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Participation Exemption Feedback Statement
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Our ref

8 May 2024

Dear Business Tax Policy Team

**Participation Exemption - Strawman Proposal**

Matheson welcomes the opportunity to respond to the paper entitled "*Participation Exemption for Foreign Dividends Feedback Statement: Strawman Proposal*" issued by the Department of Finance on 5 April 2024 (the "**Consultation Document**"). This submission is made on our own behalf.

We support the broad tenor of the proposal and, while there are additional comments that could be made, we have limited our comments to the points that we believe are in greatest need of further reflection. We strongly endorse the desire to achieve significant administrative simplification through the participation exemption and in this respect we are very supportive of the proposal to not restrict the exemption to dividends paid from trading profits.

The main aspects of the proposal where we consider further reflection is required are:

- the geographic scope; and
- the commencement provision.

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1. Proposed geographic scope

Under the strawman proposal, the participation exemption is limited to dividends received from companies resident in the EU, the EEA or jurisdictions with which Ireland has a double tax treaty. In this respect, we think the proposal is overly narrow in scope and will not position Ireland as a location of choice for holding companies.

We understand from page 11 of the Consultation Document that the proposal to limit the participation exemption to dividends received from EU, EEA and treaty partner jurisdictions is intended to protect against the use of the regime for double non-taxation. We think that objective can also be achieved under a more expansive participation exemption, provided the design incorporates appropriate guardrails. We therefore advocate for the participation exemption to apply to a broader scope of dividends and to protect against double non-taxation by incorporating mechanical guardrails designed to disapply the exemption to dividends that are paid out of untaxed profits.

Similar to the operation of double tax relief under Schedule 24, the participation exemption should be available in respect of dividends received from any jurisdiction, provided that at least one guardrail is satisfied. For that purpose, we suggest the following guardrails:

- **Relevant territory guardrail** – as proposed in the Consultation Document, this guardrail would be satisfied if the dividend was paid by a company resident in an EU, EEA or treaty partner jurisdiction;

- **Pillar Two guardrail** – this guardrail would be satisfied if the dividend was paid by a company that is a constituent entity of the same Pillar Two group as the Irish recipient. The Pillar Two rules ensure that profits of in-scope groups are subject to a minimum effective rate of 15%. As such, dividends received from companies that are constituent entities of the same Pillar Two group as the recipient should not give rise to a double non-taxation risk;

- **Taxing jurisdiction guardrail** – this guardrail would be satisfied if the dividend was paid by a company that is resident for tax purposes in a jurisdiction that taxes profits at or above a specified rate. In this case, the rate tested should be the statutory rate (as testing the effective rate would re-introduce the complexities inherent in the current credit system). We note that a number of European jurisdictions adopt a similar approach, including:

  - Belgium where we understand the threshold tax rate is set at 15%;

  - Luxembourg where we understand the threshold tax rate is set at 8.5%;

  - The Netherlands where we understand the threshold tax rate is set at 10%; and

  - Spain where we understand the threshold tax rate is set at 10%.

We consider that adopting this approach can position Ireland as a location of choice for holding companies while ensuring a robust regime that respects international best practices and that protects against double non-taxation.

2. Proposed commencement provision

The proposed commencement provision warrants further consideration. A significant number of large domestic and multinational groups operate financial years commencing on dates other than 1 January. Those groups will be prejudiced by the proposal to apply the participation exemption to dividends received in accounting periods beginning on or after 1 January 2025. For example, a group whose financial year begins on 1 September will not be able to benefit from the participation exemption until 1 September 2025, whereas, a group whose financial year begins on 1 January 2025 will be able to benefit from the exemption from 1 January 2025. In practical terms, we expect that this difference in treatment will impact commercial decisions on when to pay dividends which seems difficult to justify.

We note that previous changes to the Irish tax treatment of inbound dividends commenced on the same specified date for all taxpayers, rather than by reference to the commencement of accounting periods. These include:

- Section 21B of the Taxes Consolidation Act 1997 ("**TCA**") which provided for the 12.5% rate to apply to certain categories of dividends (which before then had been taxed at the 25% rate). It was introduced by section 43 of Finance Act 2008 and applied to dividends received on or after 1 January 2007 (without any reference to the accounting period of the recipient).

- Section 50 of Finance Act 2010 extended the application of the 12.5% rate in section 21B TCA and applied to dividends received on or after 1 January 2010 (again, without any reference to the accounting period of the recipient).

- Section 53 of Finance Act 2012 further extended the application of the 12.5% rate in section 21B TCA and, again, the change applied to dividends received on or after 1 January 2012.

The only time a change made to section 21B TCA applied from the commencement of an accounting period was when the rules for self-assessment were modernised in Finance Act 2012. As part of those changes, the cross-reference to the provisions under which a tax return is made in subsection (7) had to be updated. As that change related to administration, it was appropriate to apply it from the commencement of the accounting period.

We do not think that it is appropriate or necessary to apply the participation exemption by reference to the commencement of an accounting period. We consider that the approach previously taken to changes in the treatment of inbound dividends should also apply for the participation exemption.

We note that under such an approach, taxpayers with financial years commencing on dates other than 1 January will apply the tax and credit system to in-scope dividends received before 1 January 2025 and the exemption system to in-scope dividends received from 1 January 2025. As the proposal in the Consultation Document envisages companies applying both systems in parallel to in-scope and out-of-scope dividends in any event, we do not expect that requiring companies with financial years commencing on dates other than 1 January to differentiate between pre-1 January 2025 dividends (which would be treated in the same way as out-of-scope dividends) and post-1 January 2025 dividends (which would qualify for the exemption) will increase the administrative burden either for taxpayers or for the Revenue Commissioners.

3. Legislative drafting

Whilst we understand the current process is focussed on the architectural design of the exemption, there is one point that we think should be highlighted at this stage with respect to the legislative drafting. That relates to the control requirements that must be satisfied to avail of the exemption. In that respect, the requirement to hold 5% of the paying entity should not be overly prescriptive and it should be capable of being satisfied by the wide range of bodies corporate that exist in other jurisdictions. For example, it should not require that the taxpayer holds 5% of the "ordinary share capital" of the payer as not all jurisdictions have an equivalent concept.

4. Existing inbound dividend framework

In parallel with this process, we think it would be timely to review the existing inbound dividend tax framework. The existing regime is overly cumbersome and in need of simplification. For example, the application of section 21B TCA and, in particular, the requirement to trace through large groups to confirm whether dividends are paid from trading profits imposes a significant administrative burden on corporate groups that have established operations abroad. We intend to provide a separate submission on the simplifications that could improve those provisions.

We trust that the considerations included above would be seen as reasonable and will be taken into account in the design of the participation exemption. We would welcome the opportunity to engage further if you would like to discuss any aspect.

Yours sincerely

Sent by email, bears no signature

**Shane Hogan | Head of Tax**
**MATHESON**