Solicitors
70 Sir John Rogerson's Quay
Dublin 2 Ireland

T +353 1 232 2000
F +353 1 232 3333
W www.matheson.com
DX 2 Dublin

Matheson

Deirdre Donaghy
Department of Finance
Government Buildings
Merrion Street Upper
Dublin 2
By Email deirdre.donaghy@finance.gov.ie

Our Ref | Your Ref | 13 May 2015

Dear Ms Donaghy

Finance Bill 2015

Matheson is an Irish law firm and our primary focus is on serving the Irish legal and tax needs of international companies and financial institutions doing business in Ireland. Our clients include over half of the Fortune 100 companies. We also advise seven of the top ten global technology companies and over half of the world's 50 largest banks. We are headquartered in Dublin and also have offices in London, New York and Palo Alto. More than 600 people work across our four offices, including 75 partners and tax principals and over 350 legal and tax professionals. In advance of Budget 2016, we have set out below our proposals on changes that should be considered for the Finance Bill 2015.

The first section of our letter sets out changes that should be made to enhance Ireland's regime for taxing those holding and exploiting intellectual property ("**IP**") in Ireland. The suggestions are made on the premise that a knowledge development box will be introduced in Finance Act 2015 and accordingly are focussed on other aspects of Ireland's IP regime.

The second section outlines changes that ought to be made to the grandfathering provisions included in Finance Act 2014 ("**FA 2014**") in respect of the corporate tax residency rules. These changes are also relevant to Ireland's position as the location of choice for holding and exploiting IP.

The third, fourth and fifth sections suggest changes to ease the administrative burden on taxpayers and to facilitate the implementation of changes under the Companies Act 2014. Finally, the sixth section proposes technical amendments to the provisions that outline the tax treatment of share-based remuneration.

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1 Section 1: Ireland's IP regime

In the 2015 budget statement, Minister Noonan recognised that companies are increasingly investing in knowledge-based capital and announced that Ireland would introduce a knowledge development box to incentivise such investment in Ireland. Improving Ireland's IP regime is one of the key proposals in the Road Map for Ireland's Tax Competitiveness. As initial steps, amendments were made to the capital allowances regime for intangible assets and to the research and development ("**R&D**") tax credit in FA 2014. We welcome these changes and the overall move to improve Ireland's IP regime so that it is "best in class". In light of this policy aim, the following changes to the existing regime should be made:

- the disposal of patent rights as part of a group reorganisation should not give rise to a charge to tax under section 757 of the Taxes Consolidation Act 1997 ("**TCA**");
- relief under section 291A TCA should continue to be available following a group reorganisation;
- the categorisation of income arising from IP as income from a separate trade under section 291A TCA should be removed;
- expenditure on R&D outsourced to third parties should qualify for the R&D tax credit;
- an exemption should be available from withholding tax on royalty payments made to Irish companies; and
- the regime for relieving foreign tax incurred on royalty income should be simplified.

1.1 Treatment of disposal of patent rights

Irish tax law distinguishes between the disposal of patents themselves and the disposal of "patent rights" in the following manner:

- the disposal of patents is regarded as a capital disposal and any gain arising is subject to the capital gains tax rate of 33%; whereas
- the disposal of "patent rights" (eg a licence granted to use a patent) is not subject to capital gains tax, but instead is chargeable to tax under Schedule D, Case IV pursuant to section 757 TCA and is subject to corporation tax at 25%.

1.1.1 *Issues arising under section 757 TCA*

Section 757 TCA was introduced in Ireland in 1967 (prior to the introduction of capital gains tax) as an anti-avoidance measure to prevent certain receipts from being earned tax free. Once capital gains tax was introduced, the reason for this anti-avoidance measure fell away. In practice, the continuing existence of this provision gives rise to anomalies in the tax treatment of reorganisations.

Irish tax legislation permits companies to restructure their operations in a tax-free manner where no actual gains are realised (for example, where assets are transferred intra-group under section 617 TCA or on a restructuring under section 615 TCA). However, a charge to corporation tax at 25% can arise on the disposal of patent rights as part of the same reorganisation with no available reliefs. This requires businesses seeking to restructure to perform a costly and burdensome valuation exercise to try to identify the value of the patent rights element of the business. In some cases, it can even result in the proposed reorganisation being abandoned or being restructured, thereby increasing cost.

1.1.2 *Proposal*

Section 757 TCA should be repealed and patent rights should be treated as any other chargeable asset (as is clearly envisaged by section 533(h) TCA).

If this is not possible, at the very least, changes should be made to facilitate reorganisations of businesses in a tax efficient manner where existing reliefs and exemptions are available for the disposal of capital assets. This could be achieved by providing that section 757 TCA will not apply to disposals of patent rights, where, the transaction qualifies for relief or exemption from Irish tax on chargeable gains pursuant to the various reorganisation reliefs available.

1.2 **Section 291A and group reorganisations**

As noted above, Irish tax legislation recognises that companies should be able to restructure their operations in a tax-free manner where there are no actual realised gains. In the context of the reorganisation of a trade, companies will rely on section 617 TCA or section 615 TCA (from a capital gains tax perspective) and section 400 TCA (from a corporation tax loss and capital allowance perspective). These provisions recognise that the new owner of the trade should step into the shoes of the old owner, and take on the historical base cost for capital gains tax purposes and the historical tax written down value for capital allowances purposes.

However, where the assets transferred as part of a reorganisation include IP in respect of which the transferor company has claimed capital allowances under section 291A TCA, the provisions do not operate in the usual way and the benefit of the relief available under section 291A TCA is lost.

1.2.1 *Issues arising on group reorganisations*

Section 291A(9) TCA specifically provides that where relief is claimed under section 615 or 617 TCA *"[t]his section shall not apply to the acquisition by a company… of a specified intangible asset".* This provision precludes a company from claiming capital allowances on intangible assets it has acquired where the transferor claims relief from tax on chargeable gains (whether at the transferor's tax written down value or otherwise). We cannot see any policy reason to treat intangible assets differently to other plant and machinery. We believe that any acquiring company in these circumstances should rightly be entitled to claim capital allowances in respect of the acquired IP.

1.2.2 *Proposal*

We suggest that section 291A(9) TCA could be amended to provide *"Save as allowed by section 308A and section 400, this section shall not apply to the acquisition….."*

1.3 **Separate trade under section 291A TCA**

We welcome the changes made to section 291A TCA in FA 2014. However, we consider that one further change should be made to make the provisions less burdensome from a compliance perspective.

Section 291A(5) and (6) TCA currently require taxpayers claiming capital allowances on acquired IP to treat income derived from that IP as income from a separate trade. This provision will apply where a taxpayer has both developed IP and acquires IP. In those circumstances it requires taxpayers to artificially segregate a single trade into two separate trades and apportion common costs between the two trades on a just and reasonable basis. This requirement adds unnecessary complexity to the regime and is administratively burdensome.

1.3.1 *Proposal*

The separate trade requirement in sections 291A(5) and (6) TCA should be removed.

1.4 **Extending the R&D tax credit to outsourced R&D**

We welcome the changes made to the R&D tax credit regime in FA 2014 and in particular the move to a full volume-based regime. Overall the Irish R&D tax credit regime compares well to those available in other jurisdictions. However, one disadvantage of the Irish regime when compared to those available in other European jurisdictions is that generally the cost of R&D that is outsourced is not available for the purpose of the credit.

This does not reflect how multinational companies typically manage their R&D function. Usually multinational companies outsource some of the R&D function to third parties (most notably, pharmaceutical firms tend to outsource clinical trials to specialist third parties) and some of the R&D function to related parties located in other jurisdictions with specialist expertise.

1.4.1 *Proposal*

Expenditure on R&D outsourced to third parties should always qualify for the purposes of calculating the R&D tax credit. Further, expenditure on R&D outsourced to related parties outside Ireland should also qualify provided the Irish taxpayer retains personnel in Ireland to oversee and manage that R&D.

1.5 **Withholding tax treatment of royalty payments made to Irish companies**

It is generally possible for Irish companies to pay royalties to companies in EU Member States and double tax treaty partner jurisdictions free from Irish withholding tax. That is not the case where similar payments are made to Irish companies and generally exemption from withholding tax is only available if the payer and recipient companies are related through 51% commonality of ownership. Given Ireland's success in attracting IP-intensive businesses to Ireland, the increasing commercial dealings between these Irish-based businesses and the desire to promote Ireland as the location of choice for exploiting IP, withholding tax on royalty payments made to Irish companies should be abolished.

It is difficult to justify the disparity of treatment between payments made to Irish resident recipients and non-Irish resident recipients, particularly as Irish residents will be required to include the income in their own tax returns. Further, the obligation to withhold imposes an additional and unnecessary administrative burden on both the payer and recipient.

1.5.1 *Proposal*

We suggest that section 242A TCA should be extended to provide an exemption from withholding tax in respect of royalties paid to Irish resident companies where:

- the payment is made in the course of a trade or business carried on by the payer; and
- the payment is made for bona fide commercial reasons and does not form part of an arrangement the main purpose of which is tax avoidance.

1.6 Simplifying the regime for relieving foreign tax on royalty income

Although relief is generally available for foreign tax incurred on royalties received by Irish companies, the regime is complex. It combines relief by way of credit and deduction. Different rules apply for calculating the relief depending on whether or not the payer is located in a treaty partner jurisdiction. The regime does not include a comprehensive pooling mechanism.

The entitlement to claim relief for foreign taxes incurred on royalty payments will become increasingly important as multinational companies look to bring their IP on-shore. There is real practical merit in having a regime that is less complex and easier for taxpayers to apply. Therefore, we would propose that the regime for relieving foreign tax on royalty income should be simplified in Finance Act 2015.

2 Section 2: Changes to the residence rules and Ireland's IP regime

The recent changes to the corporate residency rules introduced in section 43 FA 2014 included an anti-abuse provision which was added to the legislation during the committee stage amendments. This anti-abuse provision was intended primarily to prevent the use of shell companies formed prior to 31 December 2014 from availing of "grandfathered" status under the old residence rules and being used in Irish non-resident company structures on or after 1 January 2015.

While we understand the rationale for this change, and the need to ensure that the widespread abuse of the grandfathering provision did not arise, we also think that some unintended consequences could arise for certain multinational companies who have had long established structures and have an expectation that the old residence rules will apply until 31 December 2020.

2.1 Issues arising under section 43 FA 2014

The anti-abuse measure provides that a company which would otherwise be treated as non-resident until 31 December 2020 and grandfathered under the pre-existing rules could become Irish tax resident if both of the following events occur:

(a) there is a "*change in ownership*" of the relevant company; and

(b) there is a *“major change in the nature or conduct of the business”* of the relevant company within the relevant period.

A company falling within the anti-abuse provision becomes Irish tax resident with effect from the date of the change of ownership (regardless of which condition is satisfied first).

The timing of the disapplication of the grandfathering provisions can unfairly affect companies that satisfy the change in ownership condition first. Those companies will be treated as resident in Ireland from the date of the change of ownership even if there is no change in the conduct of business of that company for a number of years. It seems particularly unfair to time a change in tax treatment by reference to an event over which the relevant company has limited control.

It is often the case that non-resident Irish incorporated companies (“**NRIs**”) are ultimately owned by a pool of investors who at any time may choose to realise their investment by selling their shares in the parent company of the NRI group. Any major change in the conduct of the NRI’s business after such a sale will trigger a change of residence from the date of the change of ownership. It is possible that an NRI that wishes to transfer an IP trade to Ireland could be treated as undergoing a major change in the conduct of its business. If such an NRI previously underwent a change of ownership, the grandfathering provisions would cease to apply from the date of the change of ownership. As a result, the transfer of the IP trade to Ireland would fall within the charge to Irish tax. This is a result that Irish tax policy clearly does not support.

2.2 Proposal

We recommend amending section 43(2)(b) FA 2014 so that the grandfathering provisions cease to apply with effect from the date immediately after both conditions have been satisfied.

3 Section 3: Application of section 29 TCA to companies migrating to Ireland

The current language in section 29 TCA gives rise to ambiguity in the context of the taxation of companies that are not resident in Ireland for the entirety of a calendar year. While we understand that confirmations have been provided on this point in the past, we would be grateful if consideration could be given to now legislating for those confirmations.

3.1 Background

Section 29(2) TCA provides that a company shall be chargeable to CGT in respect of chargeable gains accruing to such company “*in a year of assessment for which such [company] is resident …in the State*.” However, companies are subject to corporation tax on capital gains by reference to accounting periods, and not years of assessment.

There is no case law or published Revenue guidance on whether a company that is resident for part only of a year of assessment is considered to be resident "for" the year of assessment for CGT purposes or whether such company should only be considered resident for CGT purposes from the date of commencement of its accounting period.

It seems unreasonable that Ireland should have the right to subject a company to Irish taxation as if it were resident at the time of a disposal, when it clearly was not so resident at that point. With this in mind, we understand that it has previously been confirmed that:

(a) the reference to "year of assessment" in section 29(2) TCA should be read as "accounting period" in so far as it relates to a company and that on this basis, a company is chargeable to CGT (or in accordance with section 21(3) TCA corporation tax on chargeable gains) in respect of chargeable gains accruing to it in an "accounting period" for which the company is resident in Ireland; and

(b) that a company which is resident for part only of a year of assessment (ie the calendar year) is not considered to be resident "for" the year of assessment but rather only for the period after the start of its accounting period or before the end of its accounting period.

3.2 Proposal

Include an additional line in section 29(1) TCA which states:

"references in this section to "year of assessment" shall be construed as referring only to an "accounting period" in the context of a company."

4 Section 4: Mergers and stamp duty

4.1 Mergers under the Companies Act 2014 and section 87B SDCA

The Companies Act 2014 (the "**Act**") was signed into law on 23 December 2014. It consolidates and modernises existing Irish company law. One of the key changes is introduced in Part 9 of the Act which provides for mergers. On commencement of the provisions, it will be possible for one Irish company (or more) to merge into another Irish company. Under the merger transaction, all of the assets and liabilities of the merging company (or companies, as the case may be) will be transferred to the acquiring company and the merging company (or companies) will be dissolved without going into liquidation. Under the Act, mergers can be effected in a number of different ways. The types of merger that can be undertaken are based on those available under the Directive of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies (the "**Directive**"). The Directive was implemented in Ireland under the European Communities (Cross-Border Mergers) Regulations 2008 (the "**Regulations**").

Section 87B of the Stamp Duties Consolidation Act 1999 ("**SDCA**") was amended to provide that cross-border mergers effected under the Regulations would be not chargeable to stamp duty. Similar relief must be available for mergers effected under the Companies Act 2014. If no relief from stamp duty is available, it will fundamentally undermine the company law changes. Accordingly, we would recommend that section 87B SDCA is extended to apply to mergers effected under the Act.

4.2 Changes to section 80 SDCA to accommodate the Act

In addition, in order to accommodate the changes made under the Act, section 80 SDCA should also be updated.

Section 80 SDCA provides relief for reconstructions and amalgamations. For a company to be considered a 'target company' for the purposes of section 80(6) SDCA, the company that acquires it (referred to in section 80 SDCA as the 'acquiring company') in some circumstances must include the acquisition of the target company as one of its objects. In practice, this means that the objects clause in the memorandum of association of the acquiring company is usually amended prior to any acquisition in respect of which relief under section 80 SDCA is claimed to specifically include the acquisition of the target company as a separate object of the company. Following the enactment of the Act, most Irish companies will not be required to have an objects clause in their constitutional documents. In light of these changes in the Act, the requirement in section 80(6) SDCA for an acquiring company to have the acquisition of a target company as one of its objects should be deleted.

The Act will also remove the requirement for all Irish companies to have an authorised share capital. Section 80(5) SDCA clarifies that for the purposes of section 80 a company that *"issues any unissued share capital shall be treated as if it had increased its nominal share capital"*. It is unclear how this provision will apply to companies that do not have an authorised share capital. Section 80(5) SDCA consequently also must be amended to reflect the fact that not all Irish private limited companies will be required to have an authorised share capital.

4.3 Changes to section 79 SDCA

Although not directly related to the Act, the opportunity should also be taken to amend section 79 SDCA so that relief granted is not subsequently clawed back if following the relieved transfer, either the transferor company or the transferee company is wound-up or dissolved. A similar carve-out is available under section 623(1)(d) TCA where an entity that has acquired an asset from a group company is subsequently wound-up or dissolved and no claw back applies in respect of group relief previously claimed under section 617 TCA. In practice, Revenue are willing on a concessionary basis to confirm that the stamp duty relief granted under section 79 SDCA will not be clawed back where the winding-up is effected for bona fide reasons and the transferred asset remains within the group. It would be helpful to taxpayers and tax practitioners if this practice was enacted into legislation. In this respect, we suggest that sections 79(5)(c) and 79(7)(b) SDCA be amended.

5 Section 5: Withholding taxes on interest paid to Irish companies

While it is generally possible for Irish companies to pay interest to companies in EU Member States and double tax treaty partner jurisdictions free from Irish withholding tax, that is not the case where interest is paid to Irish companies. Under existing Irish law, exemptions from withholding tax are available in respect of interest payments made to non-Irish resident companies if:

- interest is paid to persons resident in an EU Member State or a double tax treaty partner jurisdiction and that jurisdiction imposes tax on interest received from sources outside that jurisdiction (section 246(3)(h) TCA);
- interest is paid to persons resident in a double tax treaty partner jurisdiction and the interest is exempt from income tax under the terms of the treaty (section 246(3)(h) TCA); or
- interest is paid to an associated company that is resident in an EU Member State other than Ireland (section 267I TCA).

The exemptions available from withholding tax on interest paid to Irish companies are more restrictive. Exemptions are only available in a group context, or to particular types of companies, such as banks, funds and registered non-bank lenders. The disparity of treatment between interest payments made to Irish resident lenders and non-Irish resident lenders is difficult to justify.

The equivalent UK legislation provides a full exemption from withholding tax on interest where the borrower reasonably believes that the company is resident in the UK for UK tax purposes or the interest is within the charge to corporation tax by virtue of the lender having a permanent establishment in the UK. We see no reason why the Irish legislation should not be amended to provide a similar exemption for interest payments made to Irish resident companies.

6 Section 6: Share-based awards – technical amendments

6.1 Employer filing obligations

Employers are required to notify Revenue of share-based awards made to employees under sections 128, 128C(15), 128D(8), 128E(9) and 897B TCA. Detail in relation to the awards was historically provided in the Form RSS1. However, the Form RSS1 was amended for the 2012 tax year and all subsequent years to only require detail in respect of share options and other rights granted under section 128 TCA.

We understand from our correspondence with Revenue that as shares, restricted shares, forfeitable shares and convertible securities are within the scope of PAYE, they no longer require employers to provide details of such awards separately (and on that basis amended the Form RSS1). The various technical requirements to provide the relevant information to Revenue remain in the legislation. Accordingly, we suggest that the following provisions be deleted:

(a) section 128C(15) TCA;

(b) section 128D(8) TCA;

(c) section 128E(9) TCA; and

(d) section 897B TCA (in full).

6.2 Exchange of restricted share units

Currently, section 128D(4) TCA provides a relief in respect of restricted shares. The maximum relief is available where the period of restriction lasts for 5 years or more. If the relevant director or employee disposes of the shares before the period of restriction has elapsed, the relief is clawed back. This claw back also arises in circumstances where restricted shares are exchanged for shares with equivalent restrictions. This result is anomalous and we suggest that section 128D(5) TCA be amended to include the additional underlined text set out below:

> *"Where [an amount chargeable to income tax] under Schedule E or Schedule D on the acquisition of shares by a director or employee is reduced in accordance with subsection (4), and—*
>
> > *(a) the restriction on the freedom of the director or employee to assign, charge, pledge as security for a loan or other debt, transfer, or otherwise*

dispose of the shares acquired by him or her is subsequently removed or varied, or

(b) the shares are disposed of in any of the circumstances mentioned in subparagraphs (i) and (ii) of subsection (3)(c) before the specified period expires, <u>except where the new shares acquired under sub-paragraph (I) or (II) of subsection 3(c)(ii) are subject to the same restrictions for the unelapsed specified period as the shares which have been disposed of</u> …"

Thank you for taking the time to consider our suggestions. Should you wish to discuss any of the points raised in further detail, please do not hesitate to contact Olivia Long of this office (E: olivia.long@matheson.com; T: 232 2363).

Yours faithfully

Sent by email, bears no signature

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