

The most significant change announced was the introduction of new corporate tax rules in line with the Organisation for Economic Co-operation and Development's (OECD's) Pillar Two proposal and as required by the European Union's directive on ensuring a global minimum level of taxation for multinational enterprise (MNE) groups and large-scale domestic groups in the EU[1] (the 'EU Minimum Tax Directive').

Irish legislation is explicitly required to be interpreted in a way that is consistent with the OECD Model Rules and the OECD's agreed administrative guidance, except to the extent that this would be inconsistent with the EU Minimum Tax Directive. However, the EU Minimum Tax Directive is also designed to be consistent with the OECD Model Rules and there should be consistency across all three sets of rules.

The OECD Model Rules apply to MNE groups, that is, groups where not all entities are located in the same jurisdiction or where a permanent establishment of an entity is located in another jurisdiction. One distinguishing feature of the Irish (and EU) implementation is that the rules can apply to a 'large-scale domestic group', that is, a group where all entities are located in the same jurisdiction. The rules can also be applied to standalone entities that exceed the revenue threshold.

Groups (or standalone entities) that have revenue of at least €750m in at least two of the previous four accounting periods will be subject to these new rules.

In-scope entities may be liable to three new top-up taxes: the income inclusion rule (IIR), the undertaxed profits rule (UTPR) and a qualified domestic top-up tax (QDTT). These effectively operate as three different collection mechanisms for the same amount of top-up tax; the amount of top-up tax due is the amount that would bring the effective tax rate of the group in the relevant jurisdiction up to 15 per cent where it would otherwise be below 15 per cent. If the top-up tax is fully collected under one tax head, no further tax liability should arise under the other tax heads.

The overall effect of these taxes is to cause relevant groups to have an effective tax rate of at least 15 per cent in each jurisdiction in which the group is located. The QDTT will apply to entities that are located in Ireland in respect of their Irish profits. The IIR is imposed on parent entities (except to the extent that a parent entity of that entity has applied or been subject to the IIR) in respect of the entity itself and all its subsidiaries.

[1] Council Directive (EU) 2022/523 of 14 December 2022.

The UTPR applies to all other entities within the group to the extent that the top-up tax amount has not been already collected under an IIR or QDTT; in practice, this will apply in respect of parent and sister entities located in jurisdictions that have not implemented Pillar Two.

The IIR and QDTT take effect for accounting periods beginning on or after 31 December 2023. The UPTR will take effect for accounting periods beginning on or after 31 December 2024, subject to the following two caveats: (1) where the ultimate parent entity (UPE) is located in Estonia, Lithuania, Latvia, Malta or Slovakia, the UPTR takes effect from 31 December 2023 (those jurisdictions have claimed an exemption from implementing the EU rules); and (2) Ireland has implemented the UTPR safe harbour (as provided for in the OECD's July 2023 Agreed Administrative Guidance), which will delay the effect of the UTPR for jurisdictions with a statutory corporation tax rate of at least 20 per cent until 1 January 2027.

Ireland has also opted to implement the transitional country-by-country reporting safe harbour and the qualified domestic minimum top-up tax safe harbour, each in line with the relevant guidance published by the OECD.

These new Pillar Two rules will have no effect for groups falling below the €750m threshold, and the Irish corporation tax rate of 12.5 per cent will continue to be available to those companies in accordance with existing rules.

**New outbound payments rules**

With effect from 1 April 2024, additional conditions have been placed on outbound payments of interest, royalties and distributions, where those payments are made to associated entities located in no-tax or zero-tax jurisdictions, or jurisdictions on the EU's list of non-cooperative jurisdictions (specified territories). Jurisdictions that generally have a tax rate above zero, but have, as a feature of their tax regime, free-trade zones or special economic zones, are not treated as no-tax/zero-tax jurisdictions.

Affected payments will no longer be able to rely on any existing exemptions from Irish withholding tax.

In addition, payments to associated entities located in specified territories are now subject to the following additional withholding tax provisions:

- 'short interest', that interest that is not capable of arising for a period of at least one year, is subject to withholding tax (generally, the withholding tax charge only applies to 'yearly' interest); and
- the royalty withholding tax charge is expanded beyond just patent royalties to also include patents for copyright, trademarks, designs or models, plans, secret formulae or processes.

Two entities shall be 'associated' for this purpose if one in respect of the other, or a third entity in respect of both:

- is directly or indirectly entitled to more than 50 per cent of the entity's ownership rights, voting rights or profits; or
- has 'definite influence' over the entity. An entity has 'definite influence' over another entity where it has the ability to participate on that other entity's board of directors (or equivalent) and that ability causes, or may cause, the affairs of that other entity to be conducted in accordance with the first-mentioned entity's wishes.

These rules can be disapplied in certain circumstances, provided it is reasonable to consider that the payment will be subject to tax, which could be a Pillar Two tax in a jurisdiction other than the specified territory.

Where the arrangement under which the payment is made was in place on or before 19 October 2023, these new rules will not apply to such payments under 1 January 2025.

**New capital gains tax ‘angel investor’ relief**

Ireland’s Budget 2024 introduced new capital gains tax (CGT) relief for ‘investment in innovative enterprises’. The stated aim of this relief is ‘to assist [small and medium-sized enterprises] SMEs in attracting investment and to make Ireland a more attractive location for angel investors’.

Where the relief applies, the CGT rate is reduced to 16 per cent (or 18 per cent in the case of an investment through a partnership), compared with the standard CGT rate of 33 per cent. The maximum gain that can avail of this relief is limited to twice the value of the initial investment. There is also a lifetime limit of €3m of gains to which this relief can apply.

The investment must be in the form of fully paid-up, newly issued shares and must be of an amount of at least €10,000, constituting between five per cent and 49 per cent of the total ordinary issued share capital of the company. The requirement as to the minimum shareholding does not apply where the investment is at least €20,000 (but the investment must still be in the form of fully paid-up, newly issued shares). The shares must be held by the investor for a period of at least three years.

There are a number of conditions that must be satisfied by the investee company, including that it must be tax resident in Ireland or another EU or European Economic Area (EEA) Member State or the United Kingdom. In particular, there are a number of conditions that must be fulfilled in order for it to demonstrate that it is an ‘innovative’ company and that it intends to, and has sufficient expertise and experience to, implement its business plan.

Finally, the investor must not be connected to the investee company, and there are a number of specific anti-avoidance provisions that must be complied with in the law.

**R&D tax credit**

The R&D Tax Credit (which was introduced in 2004) has been increased to 30 per cent (from 25 per cent) of qualifying R&D expenditure and the first-year refundable tax credit has been increased to €50,000 (from €25,000).

The increase of the tax credit to 30 per cent is designed to preserve the net value of the credit for entities that are subject to additional taxes under Pillar Two. This will also result in a real increase in benefit for smaller businesses.

The relief was previously amended to become a ‘qualified refundable tax credit’ for Pillar Two purposes.

**Carbon tax**

The rate of carbon tax per tonne of carbon dioxide for petrol and diesel increased from €48.50 to €56 with effect from 11 October 2024.

The government has committed that revenue raised from the carbon tax will be used to part-fund a national retrofitting programme and to support farmers in the green transition.

**DAC7 joint audits**

The ‘joint audit’ provisions in Directive (EU) 2021/514 (‘DAC7’) have now been implemented in Ireland, providing a legal framework for EU tax authorities to jointly carry out cross-border audits.

DAC7 was partially introduced into Irish law in the Finance Act 2022 by providing that a foreign tax official can be present or participate in an administrative enquiry conducted in Ireland. It did not, however, address the conduct of joint audits as set out in DAC7. The new joint-audit provisions set out the rights and obligations of the officials who participate in the joint audits.

**Participation exemption for dividends and distributions**

The government has committed to introducing a participation exemption for dividends, to take effect from 1 January 2025. This is a very welcome development that will further solidify Ireland as a jurisdiction of choice for holding companies.

Currently, Irish tax arises on receipts of foreign dividends, but this tax can be (and most often is) fully relieved through a system of tax credits in respect of both withholding tax on dividends and taxes on the underlying profits from which the dividends are paid. This system has long been criticised for being unduly complex, in particular given that little to no tax revenue is generated from this charge.

While draft legislation for this exemption is not yet available, a feedback statement was published in April 2024 that sets out the government's proposed terms. Many of the proposed terms were welcomed, including that the exemption will take the form of a 100 per cent exemption for dividends paid from a subsidiary in which the recipient company holds at least five per cent of the ordinary share capital and that there will be no requirement that the profits from which the dividends are paid must be trading profits. The government has also signalled that it is willing to make this exemption optional, which would allow companies to continue to operate under the existing credit system for foreign dividends where they prefer to.

One issue that has been criticised by a number of respondents to the feedback statement is the proposal that the exemption would be limited to dividends paid from companies that are resident in an EU or EEA Member State or jurisdiction with which Ireland has a double tax treaty. It is hoped that this geographic scope might be expanded in the final legislation, which is expected later this year.

**Ireland's first transfer pricing determination**

The Irish Tax Appeals Commission (TAC) recently issued its determination on the first appeal by a taxpayer with regards to transfer pricing adjustments.

The case involved an appeal by a taxpayer company against four amended assessments for corporation tax raised by the Irish Revenue Commissioners for the 2015 to 2018 tax years. Specifically, the Irish Revenue had sought transfer pricing adjustments in relation to share-based awards (SBAs) granted by the parent company to employees of the taxpayer company, where the parent company did not charge the taxpayer company for the provision of the SBAs.

Similar issues have previously been considered by the Supreme Court of Israel in the joined cases of *Kontera Technologies Ltd v Assessing Officer Tel Aviv* (CA 943/16) and *Finisar Israel Ltd v Assessing Officer Rehovot* (CA 1728/16).

The TAC determination, which ran to 145 pages, was comprehensive in its analysis and firmly grounded in OECD Transfer Pricing Guidance, rather than Irish domestic rules, which will be of use to taxpayers in any jurisdiction facing similar issues. The TAC concluded that 'the risk and the cost of issuing the SBAs lies with the parent company, not with the Appellant… [the parent] is the sole decision maker in relation to an award of the SBAs across the organisation, the administration of the infrastructure to manage awards of the SBAs and being a party to the SBAs agreement with eligible employees'. It also found that there was no economic rationale for the appellant to receive service fees or operating profits associated with the SBAs expense in its statutory financial accounts. The TAC determined that the arm's length principle requires that the SBAs expense should be excluded from the appellant's cost base in computing its mark-up on costs on the basis that SBAs are notional costs, which are included in financial statements for accounting purposes, but not costs that are incurred by the appellant in the provision of services.

The TAC accepted that the SBAs had been properly accounted for under Financial Reporting Standard (FRS) 102, but noted that this was not determinative for the question of the transfer pricing treatment; 'the correct accounting treatment is determined by the application of FRS 102, but it does not ask the question, who bore the legal and economic risk and who should be entitled to earn the profits referable to this cost, in accordance with OECD Guidelines'.

It was mutually agreed between the appellant and the Irish Revenue that the transactional net margin method (TNMM) was the appropriate transfer pricing method to be applied in the circumstances and that the margin applied was within an appropriate arm's length range. As a result, the TAC held that the Irish Revenue could not challenge aspects of the comparability analysis; once the results fell within an acceptable arm's length range, no transfer pricing adjustment should arise.

Irish transfer pricing rules were significantly expanded in 2020, so it is likely that we will see more cases before the Appeal Commissioners and courts over the coming years. The 2022 version of the OECD Transfer Pricing Guidelines apply in Ireland for chargeable periods commencing on or after 1 January 2023.