itm
Irish Tax Monitor

The Roundtable February 2024

Participation Exemption

The Department of Finance's consultation period on the introduction of a Participation Exemption for Corporation Tax ended in mid-December. Can you comment on the plans?

Michelle Adams

Michelle Adams, Manager, Financial Services Tax, BDO: Ireland operates a worldwide tax regime meaning all profits, including foreign source profits, are taxable by an Irish resident company with double tax relief for the foreign tax paid, referred to as the "tax and credit" model. Ireland stands out as it is the only EU country and one of a very small number of OECD countries that does not currently implement any form of participation exemption for dividends.

The potential introduction of territorial elements to the corporation tax system were reviewed with the launch of a public consultation on a territorial system in December 2021. The initial consultation was to act as a scoping exercise and some key themes came from the responses including:

i. The participation exemption should be implemented for both foreign dividends and foreign branch profits.
ii. The participation exemption should be an option and the current tax and credit system should remain in place.
iii. The conditions should be aligned with the conditions which already exist under Section 626B.
iv. There should be no trading requirement to avail of the exemption.
v. The 25% corporation tax rate should be removed.
vi. The UK participation exemption regime is a good example of how the Irish regime should be implemented.

On 14th September 2023, the Department of Finance published a roadmap for the introduction of a participation exemption which included a timeline for the implementation. As part of this, a consultation period was open until 13th December 2023 which included 53 questions that were tailored to gather further information on the above key themes. Some of the questions asked included a request for an opinion on the design of the exemption, including whether we should adopt similar designs to other jurisdictions, what jurisdictions the exemption should apply, should the income be excluded from the charge to tax or included with a deduction in arriving at the taxable income, should full or partial relief be available, what types of dividends should qualify, should a minimum shareholding apply and should the exemption be optional.

The roadmap also advises that the department is committed to further detailed examination of policy considerations relevant to the possible introduction of a foreign branch participation exemption. The consultation raised 8 queries aimed at gathering additional information.

The Department will consider the responses and further stakeholder engagement until March 2024 and the expectation is that the legislation for the participation exemption on foreign dividends will be delivered in Finance Bill 2024 in the final quarter of the year and will take effect from 2025.

It is clear that the introduction of a participation exemption for foreign dividends and foreign branch profits will be well received with the consensus view that Ireland's current worldwide system of taxation reduces our attractiveness as a location for inward investment due to the complexity and administrative burden of operating the tax and credit model. The introduction of a dividend participation regime is long overdue, particularly in light of the recent introduction of Pillar Two, and we eagerly await sight of the draft legislation, following receipt of the submissions made.

Personal Taxation

In your experience as a tax practice, in which areas in Ireland's personal income tax structures offer the greatest scope for success in pursuing the reforms recently recommended by the IMF in its annual Report on Ireland? (i.e. 'improving personal income tax system').

Cian O'Sullivan, Tax Director, Private Clients, BDO: The 2023 IMF report on Ireland published last December signalled an upbeat outlook on the Irish economy, indicating broad support for Budget 2024 which will be welcomed by the Government.

Highlighting a low revenue-to-GDP ratio compared to other advanced economies, the IMF noted in their 2022 report that there is scope to broaden the tax base including by expanding and reforming the personal income tax system. These recommendations have been reiterated in the 2023 report.

While exchequer receipts have exceeded forecasts in recent years and shown strong resilience through the pandemic and other external factors, there is wide acceptance that major fiscal risks/challenges lie ahead underpinned by an ageing population, high levels of public debt and vulnerable Corporation Tax receipts. Increased tax revenues will be required to tackle these issues with reforms to the current personal income tax system being one means to achieving this.

Outlined below are some of the areas under consideration:

c) PRSI Reforms: The current 4:1 ratio of worker to pensioner is expected to decrease to 2:1 by 2050. Reforms include extending PRSI to currently exempt sources of income (for example, share-based remuneration) and an increase in the employee and employer rates. Our combined PRSI rate is currently the lowest in Europe. A modest 0.1% increase was announced in the recent Budget. It is expected these rates will increase more dramatically in the coming years.

Cian O'Sullivan

d) Wealth Taxes: Experience from EU counterparts, for example France, show a wealth tax can have an adverse impact and trigger a flight of capital. Indeed the 2022 Commission on Taxation and Welfare report recommends against the introduction of a tax on net wealth highlighting the already progressive nature of our personal income tax system.

e) Capital Taxes: CAT and CGT account for just under 3% of the current tax take. With personal wealth in Ireland at an all-time high and continuing to grow, changes to CAT and CGT may arise in the coming years. This may take the form of increases/decreases to the rates (both currently 33%) and/or reforms to current relief measures. The first of these reforms was announced in the most recent Budget where a €10m lifetime cap on CGT Retirement Relief on transfers within the family was announced. Previously there was no cap up to the age of 66. Differing opinions exist on the lock-in impact of increases to the CGT rate versus the release impact of decreases, and the stimulus from such a release. Any adverse effects of an increase in the rates will need to be carefully considered given our headline rates are high when compared internationally.

f) Local Property Tax, which can be seen as a proxy for wealth tax, is functioning well and measures to increase its yield in future years may be introduced.

g) The removal of age-based restrictions to PRSI and USC will broaden the income tax base. Currently, individuals over 66 (70 from 1 January 2024) are exempt from PRSI and a reduced 2% rate of USC on income under €60k applies.

h) Reforming the remittance basis of tax: In the UK a remittance basis charge was introduced along with a time limit for availing of the remittance basis. No such measures currently exist in Ireland. The Labour party in the UK are campaigning on totally abolishing the regime. This, along with recommendations from the Commissions on Tax and Welfare, could prompt changes to the current regime in Ireland.

Even with record breaking tax revenues in recent years, higher taxes and a broadening of the tax base appear inevitable to maintain fiscal stability. The way this is achieved will need to be nuanced and equitable to achieve public buy-in, and with an election looming it will be interesting to see how these measures will be positioned politically.