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Ireland: Trends and Developments

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Trends and Developments

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Living in Interesting Times – the Quest for Certainty

The winds of change that have swept through the international tax landscape in recent years show no signs of abating, and reform remains the order of the day. The scale of recent reformative measures has resulted in Ireland's tax code becoming broader and more sophisticated, but also more complex. This complexity has resulted in increased scope for disagreement between taxpayer and tax authority, as both sides seek to interpret and apply the new rules. In line with Ireland's well-established track record in international business, the increased scope for uncertainty and dispute has been counterbalanced by significant investments in resources for dispute avoidance and resolution.

This article will examine a number of recent developments and trends in key areas of Irish tax practice that are likely to have an impact on the quest for certainty in coming years.

The OECD's two pillars

The OECD's two-pillar proposal will result in major reform of the international tax framework and the introduction of new rules and concepts. Ireland is actively engaged with both pillars and is likely to introduce relevant measures in line with EU timelines. As such, Ireland is expected to fully transpose the Pillar Two EU Directive (the "Directive") with effect for accounting periods commencing on or after 1 January 2024.

In light of the scale of the Pillar Two rules, there is considerable work to be done as part of Ireland's transposition to ensure that, among other things, the new rules can operate harmoniously within Ireland's tax code and not produce any unintended consequences. Some steps have already been taken to address identified anomalies, including the following.

- Research and Development (R&D) tax credit: Ireland's R&D tax credit rules have been amended to ensure that the credit is a qualifying refundable tax credit for Pillar Two and US foreign tax credit purposes.
- Knowledge Development Box (KDB): the effective tax rate of the KDB (ie, Ireland's patent box) will be increased to 10% (from 6.25%) to align with the Pillar Two "subject-to-tax rule" once agreement on implementation is reached at the OECD/G20 level. It remains to be seen what further changes will be required to align the KDB (which reduces a taxpayer's effective tax rate by way of tax deduction) with Pillar Two more generally.
- Territorial tax system: in conjunction with the implementation of Pillar Two, Ireland is also considering moving towards a territorial corporation tax system, which will include a dividend participation exemption and a foreign branch exemption to replace the current credit-based system. This would better accommodate the implementation of the Pillar Two rules by providing for greater clarity and significantly less complexity in the tax code.

Ireland is also very likely to introduce a Pillar Two-compatible qualifying domestic top-up tax.

In line with recent experiences, the government is expected to publish a number of consultations throughout 2023 on the transposition of the Directive, to minimise uncertainty and complexity in the legislative process and to ensure provisions are well considered and signposted in advance. In addition to the anomalies identified above, the interaction of Ireland's Pillar Two rules with US global intangible low-taxed income (GILTI) and foreign tax credit rules will be particularly important to many multinational taxpayers who have a significant presence in Ireland. From a policy perspective, Ireland is expected to take all reasonable steps available to minimise any uncertainty in this context.

Digital services taxes (DSTs)

The delayed implementation of the OECD's Pillar One proposal means that DSTs are likely to remain a feature of the international tax landscape for the short term at least. DSTs present several challenges for multinational taxpayers as they are typically structured to fall outside the scope of double tax treaties, which can give rise to uncertainty as to the creditability of the relevant DST.

Helpfully, Irish Revenue recently published guidance confirming that, when incurred wholly and exclusively for the purposes of a trade, the DSTs imposed by certain countries including Austria, France, Italy, Spain, the UK and India may be treated as tax-deductible expenses. Irish Revenue confirms that the deductibility of DSTs imposed by other countries will be confirmed on a case-by-case basis. As such, the list of countries specified in the guidance is expected to continue to grow as other DSTs are considered in practice.

Although Irish Revenue's published position aligns with established tax law principles on deductibility, the guidance has eliminated some of the uncertainty that existed in the market around the tax treatment of DSTs.

Transfer pricing (TP)

Ireland's TP rules were significantly expanded with effect from 1 January 2020; as such, the expanded rules are now live in the audit cycle. The expansion of the TP regime was accompanied by an enhancement in Irish Revenue's TP capabilities and, in practice, there has been a noticeable increase in TP-related queries and audits initiated by Irish Revenue in recent years. This increased audit activity has, in turn, resulted in an increase in TP-related disputes, and this trend is expected to continue over the coming years.

The TP queries taxpayers are facing from Irish Revenue range from general queries on the application and administration of group TP policies to specific queries on the suitability of a particular methodology or the approach applied to pricing intangibles.

Tax authorities in market jurisdictions continue to challenge the TP applied to transactions with principal companies in supply chains. In recent years, there has been an increased focus on the application of Chapter IX of the OECD's TP guidelines (the TPG) to group restructuring transactions, with many tax authorities adopting a narrow approach to such transactions in a bid to maximise taxing rights.

The recent trends in TP challenges are expected to continue in Ireland and internationally in the coming years, as additional tax periods are audited through the lens of the updated TPG.

Customs & Excise (C&E)
C&E duties is another area where there has been, unsurprisingly, a significant increase in activity in recent years. The UK's withdrawal from the EU remains a source of uncertainty in practice as the scope of the EU-UK Trade and Cooperation Agreement continues to be explored. This uncertainty is compounded by ongoing political developments surrounding the Northern Ireland Protocol.

In response to Brexit, Irish Revenue increased its C&E capacity significantly, resulting in C&E audit queries becoming more prevalent in practice. Increasingly, the focus of C&E audit queries has gone beyond importers of goods for resale to include the importation of plant and machinery for use in a business and the interaction of TP adjustments on a taxpayer's liability to C&E duties.

Financial services
Ireland's participation in the OECD's BEPS initiative resulted in the introduction of a number of new rules and regimes into the Irish tax code following the Anti-Tax Avoidance Directives (ATAD). This included the introduction of general anti-hybrid rules and an interest limitation rule (ILR) in accordance with ATAD.

These tax rules are particularly relevant in financial services transactions in Ireland, such as collateralised loan obligations, securitisations and asset financing (such as aircraft), where financing vehicles depend on interest deductibility to manage their tax base. Most financial services structures that implement lending or credit strategies (and primarily earn interest or equivalent income) fall outside the scope of the ILR. There are also exemptions from the ILR for structures that are not financially consolidated with other entities or that form part of financially consolidated groups with a comparable capital structure. The ILR took effect in Ireland from 1 January 2022. As a result, the impact (if any) of the ILR will be the likely focus of the 2023 audit and tax compliance cycle and queries from the Irish tax authorities.

Financial year 2022 was a notable year for the formation of tax transparent Irish limited partnerships (ILPs), with a material increase in the number of ILPs formed and strong interest in ILP formations from both managers and investors.

Ireland also implemented the BEPS reverse hybrid rule with effect from 1 January 2022. This rule applies to transparent funds and can impose a tax charge on ILPs if a material investor (50% or more) treats the ILP as tax opaque. Ireland implemented the reverse hybrid rule flexibility, so that unconnected investors are not automatically aggregated to reach the 50% threshold and hybrid outcomes do not arise if a material investor is tax-exempt or established in a jurisdiction that does not impose tax. This has meant that the reverse hybrid rule has largely had no material impact on ILPs and can easily be managed by ILPs and investment managers.

In all cases, Ireland's implementation of general anti-hybrid rules, the ILR and the reverse hybrid rule has required tax advisers in Ireland to conduct greater tax diligence on upstream fund and financing structures to understand the tax treatment of ultimate investors. Evidence of this diligence is being required by audit firms and tax compliance agents to support annual tax compliance in Ireland, and may be sought by the Irish tax authorities.

Tax disputes have also become more commonplace in the financial services industry. A number of Irish tax court judgments in 2022 are directly relevant to the financial services industry, including with respect to the proper tax treatment of debt forgiveness. It is also understood that there are a number of judgments to be published which will be of interest to the industry, including whether loans secured on Irish real estate are within the charge to Irish capital gains tax and whether certain foreign withholding taxes are deductible for Irish corporation tax purposes.

EU ATAD III

The Swedish presidency of the Council of the EU has brought renewed vigour to the proposal for an EU directive targeting the use of so-called "shell" entities (ATAD III). Although the revised scope of ATAD III remains to be seen at the time of writing, it is expected that Ireland will seek to transpose any measure introduced with the same business-focused pragmatism that was applied to the transposition of the EU's ATAD I and II directives.

Stamp duty on public takeovers

In general, a transfer of shares in an Irish company is subject to stamp duty at 1% of the market value of the relevant shares. Prior to a change in domestic tax law introduced in October 2019, Irish public company takeover transactions were typically effected by way of a cancellation scheme of arrangement, which did not involve a transfer of shares and did not therefore trigger Irish stamp duty.

The 2019 law change was successfully challenged by a taxpayer before the Tax Appeals Commission (TAC) (ie, Ireland's tax court) as being contrary to the EU Capital Duties Directive. However, the dispute did not reach the constitutional courts so the relevant provision remains in the domestic tax code. As such, there remains uncertainty as to the correct application of Irish stamp duty in the context of public company takeover transactions. It is likely that this uncertainty will persist until the law is challenged before the constitutional courts, as there is currently no indication that the law will be revised by the legislature voluntarily.

Resolving uncertainty

It is clear from the foregoing that the unprecedented scale of international tax reform in recent years has produced inevitable uncertainty, which is likely to persist, for the short term at least, as the new rules bed down.

A number of actions have been taken in Ireland to counteract this uncertainty and to provide as much clarity for taxpayers as possible in the circumstances. In particular, significant investment has been made in Ireland's tax dispute resolution fora in a domestic and international context to ensure that the inevitable divergences on the application of the new rules can be settled in an efficient and effective manner.

In a domestic context, TAC has been reformed and modernised, and now operates as a key driver in resolving complex and high-value disagreements between taxpayers and Irish Revenue. TAC's continuing success in this context is reflected in the following combined statistics for 2021 and 2022:

- 4,454 tax appeals were closed, representing more than EUR3.7 billion of disputed tax (the majority of which was corporation tax);
- 2,928 new tax appeals were received and 741 hearings were scheduled; and
- 320 final determinations were issued.

Interestingly, the statistics also highlight TAC's effectiveness in facilitating resolution by settlement between taxpayer and Irish Revenue, particularly in higher value disputes. For example, in 2021 (the figures for 2022 have not yet been released), 92% of the total tax in dispute in cases scheduled for hearing was resolved by pre-hearing settlement or withdrawal of proceedings.

In an international context, the Irish competent authority (CA) team has been enhanced with significant investment in response to the material increase in Ireland's mutual agreement procedure (MAP) caseload. For example, Ireland had 43 open MAP cases on 1 January 2017, but this figure grew to 151 within four years.

Ireland's investment in, and the practical and principled approach of, the Irish CA team is reflected in the team's impressive performance in resolving disputes efficiently. In 2021 (the figures for 2022 have not yet been released), the Irish CA team closed 172 MAP cases and was recognised with a number of OECD awards, including:

- the shortest average time to close MAP cases in the non-TP category, taking approximately five months to close non-TP MAP cases; and
- first place in the caseload management category for having the highest closing ratio of TP and other cases (in other words, of the jurisdictions with the most MAP cases, Ireland closed more cases than any other jurisdiction).

The applicability of mandatory binding arbitration (MBA) to MAP cases will further enhance the efficiency of the Irish CA team in resolving international disputes. Although the exact impact of MBA on MAP cases will not be reflected in statistics for a number of years, in practice the positive effect of MBA on MAP proceedings is already apparent.

Matheson LLP services the legal needs of internationally focused companies and financial institutions doing business in and from Ireland. It has more than 775 people working across six offices (in Dublin, Cork, London, New York, Palo Alto and San Francisco), including 105 partners and tax principals and more than 530 legal, tax and digital services professionals. The firm has the largest tax practice group amongst Irish law firms, with more than 40 lawyers and tax advisers and 19 partners and tax principals. The size of the tax practice gives the firm the ability to specialise, which distinguishes it from the tax departments of other Irish law firms. The team advises many leading domestic and international corporations and financial institutions doing business in and from Ireland, focusing on the timely delivery and implementation of integrated cutting-edge tax advice.

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