Ireland as a European gateway jurisdiction for China – outbound and inbound investments

Matheson

WHY IRELAND?

Ireland offers significant opportunities as a gateway into the European market for Chinese investors and for multinational companies looking to invest into China.

Since joining the European Union in 1973, Ireland has developed a small, open, pro-business economy which is seen as an excellent gateway into the European market, particularly for US-based companies.

Typically, multinational companies looking to avail of Ireland's low 12.5% corporation tax rate will establish an Irish incorporated limited liability company as a trading platform for the European / EMEA area. Provided the Irish company has a sufficient level of substance and activity, it will benefit from Ireland's 12.5% corporation tax rate on its trading profits.

In addition to this low headline corporation tax rate, Ireland offers a competitive physical, regulatory and commercial framework within which to do business. Ireland is an English-speaking, EU and Eurozone member with a common law based system of law. Ireland's EU membership offers the benefit of free movement of goods, people and capital within the EU area to companies established in Ireland. Ireland's membership of the Eurozone means that foreign exchange issues can be managed from a single location for a large section of the European market.

All of these factors leave Ireland ideally placed to provide a low corporation tax rate profit centre for the European / EMEA operations of multinational companies.

It comes as no surprise, therefore, that a 2012 survey, commissioned by Matheson and carried out by the Economist Intelligence Unit, confirms that Ireland's most important competitive advantages are *"access to EU markets, a competitive corporate tax infrastructure, a uniquely talented workforce and a stable regulatory framework that supports business*" (see http://www.matheson.com/fdi for a link to the full report and other information about the advantages of foreign direct investment into Ireland).

For all of these reasons, together with the advantages offered by the China / Ireland double tax treaty (the "**DTA**") and Ireland's credentials as a holding company location, Ireland is emerging as an interesting alternative to other gateway jurisdictions for investment from China into Europe and for investment into China.

OUTBOUND - IRELAND AS A GATEWAY TO EUROPE FOR CHINESE COMPANIES

One of the primary tax benefits of doing business in Ireland is Ireland's standard corporation tax rate of 12.5%. This low rate applies to all '*trading*' income (broadly equivalent to active income). Non-trading income (broadly equivalent to passive income) is generally taxable at 25%.

In addition, no Irish capital gains tax applies on the sale by a Chinese resident parent company of shares in an Irish resident company provided that the Irish company does not derive more than 50% of its value from Irish real estate. Coupled with the broad Irish domestic exemptions from withholding tax on dividends and payments of interest and royalties (see below for further detail), the net result is that a Chinese parent company should not suffer any additional tax leakage on its overseas investment at the Irish intermediate holding company level.

The Chinese investor can also benefit, through the use of an Irish holding company, from the broad range of holding company benefits (including IP benefits) offered by Ireland:

- Ireland has no specific '*thin capitalisation*' rules. This means there is generally no restriction on wholly debt-funded Irish holding companies.
- Ireland has no '*controlled foreign company*' rules.
- A tax deduction for funding costs is available to Irish holding companies for externally-sourced and certain internally sourced, debt capital. Any excess deduction can be used to offset other taxable profits of the holding company.
- Ireland has a wide tax treaty network which gives it a significant advantage over other '*low tax*' jurisdictions. Currently, 69 tax treaties have been signed (with negotiations underway for an additional three treaties).
- Ireland has broad domestic exemptions from Irish withholding taxes on payments of dividends, interest and royalties to persons resident in tax treaty partner countries (and additionally, in the case of dividend payments, to companies controlled by persons resident in tax treaty partner countries). Pursuant to these exemptions, dividends and payments of interest and royalties made in the course of the Irish company's trade or business to a Chinese parent company should be exempt from Irish withholding taxes without requiring clearance under the DTA.
- Ireland allows for the onshore pooling of '*excess*' foreign tax credits on foreign dividends. The excess credits can be set-off against any Irish tax due on other foreign dividends.

From an IP holding company perspective, Ireland offers substantial tax incentives to encourage and foster the growth of IP rights, including incentives for both the purchase and internal development of IP by Irish companies:

- A tax deduction is available in respect of capital expenditure incurred on most forms of IP. The deduction can be taken in line with the accounting depreciation on the IP or alternatively, over a maximum 15 year period, whichever is the lesser. The tax deduction can be used to achieve an effective tax rate of 2.5% on profits from exploitation of the IP purchased. Provided the IP is held for five years, a subsequent disposal of the IP will not result in a clawback.

- Ireland offers a 25% corporation tax credit to companies within the charge to Irish tax which carry out qualifying research and development ("**R&D**") expenditure. Where the credit is not exhausted by the offset against a company's corporation tax liability, a company may, within limits, reclaim the excess tax credit in instalments from the Irish tax authorities. The credit may also, within certain limits, be surrendered by a company to key R&D employees to reduce their income tax liability.
- Irish tax law exempts the sale, transfer or other dispositions of IP from stamp duty, with a broad definition of IP also applying for the purposes of this exemption. No other transfer taxes would apply on the sale of IP.

INBOUND - IRELAND AS A GATEWAY TO CHINA FOR INTERNATIONAL COMPANIES

Irish companies can also be used as a gateway for international companies seeking to invest into China. From a business organisation perspective, this may be attractive to many multinational companies which already have a substantial presence in Ireland.

There are two main advantages of using an Irish holding company to invest into China. Firstly, Chinese dividends may be paid to the Irish company with a low level of Chinese dividend withholding tax and, usually, with no Irish tax payable. Secondly, profits arising on the disposal of a Chinese subsidiary can be exempt from both Chinese tax (provided the subsidiary does not derive its value from Chinese real estate) and Irish tax.

Dividends paid by Chinese subsidiaries to Irish holding companies benefit from a low rate of taxation:

- Pursuant to the DTA, the rate of Chinese withholding tax is only 5%, once the Irish holding company has at least a 25% shareholding in the Chinese subsidiary. This is the lowest rate of Chinese withholding tax available in the treaties entered into by China and compares favourably to the standard 10% rate which usually applies.

  The Irish company is only subject to 12.5% Irish corporation tax on Chinese dividends paid out of trading (active) profits and Chinese tax (both withholding tax and underlying tax) may generally be credited against this liability. Usually, this is sufficient to ensure that no additional Irish tax is actually payable on Chinese dividends to Ireland.

Profits or gains arising on any disposal of Chinese subsidiaries by the Irish company may be exempt from both Chinese and Irish taxation:

- No Chinese capital gains tax applies on the sale of Chinese shares by Irish companies, other than where the shares derive their value from Chinese real estate. Importantly, there is no minimum shareholding requirement in order to claim this benefit (in contrast to many other holding company jurisdictions).
- No Irish capital gains tax applies on the sale of Chinese shares by an Irish holding company where, broadly, a 5% shareholding is maintained for a minimum 12 month period and the group, as a whole, carries on a trade.

To obtain the benefits of the DTA, the Irish company must ensure that it meets the DTA's '*residence*' and '*beneficial ownership*' tests. From a Chinese perspective, the Irish company must be treated as a '*resident of Ireland*' and as the '*beneficial owner*' of the shares in the Chinese subsidiary.

The Chinese State Administration of Taxation has published a number of circulars in relation to obtaining treaty benefits including, in particular, Circular 601 released in October 2009. Circular 601 lists seven factors aimed at determining whether a company claiming beneficial ownership for treaty benefits is merely a conduit entity or is a genuine beneficial owner of the shareholding in the Chinese subsidiary. Provided the Irish company has sufficient substance in Ireland, it should be possible for it to avail of the key benefits under the DTA. To the extent that the ability to demonstrate substance is important, Ireland would provide a good fit for many multinational companies which, as noted above, may already have a significant presence in Ireland.

In addition to these significant treaty benefits, the Irish company would be able to benefit from many of the tax advantages set out in the previous section on Ireland as a gateway to Europe for Chinese companies.

ADDITIONAL IRISH STRUCTURES

Ireland is not just a favourable jurisdiction for trading and holding company structures. Ireland also offers other interesting investment opportunities particularly in the areas of investment funds, aircraft leasing and securitisation transactions.

Investment Funds

Ireland is widely recognised as one of the world's most advantageous jurisdictions in which to establish investment funds, providing a very favourable taxation environment: a corporate tax rate of 12.5%; no Irish taxes on income or gains made by non-Irish resident / ordinarily resident investors; no stamp duty on fund units; no annual subscription tax for funds; and no fund tax.

Importantly, the EU framework for investment funds permits certain investment funds established in Ireland to be granted an '*EU passport*' enabling its units or shares to be marketed and sold in all other EU Member States. The Irish Stock Exchange is widely regarded as one of the leading exchanges in the world for the listing of investment funds. Ireland's position as a leading funds domicile is demonstrated by the fact that:

- 30% of Europe's cross-border market is domiciled in Ireland.
- 388 fund promoters from over 50 countries use Ireland to distribute UCITS and other funds to over 70 countries across the globe.
- 32% of European ETFs and 30% of European money market funds are domiciled in Ireland.
- 41% of the world's alternative investments funds are administered in Ireland.
- Ireland has the largest number of stock exchange listed investment funds in the world.

Aircraft Leasing

Ireland has become an increasingly popular jurisdiction for the establishment of companies which engage in the acquisition and leasing of aircraft. Ireland's low tax environment and extensive double tax treaty network contributes to its popularity. Ireland does not impose withholding tax on lease rental payments. In addition, lease rental payments to an Irish company can often be made by the lessee to the Irish holding company with a reduced or zero rate of withholding tax due to Ireland's tax treaty network.

Ireland's aircraft leasing offering is further enhanced by its favourable capital allowances (tax depreciation) regime for capital expenditure incurred on the aircraft acquisition (including renewal, improvement and reinstatement expenditure) which allows for the expenditure to be written off for tax purposes over a period of eight years (subject to a partial clawback on a subsequent disposal of the asset).

Ireland's position as a leading aircraft leasing jurisdiction is reflected by the fact that:

- Over EUR 83 billion of aircraft assets are under management in Ireland.
- 7 of the top 10 aircraft lessors have operations in Ireland.
- Half of the world's leased fleet of commercial aircraft are leased or managed through Ireland.

Securitisation Transactions

In recent years, Ireland has become the jurisdiction of choice for the establishment of special purpose vehicles ("**SPVs**") for a broad range of structured finance transactions. Due to favourable tax rules, it is possible to ensure that there is no tax leakage at the level of the Irish SPV so that the entire profit on the investment may be returned to the investors. As noted above, broad domestic exemptions from withholding taxes are available so that the investors' return is not subject to tax in Ireland. In addition to these tax advantages, Ireland has a highly regarded regulatory regime and has consistently introduced and refined its legislation dealing with structured finance transactions making Ireland a key jurisdiction for the location of structured finance SPVs.

CONCLUSION

Ireland is a first-choice low tax platform. A large number of multinational groups have already based significant operations in Ireland to avail of Ireland's key benefits. In the context of increased scrutiny of tax haven jurisdictions, Ireland, as an onshore EU jurisdiction, with the necessary infrastructure to support profit-generating activities, is ideally placed to provide a gateway option into the European market for Chinese investors and for multinational companies looking to invest into China. In addition, Ireland is a first choice jurisdiction for other investment structures including investment funds, aircraft leasing and securitisation transactions.

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