

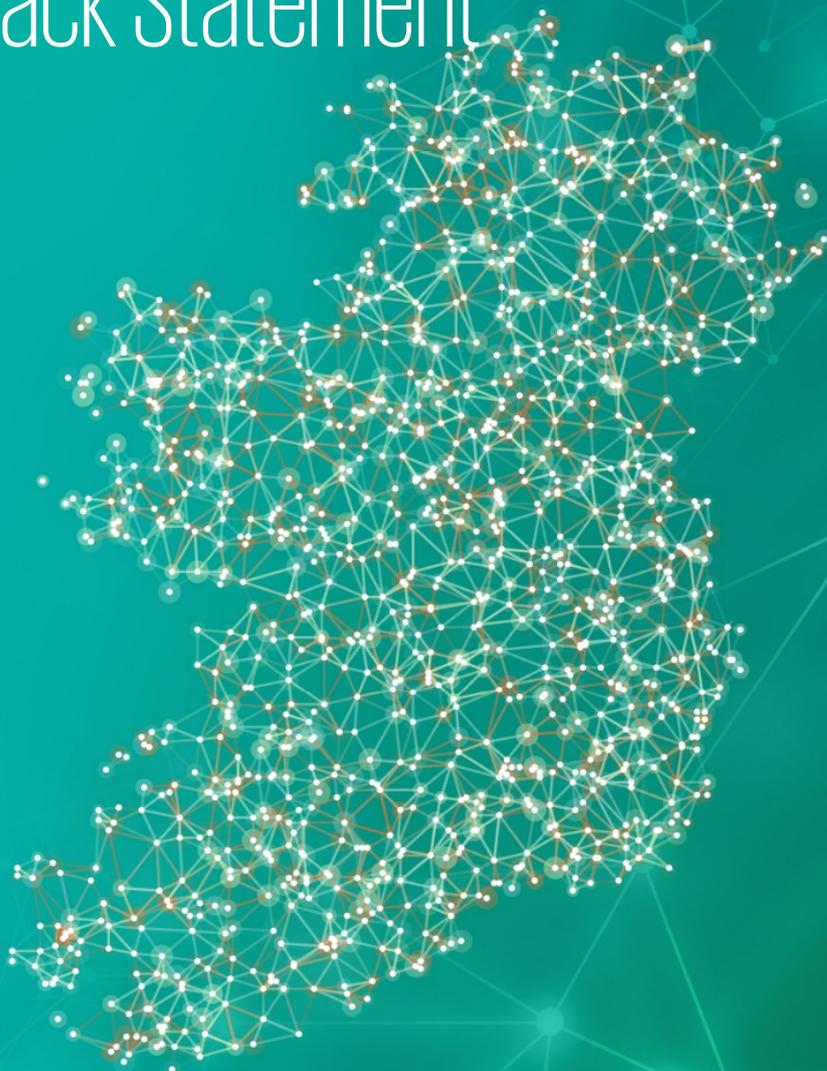


ATAD IMPLEMENTATION

Controlled Foreign Company (CFC) Rules – Feedback Statement

KPMG Response

28 September 2018





KPMG
1 Stokes Place
St. Stephen's Green
Dublin 2
D02 DE03
Ireland

Telephone +353 1 410 1000
Fax +353 1 412 1122
Internet www.kpmg.ie

ATAD Implementation – CFC Feedback Statement
Business Tax Team
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
D02 R583

Email: ctreview@finance.gov.ie

28 September 2018

Dear Sirs

KPMG Response to ATAD Implementation – CFC Feedback Statement

KPMG is pleased to enclose our submission in response to the public consultation by the Department of Finance on the CFC Feedback Statement.

Ireland's corporation tax regime has formed an important part of Ireland's policy initiatives which serve to attract and retain foreign direct investment (FDI) as well as making Ireland an attractive location for domestic entrepreneurs to conduct business through corporative entities. KPMG acknowledges the continuing importance to Ireland of ensuring that its corporation tax regime maintains its competitiveness from an international perspective whilst aligning the regime with initiatives under the European Union (EU) Anti-Tax Avoidance Directive (ATAD).

In its exposition of the outline framework for Ireland's proposed CFC regime, the Department of Finance notes that it is essential for both businesses and Revenue that the implementation of the regime is clear, unambiguous and operable in practice.

In overall terms, we consider that the CFC regime selected from those set out under ATAD and its proposed implementation framework is well positioned to meet these policy objectives. As Ireland does not already have a CFC regime, it faces challenges in adopting a new regime which is aligned with the ATAD framework and which fits into its existing corporation tax regime in a manner that is well understood by business and Revenue alike. Certainty of tax outcomes promotes and sustains investment by business.

KPMG has responded to questions raised in each of the sections of the CFC Feedback Statement document. Our responses are of two types:

- Suggested changes to the outline legislative measures in order to ensure that they can be understood and have the intended effect, and
- Suggested matters for inclusion in related guidance. Given that the fundamental approach under the proposed CFC regime is one that is based on principal purpose tests we consider that providing clarity on the implementation of the measures for business and Revenue alike is best achieved by releasing detailed guidance to enable businesses operating in different sectors to understand the intended application of the regime.

In framing our responses, we believe we have made suggestions that balance the requirement for Ireland to align the regime with the requirements under ATAD with measures that can be understood and implemented by business and Revenue within the framework of Ireland's existing corporation tax regime. We have looked to test the application of the proposed measures by suggesting a number of case studies scenarios that could be used in guidance to explore and illustrate the operation of the measures.

The contact for this submission is Sharon Burke. Contact details: email: sharon.burke@kpmg.ie. Direct line: (01) 4101196.

Sharon Burke

Sharon Murphy • Marie Armstrong • Darina Barrett • Alan Boyne • Brian Brennan • Gareth Bryan • Sharon Burke • Niall Campbell
Patricia Carroll • Brian Clavin • Jim Clery • Colm Clifford • Kevin Cohen • Mark Collins • Ivor Conlon • Michele Connolly • Adrian Crawford
Hubert Crehan • Killian Croke • Brian Daly • Michael Daughton • Eamon Dillon • Paul Dobey • Robert Dowley • Michael Farrell • Patrick Farrell
Jorge Fernandez Revilla • Caroline Flynn • Andrew Gallagher • Laura Gallagher • Frank Gannon • Orla Gavin • Michael Gibbons
Ruaidhri Gibbons • Roger Gillespie • Colm Gorman • Seamus Hand • Johnny Hanna • John Hansen • Ken Hardy • Michael Hayes
Selwyn Hearn • Declan Keane • Gillian Kelly • David Kennedy • Jonathan Lew • Liam Lynch • Olivia Lynch • Tim Lynch • Ryan McCarthy
Pat McDaid • Tom McEvoy • Emer McGrath • Niamh Marshall • David Meagher • Brian Morrissey • Cliona Mullen • Ian Nelson
Colin O'Brien • Conor O'Brien • Paul O'Brien • Barrie O'Connell • Conall O'Halloran • Sean O'Keefe • David O'Kelly • Eoin O'Lideadha
Garrett O'Neill • Terence O'Neill • Colm O'Sé • Conor O'Sullivan • Eoghan Quigley • Vincent Reilly • Eamonn Richardson • Colm Rogers
Eamonn Russell • Anna Scally • Paul Toner • Eric Wallace • Kieran Wallace • David Wilkinson • Tom Woods

Offices: Dublin, Belfast, Cork and Galway

KPMG, an Irish partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity

KPMG is authorised by Chartered Accountants Ireland to carry on Investment Business.

Contents

Executive Summary	1
SECTION 1: Structural Approach	2
SECTION 2: Article 7(1)(a) - Definition of ‘control’	4
SECTION 3: Article 7(1)(b) - Effective Tax Rate	7
SECTION 4: Article 7(1)(b) - Calculation of Effective Tax Rate	9
SECTION 5: Article 7 - The CFC Charge	14
SECTION 6: Additional provisions and “Cash Box” companies	25
SECTION 7: Recital 12 - Exempt period	28
SECTION 8: Article 7(2) and Article 8(2) - Connected company undertaking SPFs	30
SECTION 9: Article 7(1)(b) - Definition of undistributed income	32
SECTION 10: Miscellaneous Definitions	37
SECTION 11: Other issues	39
Appendix I	40
Appendix II	45

Executive summary

This document is KPMG's response to the Department of Finance's September 2018 Feedback Statement on ATAD Implementation, the Controlled Foreign Company (CFC) rules.

In framing our response, KPMG has analysed the frameworks available to European Union (EU) Member States in implementing CFC Rules which are set out under the EU Anti-Tax Avoidance Directive (ATAD). As the largest provider of tax services in Ireland, our clients operate across a range of business sectors based in Ireland. In providing our detailed feedback, we have taken soundings from businesses based in Ireland who operate internationally through subsidiaries – whether they form part of groups that are headquartered in Ireland or outside Ireland.

In overall terms, we consider that the CFC regime selected from those set out under ATAD and its proposed implementation framework is well positioned to meet Ireland's policy objectives of implementing a regime that is clear, unambiguous and operable in practice. As Ireland does not already have CFC Rules, it faces challenges in adopting a new regime which is aligned with the ATAD framework and which fits into its existing corporation tax regime in a manner that is well understood by business and Revenue alike. Certainty of tax outcomes promotes and sustains investment by business.

KPMG has responded to questions raised in each of the sections of the CFC Feedback Statement document. Our responses are of two types:

- Suggested changes to the outline legislative measures in order to ensure that they can be understood and have the intended effect, and
- Suggested matters for inclusion in related guidance. Given that the fundamental approach under the proposed CFC regime is one that is based on principal purpose tests we consider that providing clarity on the implementation of the measures for business and Revenue alike is best achieved by releasing detailed guidance to enable businesses operating in different sectors to understand the intended operation of the regime. Throughout this submission response, we have suggested points of interpretation which could usefully be confirmed in guidance. We have also suggested in Appendices a number of case study examples which are designed to illustrate the implementation of the CFC Rules in different Controlled Foreign Company scenarios.

Structural Approach

The CFC Rules Feedback Statement sets out a framework for adoption of a controlled foreign company (CFC) regime under the EU Anti-Tax Avoidance Directive (ATAD) that seeks to tax in Ireland undistributed income of CFCs that has arisen from the artificial diversion of profits from Ireland. This is expressed as being a CFC charge which arises from the attribution of undistributed income of a CFC that arises from non-genuine arrangements put in place for the essential purpose of securing a tax advantage.

The recitals to ATAD make clear, in the case of a CFC regime which is targeted at artificially diverted profits of CFCs, that CFC measures should be precisely targeted to situations where most of the decision-making functions which generated the diverted income at the level of the CFC are carried out in the Member State of the taxpayer. As noted in the section of the Feedback Statement that discusses the CFC Charge, it is essential for both business and Revenue that the CFC charging provision is clear, unambiguous and operable in practice.

KPMG agrees that the proposed approach to adoption of a CFC regime is consistent with the existing Irish tax policy focus on the taxation of activities with substance in Ireland. The use of transfer pricing principles to establish an arm's length amount for the CFC charge on undistributed income which is attributable to relevant Irish activities is inherently one which looks to the economic substance of arrangements.

This approach appears to be aligned with case law considered by the Court of Justice of the European Union on the appropriateness of anti-abuse tests adopted by Member States which must nonetheless respect freedoms under the Treaty for Functioning of the European Union (TFEU).

The proposed CFC framework applies anti-avoidance rules which are based on principal purpose tests. One of the challenges of meeting the stated policy ambition of providing clear and unambiguous measures is of ensuring there is consistent interpretation by businesses and Revenue alike of tests which can be inherently subjective in nature. We consider that the best possible clarity can be achieved where the policy intent behind the principal purpose tests is explained in detailed guidance. Such guidance should draw on real life examples to create illustrative scenarios that provide guidance on the operation of the measures. This should mean that taxpayers operating in a broad range of business sectors can identify facts and circumstances that are relevant to them and be assured that they are applying the tests in the intended manner.

In this submission, KPMG has grouped comments into:



- Suggestions that relate to proposed legislative wording to achieve the understood intention of the legislative measures. These are indicated by using this symbol. Unless stated otherwise, legislative references are to provisions in the Taxes Consolidation Act, 1997 (TCA 1997).



- Suggestions on points of interpretation and implementation of the measures that should be included in guidance. These include suggested case study scenarios drawing on real life examples that could be used to illustrate for taxpayers and Revenue the scope and application of the tests particularly those that look to purpose and the intent of the taxpayer. These are indicated by this symbol.

In framing our response, KPMG has taken into account:

- The requirement for measures to be proportionate in their application across different types of taxpayer, including those taxpayers who may be less familiar with the transfer pricing principles upon which the legislative measures are based,
- The proportionate burden of compliance which could be alleviated where lower risk CFCs such as those with low profits or low-value activities are excluded from the scope of the measures,
- The requirement to exclude from the scope of charge profits already within the scope of charge to Irish tax or Irish source income expressly exempted from Irish tax, and
- Appropriate relief for foreign tax so as to avoid the double taxation of profits within the scope of the CFC charge.

We have included in Appendix I and II to this submission document a range of suggested scenarios that could be included in guidance in order to support the implementation of the CFC Rules.

Definition of ‘control’

We have set out below our comments in relation to the proposed definition of ‘control’. We understand that the definition of control for a CFC rule under ATAD is intended to encompass control rights which can be achieved by voting rights as well as rights to capital and profits, whether the rights are held directly or indirectly. The control test is applied to the taxpayer taking together the holdings of ‘associated enterprises’.

Our comments focus on:

- a suggested approach to defining some supplementary terms which are used in the proposed measures, drawing on definitions elsewhere in TCA 1997.
- matters to include in guidance. These are a combination of points of interpretation which we suggest would be useful to confirm in guidance in order to support a consistent interpretation of the measures as well as guidance on points which might benefit from illustrative examples.

Suggested approach

KPMG comments

“The following approach could be used to define “control” for the purposes of a CFC charge.”

“control” shall be construed in accordance with **subsections (2), (4), (5) and (6) of section 432, as if there were –**

- (a) substituted the words “equity holders” for the word “participators” in paragraph (c).**
- (b) included the following after paragraph (c) in subsection (2):**
 - “(d) any part of the issued share capital of the company and thereby control the composition of its board of directors.”, and
- (c) substituted the following for subsection (6):**

“For the purposes of subsection (2), there may also be attributed to any person all the rights and powers of –

 - (a) any associated company, within the meaning of [possible definition below], of such person,**
 - (b) any company of which such person has, or such person and associates of such person have, control,**
 - (c) any 2 or more companies of which such person has, or such person and associates of such person have, control,**
 - (d) any associate of such person, or**
 - (e) any 2 or more associates of such person,**



It would be useful to confirm that subsection (3) of section 432 is to be ignored and does not apply. Its exclusion from the scope of the suggested approach makes sense as it does not seem to fit with an approach which expressly attributes rights of one person to another in accordance with the attribution approach set out in ATAD, Article 7.1. Such attribution rules are included in the new subsection (6).



In order to align the approach adopted with the approach in the definition for associated companies, we suggest that the reference to participator should be changed to ‘equity holder’. In this manner, it is made clearer that the rights which are taken into account are those which either allow the person to control the affairs of the company or derive from rights as a shareholder.

If it was considered necessary to include a definition of equity holder that expressly encompassed a broad range of entitlement to income and assets of the company, we suggest that a modified definition of participator (as defined in section 433) is used. This excludes rights held solely as a creditor. This is explored in more detail below.

Suggested approach

KPMG comments

“The following approach could be used to define “control” for the purposes of a CFC charge.”

including the rights and powers attributed to a company or associate under subsection (5), but excluding those attributed to an associate under this subsection, and such attributions shall be made under this subsection as will result in the company being treated as under the control of persons resident in the State if it can be so treated.”

“Equity holder”, in relation to any company, means a person having a share or interest in the capital or income of the company and, without prejudice to the generality of the preceding words, includes:

- (a) any person who possesses, or is entitled to acquire share capital or voting rights in the company,**
- (b) any person who possesses or is entitled to acquire, a right to receive or participate in distributions of the company (construing “distributions” without regard to sections 436 or 437)**
- (c) any person entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for such person’s benefit.**



It would be useful to include a definition of ‘associate’. The Feedback Statement sets out a suggested definition for ‘associated company’. Including a definition for associate should achieve greater clarity in the operation of the provisions and align the definition of associated companies with the treatment of ‘associates’ who are individuals in the manner which is set out in ATAD, Article 2 which includes a definition of “associated enterprise.”



If it was considered necessary to include a definition of equity holder that encompasses a broad range of entitlement to income and assets of the company, we suggest that a modified definition of participator (as defined in section 433) is used. In accordance with the framework for control which is set out under ATAD, this should be confined to rights arising from capital held in the company and therefore excludes rights held solely as a creditor of the company.



As noted above, we suggest that it would be useful to create a definition of an ‘associate’ who is an individual. Reference is made to an ‘associate’ in the new subsection (6) above.

ATAD, Article 2 suggests that this should be an individual who holds directly or indirectly an interest of 25% or more in the company. It would seem appropriate therefore to frame the definition of ‘associate’ using a similar approach to that which is proposed for ‘associated companies’.

We do not think it appropriate to take as a starting point the definition of ‘associate’ that is used in section 433. This definition is designed to capture interests held by individuals that are less than the 25% ownership threshold set out under ATAD for the aggregation of holding rights and seeks to attribute control to individuals and their family members so as to broaden the scope of taxation for such individuals. The CFC charge is to apply to

Suggested approach

KPMG comments

“The following approach could be used to define “control” for the purposes of a CFC charge.”

The following approach could be used to define “associated company” for the purposes of determining control: “a company shall be treated as an “associated company” of another company where –

- (a) one of them, directly or indirectly, possesses or is entitled to acquire not less than 25 per cent of –**
 - (i) the share capital or issued share capital of the other company, or**
 - (ii) the voting power of the other company,**
- (b) one of them is beneficially entitled to not less than 25 per cent of any profits available for distribution to equity holders of the other company, or**
- (c) in respect of those companies, a third person –**
 - (i) directly or indirectly –**
 - (I) possesses or is entitled to acquire not less than 25 per cent of the share capital or issued share capital of each of them, or**
 - (II) the voting power of each of them, or**
 - (ii) is beneficially entitled to not less than 25 per cent of any profits available for distribution to equity holders of each company.”**

companies under common control which may be traced taking together holdings by individuals who meet the 25% threshold ownership requirements to be considered associates. However, the CFC charge is not levied on individuals but on companies and is restricted to the proportionate holding of the corporate taxpayer in the CFC.



We have separately suggested that the final CFC measures should include provisions that ensure there is not a potential double charge to tax in relation to the undistributed income of a CFC where the undistributed income of the CFC is already charged to tax under other Irish measures which can apply to tax upon Irish residents the undistributed income of foreign entities e.g. section 806, TCA 1997, etc.



It would be useful for guidance to include illustrative examples of the operation of the ‘control’ test including when companies could be associated companies to allow taxpayers and practitioners to understand the manner of operation of attributed rights under the definition of control.

We have suggested in Appendix I a range of illustrative holding scenarios. These identify, based on our reading of the definitions presented in the Feedback Statement, investee companies that fall within the scope of the definition of ‘control’. These are drawn from real life holding structures for widely held corporate groups, joint ventures and privately owned groups.

We suggest that the guidance should draw attention to the distinction between the ‘control’ rules that operate to attribute rights which determine that there is a controlled entity and the charging measures which limit the CFC charge to companies (i.e. not individuals) and also limit the charge to the proportionate interest held by the company which is subject to the CFC charge in the controlled foreign company. We have included further comments on determining the proportionate amount of undistributed income that is charged to tax in the section on the CFC charge.

Article 7(1)(b) - Effective Tax Rate

We agree that it would be useful to structure the effective tax rate (ETR) test as an optional exemption. We believe this fits with the intended outcome of the CFC framework under ATAD which is to confine the CFC charge to undistributed income of a low taxed entity which is not eligible for the other exemptions from charge.

We have set out below some points of interpretation that would be useful to confirm.

Suggested approach

KPMG comments

“One possible approach is to structure the ETR test as an optional exemption. This would retain the ETR test as required by ATAD, but would allow taxpayers the option to defer consideration of the ETR test until it has been determined that the CFC is ‘controlled’ and has undistributed income within the scope of a CFC charge”.

Under this approach, an ETR test could be structured as follows:

- (1) [The CFC charge] shall not apply in relation to an accounting period of a controlled foreign company where subsection (2) applies.***
- (2) This subsection applies where the amount of foreign tax which is paid by a controlled foreign company for an accounting period is not less than the difference between –***
 - (a) the corresponding corporation tax in the State for that accounting period, and***
 - (b) the amount of such foreign tax paid for the accounting period.***
- (3) The amount of foreign tax which is paid by a controlled foreign company for an accounting period shall be determined in accordance with [section defining amount of foreign tax].***



It would be useful to confirm in guidance that the foreign tax paid is tax that is paid for the relevant accounting period of the CFC even where it is not paid in the actual accounting period. For example, tax paid for the period could include a payment on account made before the accounting period of the CFC commences, tax paid during the period and a final tax payment made after the period once such payments are referable to the relevant accounting period.



We suggest that the proposed definition of ‘foreign tax’ should:

- be tax that is considered to be equivalent to Irish corporation tax whether collected by direct assessment or deducted at source by means of withholding tax;
- include tax that is equivalent to corporation tax whether levied at the national or sub-national level, e.g. including taxes levied within a territory such as by local states or cantons, municipalities or cities;
- include, in the case of dividend income received by a CFC, withholding tax deducted from the dividend by the paying company and underlying tax of a corporation tax nature on the profits from which the dividend is paid;
- where tax has been paid on the profits of the CFC by another company that is the nominated taxpayer in a foreign fiscal consolidation, include an allocation of that

Suggested approach

KPMG comments

“One possible approach is to structure the ETR test as an optional exemption. This would retain the ETR test as required by ATAD, but would allow taxpayers the option to defer consideration of the ETR test until it has been determined that the CFC is ‘controlled’ and has undistributed income within the scope of a CFC charge”.

foreign tax paid by the nominated taxpayer which is considered to be attributable to the ‘chargeable profits’ of the CFC. This could be done by adopting an approach similar to that which is set out in paragraph 9G of Schedule 24, TCA 19997 by treating the CFC, its fellow ‘*consolidated companies*’ and the nominated taxpayer or ‘*responsible company*’ as defined in para 9G(1) as a single taxable entity.

In this manner, tax paid by the responsible company is treated as foreign tax paid by the CFC to the extent that the CFC’s undistributed income is included in the taxable profits of the deemed single company. As noted above, we do not consider that making an assumption that the CFC is not a member of a group when computing the CFC’s corresponding chargeable profits in the State should prevent the recognition of foreign tax actually paid on the CFC’s undistributed income in its state of residence.

Article 7 (1)(b) – Calculation of Effective Tax Rate

We have set out below our comments in relation to the proposed approach to calculation of the effective tax rate of the CFC. Our comments include suggested:

- legislative amendments to the proposed definitions as well as suggested supplementary definitions to support the calculation of the effective tax rate.
- points of confirmation that could usefully be included in guidance in order to ensure consistent application of the provisions.

Suggested approach

KPMG comments

This “requires a company to re-calculate a hypothetical taxable profit, and resulting tax liability”. It “is a complex requirement, requiring a range of assumptions to be made”.

A potential approach to this requirement would be as follows:

“corresponding corporation tax in the State” means the amount of corporation tax which would be chargeable in the State in accordance with [section regarding corresponding chargeable profits] in respect of the controlled foreign company’s corresponding **chargeable profits** in the State for the accounting period;

“corresponding chargeable profits in the State” means the profits of a controlled foreign company which, applying the assumptions in [section regarding corresponding chargeable profits], would be the controlled foreign company’s profits for corporation tax purposes for the accounting period;

Corresponding chargeable profits in the State

(1) For the purpose of determining the corresponding chargeable profits in the State of a controlled foreign company for an accounting period, it shall be assumed—

- (a) (i) that the company is resident in the State at all times during the accounting period,**
- (ii) if the accounting period is not the company’s first accounting period, that the company has been resident in the State since its first accounting period,**
- (iii) except where the company ceases to be regarded as a controlled foreign company in accordance with this Chapter in the accounting period, that the**



As the meaning of “profits” under the Corporation Tax Acts includes ‘income and chargeable gains’ and we understand that the policy intent is to target undistributed income, we have assumed that the definition of chargeable profits under the CFC regime will be the pre tax accounting profits of the CFC, excluding profits that are non-income or capital in character or would be profits in the character of chargeable gains under the Corporation Tax Acts.



Guidance should confirm that the meaning of chargeable profits excludes profits in the character of non-income or capital receipts or would be profits in the nature of chargeable gains for Irish tax purposes.

We suggest that a practical approach to calculating the effective tax rate would begin with excluding pre tax accounting profits of the period of the CFC that would be considered to be in the nature of capital receipts or chargeable gains for Irish tax purposes. This would leave the pre-tax undistributed accounting income of the CFC for the period as the starting point for computing the ‘corresponding chargeable profits in the State’.



We suggest that the result of an ETR calculation should be that a ‘nil’ rate of tax is applied to corresponding chargeable profits of the CFC which comprises income that would be exempt from tax if received by an Irish resident company.

This could be achieved either by defining ‘chargeable profits’ to exclude such income, or including such income in the computation of corresponding chargeable profits but applying a nil

Suggested approach

KPMG comments

This “requires a company to re-calculate a hypothetical taxable profit, and resulting tax liability”. It “is a complex requirement, requiring a range of assumptions to be made”.

- company will continue to be resident in the State in subsequent accounting periods, and**
- (iv) where the company was resident in the State in the accounting period immediately prior to its first accounting period, that the assumed residence in accordance with this subparagraph is not continuous with residence in the State immediately before the beginning of that accounting period, and that the company is, has been and will continue to be within the charge to corporation tax, and its accounting periods, as determined in accordance with [section regarding accounting periods], are accounting periods for corporation tax purposes,**
- (b) that there is no change in the place or places at which the company carries on its activities,**
- (c) that the company is not a close company within the meaning of section 430,**
- (d) where any allowance, credit, deduction, relief or repayment under the Tax Acts is dependent upon the making of a claim or election, that the company has made that claim or election which would give the maximum amount of allowance, credit, deduction, relief or repayment and that the claim or election was made within any applicable time limit.**
- (e) that the company is neither a member of a group of companies nor a member of a consortium for any purposes of the Tax Acts, and**

rate of tax when calculating the corresponding amount of corporation tax.

This treatment could apply, for example, to:

- distributions from an Irish resident company,
- income arising to a foreign insurance company that would be tax exempt if it arose to an Irish company e.g. in respect of its pensions business.

Distributions from Irish resident companies can be received by non-resident companies in a holding chain of companies where there is an Irish parent company which holds an intermediary holding company resident outside Ireland which, in turn, holds a subsidiary that is resident in Ireland. This type of holding structure can arise in groups which have made international acquisitions where Irish resident companies are held by the foreign acquired company.



It is unclear what the assumption in paragraph (b) on the place of carrying on activities means. It would be useful to explain the purpose of this assumption.



As a separate point in determining the amount of tax paid by a company, we have identified a practical issue that can arise when seeking to identify the relevant amount of tax paid by a foreign company which is a member of a foreign fiscal grouping or fiscal consolidation for foreign tax purposes.

Such arrangements are common in many jurisdictions. They often provide that a single nominated taxpayer pays tax on its own behalf and

Suggested approach

KPMG comments

This “requires a company to re-calculate a hypothetical taxable profit, and resulting tax liability”. It “is a complex requirement, requiring a range of assumptions to be made”.

- (f) ***that the company is not entitled to relief under Part 35 in respect of any amount of income, profits or gains for tax paid on such income, profits or gains under the laws of the company’s territory of residence.***

on behalf of the other members of the fiscal consolidation. As outlined below, we have suggested that it would be appropriate to attribute some part of the tax paid by the nominated taxpayer in the fiscal group to the CFC in order to properly reflect foreign tax attributable to the CFC’s profits. When applying the assumption that the CFC is not a member of a group, it is important that this should not deny the taxpayer the ability to identify the tax attributable to the CFC for the accounting period merely because it is a member of a foreign group or fiscal consolidation.



We have taken this to mean that relief could be available for third country taxes i.e. not Irish tax and not tax paid in its jurisdiction of residence (which would be creditable tax if borne by an Irish resident company) in like manner to the relief provided under Part 35, TCA 1997, e.g. if the CFC had borne third country withholding taxes on its income or borne tax equivalent to Irish corporation tax on profits arising in a third country branch. This would be useful to include in an illustrative example in guidance.



Other assumptions that would be useful to include in legislation and to illustrate by means of examples in guidance include:

- when computing corresponding chargeable profits that arise from activities in the nature of a trade that would be chargeable to tax under Case I or II if carried on in Ireland, it is permitted to follow the timing and recognition of profits in accordance with a generally accepted accounting standard of the jurisdiction of residence of the CFC,
- when computing the corresponding chargeable profits, it is appropriate to adopt the functional currency of the CFC as the starting point for measuring the income under Irish tax principles. This is to avoid period on period distortions between the Euro and the currency in which the CFC operates which are not reflective of the ETR borne on the income. Such distortions might arise if, for example, the income of the CFC were recomputed in

Suggested approach

KPMG comments

This “requires a company to re-calculate a hypothetical taxable profit, and resulting tax liability”. It “is a complex requirement, requiring a range of assumptions to be made”.

- (2) Notwithstanding subsection (1)(b), corporation tax shall be deemed to be charged on the corresponding chargeable profits in the State at the rate specified in -
- (a) *section 21(1)(f) in so far as the corresponding chargeable profits in the State consist of profits which would be chargeable to tax under Case I and II of Schedule D but for subsection (1)(b), and*
- (b) *section 21A(3) in so far as the corresponding chargeable profits in the State consist of profits which would be chargeable to tax under Case III, IV or V of Schedule D but for subsection (1)(b),*
- and the total of such corporation tax shall be regarded as the corresponding corporation tax in the State for the accounting period.
- (3) In this section, references to the first accounting period of a controlled foreign company are references to the accounting period in which the company first falls to be regarded as a controlled foreign company in accordance with this Chapter.
- (4) Nothing in this section affects any liability to, or the computation of, corporation tax in respect of a trade which is carried on by a controlled foreign company through a branch or agency in the State.

euro and then the ETR was calculated by reference to a tax paid in the local currency.



As noted above, we suggest that if the definition of chargeable profits includes income of the CFC that would be exempt from tax if it arose to an Irish resident company, there should be provision to apply a third rate of tax being a ‘nil’ rate of tax to such income.

We suggest that the subpara (a) should also refer to profits assessable under Case II to include professions conducted through corporate entities in other jurisdictions.

It is unclear what the reference to subsection (1)(b) which is included in subsection (2) opposite is intended to capture. Subsection (1)(b) of the above section refers to an assumption that there is “no change in the place or places at which the company carries on its activities”.

There is a reference in subsection (2), subpara (b) to income which would be chargeable to tax under Case V of Schedule D. A non-resident company would already be within the charge to Irish income tax on Irish rental profits under Schedule D, Case V. We have suggested below that the calculation of chargeable profits should not affect the calculation of profits such as Case V income that are already chargeable to Irish tax on the non-resident CFC albeit under income tax and not corporation tax provisions.

As such profits are already chargeable to Irish tax, they should also be excluded from the scope of charge to tax under the CFC provisions (we have referenced this in the section on the CFC charge).



We suggest that the legislation should also make clear that the computation of chargeable profits of the CFC does not affect any liability or, the computation of, income tax of the CFC in respect of income such as Irish rental income (taxable under Schedule D, Case V) which is already within the charge to Irish tax.



This exclusion from chargeable profits for profits of the CFC already subject to corporation tax (e.g. in the case of a trade carried on through a branch or agency) or income

Suggested approach**KPMG comments**

This “requires a company to re-calculate a hypothetical taxable profit, and resulting tax liability”. It “is a complex requirement, requiring a range of assumptions to be made”.

tax (e.g. in the case of rental income on Irish property) should be explained in guidance.



We understand that this provision is intended to leave unchanged the scope of corporation tax that applies to a CFC that might also be engaged in the conduct of a trade in Ireland through a branch or agency.

It would be useful in guidance to draw a distinction between this exclusion and the fact that a non-resident company with SPFs performing relevant activities in Ireland e.g. through a branch in Ireland, is potentially a chargeable company within the scope of tax under the CFC charge.

The CFC Charge

We have made suggestions below in relation to the approach to the CFC charge. These include:

- legislative changes to clarify some points of uncertainty in relation to the interpretation of the provisions, and
- matters related to guidance on the operation of the provisions that could usefully be provided using case study examples. These seek to illustrate when, for example, the essential purpose test related to a tax advantage is met or the genuine activities test might be considered to be met and how the CFC charge might apply when these tests are assumed to be failed. In Appendix II to this submission, we have included a number of short case study scenarios that might serve as a starting point for illustrating the operation of the CFC charging provisions. These have been drawn from soundings taken from businesses based in Ireland operating internationally through CFCs.

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

“The following approach to the CFC charge could be considered:

- (1) **Subject to subsections (5), (8) and (9), where in an accounting period –**
 - (a) **a controlled foreign company group has undistributed income, and**
 - (b) **relevant Irish activities in relation to the controlled foreign company group are carried on by the controlling company or a company connected with the controlling company*, and in this section any such company shall be referred to as a ‘chargeable company’,****a controlled foreign company charge shall be made on the chargeable company for the accounting period, as determined in accordance with section 27, of the chargeable company in which the accounting period of the controlled foreign company ends.**

The term controlled foreign company group is defined (see page 15 of Feedback Statement) as meaning “*the controlled foreign companies, taken together, of a controlling company*”.



Confirmation would be welcome as to whether or not the CFC charge would apply if, when taking together CFCs which have accounting losses for the period with CFCs that have undistributed income, there is a net loss arising in the controlled foreign company group in the period after taking both income and losses of individual CFCs into account.



The meaning of “relevant Irish activities in relation to the controlled foreign company group” is unclear. A separate definition of this term would be welcome. In setting out our comments below, we have assumed that it means the relevant Irish activities that should be taken into account in computing the attributable undistributed income for any particular CFC who is a member of the controlled foreign company group but that the identification of relevant Irish activities is done separately for each CFC and not on a group wide basis.



An approach to apply the CFC charge provisions which we consider is workable in practice is illustrated below. For a controlled foreign company group that has

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

undistributed income, the CFC charge on the controlling company (or connected company) is computed by taking the steps outlined below:

- step 1: identify those CFCs that are eligible for exemption from the CFC charge e.g. because the arrangements meet the essential purpose tax advantage test, there is no undistributed income in the period, the genuine activities test is met, the CFC tax rates exceeds the ETR test, etc.
- step 2: for those CFCs not eligible for an exemption, identify the relevant Irish activities which are carried out in relation to each of these CFCs separately and identify the controlled foreign company group,
- step 3: compute the amount of undistributed income of the CFC related to those relevant activities,
- step 4: add together the separate amounts attributable to the CFCs that are members of the controlled foreign group to arrive at a single chargeable amount which can be said to be the controlled foreign company group charge.

The above approach would allow the taxpayer to apply exemptions from the CFC charge to individual CFCs and targets the CFC charge on the undistributed income of those CFCs that arise from arrangements that are not eligible for the various CFC exemptions.

This approach of separately identifying the amount of undistributed income referable to each CFC instead of identifying relevant activities and undistributed income on a group wide basis would seem to be consistent with the reference in the outline provisions to the accounting period of the CFC (as there may be different accounting period ends for different CFCs) as well as the reference in subsection (4) to not exceeding the aggregate interests of the controlling/chargeable company in each of the controlled foreign companies in the group.

(2) For the purpose of subsection (1), a chargeable company shall include a

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

branch or agency of that company.

(3) The controlled foreign company charge made under subsection (1) shall be an amount equal to the undistributed income of the controlled foreign company group to the extent that such income can reasonably be attributed to relevant Irish activities undertaken by the chargeable company.

(4) The undistributed income to be attributed to relevant Irish activities for the purpose of subsection (3) shall be determined by reference to the amount that would be payable by persons dealing at arm’s length in relation to those activities but the value so attributed shall not exceed the proportion of the aggregate of the undistributed income of the controlled foreign company group that corresponds to the aggregate of the controlling company and the chargeable company’s shareholding in each of the controlled foreign companies in the controlled foreign company group.

[*See point 7 – connected company undertaking SPFs.]



As noted above in relation to subsection (1), confirmation would be welcome that it is intended that, for a controlled foreign company group that has undistributed income, the CFC charge on the controlling company (or connected company) is computed by reference to the relevant Irish activities in relation to each separate CFC that is a member of the controlled foreign company group and the separate amounts of undistributed income for each CFC are then added together to arrive at a single controlled foreign company charge amount.



We suggest that legislation should:

- Define a ‘controlling company.’
- Define the manner in which the proportionate interest in the aggregate shareholding of the controlling company and the chargeable company is determined in the case of indirect holdings by the controlling company. We suggest this might be done by determining the relevant proportion of indirect interests as a percentage in accordance with subsections (5) to (10) of section 9, TCA 1997.



Guidance would be welcome on the operation of the proportionate nature of the charge using illustrative examples. As noted in the section on the meaning of ‘control’, we have set out in Appendix I scenarios that illustrate a range of different corporate holding structures which could be used to both illustrate the application of the meaning of ‘control’ as well as the application of the proportionate CFC charge. The suggested examples illustrate that, in certain circumstances, a company can be attributed with the rights held by associated companies (25% common interest) which can lead it to be considered to ‘control’ entities owned by the associated company but that such attribution for the purposes of determining ‘control’ should not lead to a CFC charge where the company (and chargeable company) hold no shareholding interests in the CFCs.

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

- (5) Subsection (1) shall not apply in relation to undistributed income –
- (a) attributable to relevant Irish activities undertaken by a chargeable company under arrangements where –
- (i) it is reasonable to consider that such arrangements would be entered into by persons dealing at arm’s length, or
- (ii) the arrangements are subject to the provisions of section 835C,
- or,
- (b) which has **previously been assessed to a controlled foreign company charge under this section.**



Our understanding is that the fundamental principle is that if the undistributed income of the CFC is no more than would arise after taking into account an arm’s length amount attributable to SPFs engaged in relevant activities in Ireland in relation to that CFC or the arrangement is subject to Irish transfer pricing provisions (under section 835C), the CFC charging provision should not apply.



We would welcome legislative clarity on the operation of relief from a double charge where a CFC charge applies in the same period to the separate portions of the undistributed income of the CFC that is attributed to relevant Irish activities of a controlling company and a connected chargeable company. It is not clear that these separate charges could be said to have ‘*previously been assessed*’ to a CFC charge.

In order to avoid a double charge to tax, we suggest below a number of additional carve outs from the scope of undistributed income of the CFC potentially within scope of the CFC charge.

- (a) Undistributed income of the CFC should be excluded to the extent that the:
- CFC is already assessable to corporation tax on the income arising from the conduct of a trade or profession through a branch or agency in Ireland,
 - CFC is already assessable to income tax as a non-resident company e.g. in respect of Irish rental income assessable to income tax under Case V,

These exclusions are suggested to avoid a double charge to tax for income of the CFC already chargeable to tax under either the corporation tax or income tax provisions.

- (b) The undistributed income of the CFC should be excluded where it is Irish source but expressly exempt from income tax under Irish tax provisions where it meets certain conditions which are set out under Irish law. This includes income such as:

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

- interest income exempt from income tax under section 198 and from withholding tax under sections 246, 246A and 64,
- royalty income exempt from income tax, corporation tax and withholding tax under section 242A,
- dividend income exempt from income tax under section 153 and from withholding tax under section 172D.
- income of a non-resident from activities of an authorised agent conducting activities in Ireland as described by section 1035A.

(c) The undistributed income of the CFC should be excluded where the income is Irish source and taxing rights are allocated the jurisdiction of residence of the CFC under a double tax treaty.

The exclusions described at (b) and (c) above are suggested to avoid a charge to CFC tax on income for which Ireland has already taken the policy decision to exempt from Irish tax. Framing the exclusion from tax in this manner should allow Ireland flexibility in future to adjust its scope of taxing rights and the conditions relating to exempting different classes of Irish source income from the charge to Irish tax (in the case of residents of EU Member States and tax treaty jurisdictions) while still excluding income from the CFC charge where a policy decision has been taken to exempt it from tax.

(d) The undistributed income of the CFC is not doubly taxed by reason of also coming within the charge to tax under other anti-avoidance measures which can attribute income arising to a foreign company and deem it to arise to an Irish resident and assess it to tax under Schedule D, Case IV. Such measures can apply to tax undistributed income of a foreign company and could potentially lead to a double charge to tax on the undistributed income where the undistributed income is also taxed under the

- ‘transfer of assets abroad’ provisions e.g. under sections 806, and

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

- (6) Corporation tax shall be charged on the controlled foreign company charge at the rate specified in –
- (a) section 21(1)(f) in so far as the undistributed income attributable to the relevant Irish activities would be chargeable to tax under Case I or II of Schedule D had it arisen in the chargeable company, and
 - (b) section 21A(3) in so far as the undistributed income attributable to the relevant Irish activities would be chargeable to tax under Case III, IV or V of Schedule D had it arisen in the chargeable company,
- and the amount of corporation tax so chargeable shall be reduced by the amount of any creditable tax as determined by [section defining creditable tax].

- the ‘offshore fund’ provisions under section 743.

We suggest that these provisions should be amended so that they do not apply to undistributed income of the CFC to the extent that the entity is a CFC.



We suggest that it would be useful to highlight in guidance the fundamental principle that underlies the design of the CFC charge.

In essence, if members of the taxpayer group carrying on activities in Ireland are satisfied that arrangements related to the relevant activities of SPFs have been priced on an arm’s length basis or are subject to Ireland’s transfer pricing regime, the CFC charge should not apply.

This we believe is a simple and easily understood message for groups with headquarters in Ireland and meets the stated policy objective of enacting a regime that is clear, unambiguous and operable in practice.



We suggest that subpara (a) of the rate charging section should also refer to activities in the nature of a profession which are assessable to tax under Case II which can be carried on by entities in corporate form in other jurisdictions.

As noted in the earlier section on the Effective Tax Rate, we suggest that the CFC charge should not apply to undistributed income of a CFC that would be exempt from tax if received directly by an Irish resident company e.g. distributions from an Irish resident company. If such income is not excluded from the meaning of undistributed income, subsection (6) should provide for a ‘nil’ rate of tax to apply to such attributed income.



It would be useful to provide guidance on the rate of tax that applies to the CFC charge to tax by means of illustrative examples. We have suggested in Appendix II a range of case study scenarios which include scenarios in which a CFC charge is assumed to arise. These could be developed further and also

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

- (7) Subject to subsection (6), no relief, deduction or set off of any description shall be allowed against a controlled foreign company charge.
- (8) This section shall not apply to an asset or risk, whether on an individual basis or taken together as an aggregate, where the increase in the controlled foreign company’s undistributed income as against the undistributed income of the controlled foreign company where it -
- (a) did not hold, or had not held, the asset to any extent, or
 - (b) did not bear, or had not borne, the risk to any extent, is negligible.
- (9) (a) This section shall not apply in relation to an accounting period of a controlled foreign company where –
- (i) at no time did the controlled foreign company hold assets or bear risks under an arrangement where it would be reasonable to consider that the essential purpose of the arrangement was ~~not~~ to secure a tax

illustrate the rate of tax applicable to the CFC charge in the scenarios explored in different examples.



We suggest that the meaning of ‘**creditable tax**’ should include:

- foreign tax (see our suggestions in relation to the meaning of ‘foreign tax’ which are included in the section on the Effective Tax Rate test) attributable to the undistributed income whether borne directly on the undistributed income or by deduction at source through withholding tax,
- foreign tax borne in the state of residence of the CFC and in third countries, and
- a CFC charge applied by another Member State on the undistributed income of the CFC.



Guidance would be welcome on the meaning of negligible.



We suggest that there may be an additional ‘not’ included in subsection (9)(a) which is not intended. This is highlighted in red strike through text in the proposed text.



We understand that the test of ‘**essential purpose**’ is intended to meet the objective set out in the ATAD recitals of precisely targeting measures that seek to tax the

Suggested approach

KPMG comments

“The term “essential purpose” would seem to reference existing European case law with regard to CFC rules, including the Cadbury-Schweppes case in which it was found that CFC rules could be a justified restriction on the freedom of establishment on the grounds of prevention of “wholly artificial arrangements”.

- advantage, or**
- (ii) the controlled foreign company does not have any non-genuine arrangements in place.**

undistributed income of the CFC under a CFC framework that taxes profits that have been artificially diverted from the parent jurisdiction.

We understand that, where there might be said to be an alternative or comparator scenario in determining if a tax advantage exists, the comparator must be an alternative Irish tax outcome. A tax advantage might be said to arise from any number of arrangements but even if the tax advantage is the main benefit or one of the main benefits that could be said to arise from the holding of assets or bearing of business risks by the CFC, the CFC charge should not apply where securing this tax advantage cannot be said to be the **essential purpose** of the arrangement.

We believe that the application of analyses that are as complex and as potentially subjective as those that underpin this test is best illustrated using guidance that seeks to capture a wide range of taxpayer scenarios drawn from real life examples. This approach would, we believe, meet the policy intention of crafting clearly understood tests in applying the measures. As mentioned above, we have included in Appendix II a range of taxpayer scenarios that have been drawn from real life examples of arrangements put in place by businesses based in Ireland which are designed to explore the application of the tests related both to the meaning of ‘**essential purpose**’ and ‘**genuine arrangements**’.

In the analysis which is set out below this table, we have attempted to outline our understanding of the application of the genuine activities test and the interaction of this test with transfer pricing principles that apply to compute an arm’s length amount of CFC charge.

- (b) For the purpose of paragraph (a), an arrangement shall be regarded as non-genuine to the extent that –**

- (i) the controlled foreign company would not own the assets or would not have borne the risks which generate all, or part of, its undistributed income but for relevant Irish activities undertaken relating to those assets and risks, and**
- (ii) it would be reasonable to consider that the relevant Irish activities were instrumental in generating that income.**

Applying the 'genuine activities' test

We understand that the basis for application of the CFC charge is to apply transfer pricing principles using the arm's length standard to estimate the amount of the undistributed income of the CFC that can reasonably be attributed to relevant activities undertaken by the chargeable company. As arrangements that fall within the scope of the transfer pricing regime¹ or arrangements that are priced on an arm's length basis fall outside the scope of charge (subsection (5)), we have sought to explore the manner of operation of the provisions if it is assumed that there is undistributed income of a CFC that arises from arrangements that are either not within the scope of the transfer pricing regime or that have not been priced on arm's length terms. In exploring the steps to implement the CFC charge below, we have also assumed that the essential purpose of an arrangement was to secure a tax advantage.

This means considering what is meant by the genuine activities test and how this then interacts with the CFC charge provisions. We have set out below our understanding of the steps that apply in exploring the application of the provisions based on the definitions that have been set out in the Feedback Statement document.

As outlined in earlier comments, we have also made the assumption that the CFC charge is to be computed separately for each CFC with the CFC charge amounts for individual CFCs added together to form a single charge on the controlling parent or chargeable company, as the case may be.

The steps that we have taken in applying the provisions are as follows:

Step 1: Identify the arrangement

Arrangement has a wide meaning. It is essentially a plan which can potentially encompass a number of steps including the set-up of the CFC, the capitalisation of the CFC, the acquisition and holding of assets by the CFC and the management of business risks related to its assets by the CFC.

Step 2: Identify the significant people function (SPF) or the key entrepreneurial risk-taking (KERT) function that relates to the assets of the CFC and or the management of business risks associated with those assets

While there is no strict definition of an SPF in ATAD, guidance on identifying the relevant functions is available from the 22 July 2010 OECD Report on the Attribution of Profits to Permanent Establishments ('the OECD branch report'). In asking the taxpayer to construe the meaning of these terms in accordance with the OECD branch report, the Irish CFC framework is **not requiring the taxpayer to treat the CFC and its Irish parent as a single company and apply an income attribution analysis based on the assumption that the CFC is a branch of the Irish parent**. Instead, the taxpayer is being asked to construe the meaning of SPFs and KERTs in accordance with the approach to identifying such SPFs and KERTs that is adopted in the OECD branch report.

In accordance with the OECD branch report, SPFs and KERTs can broadly be defined as the conduct of fundamental business functions that lead to the assumption of risk, ownership of assets, or ongoing management of those risks and assets. These concepts essentially apply and are discussed in the 2010 and 2017 OECD Guidelines on transfer pricing in relation to the assumption of and control of risks by one company ('the controlling company') over the assets of another party ('the asset owner'). **The wording of the CFC provisions in the Feedback Statement that refers to these 'control' functions in transfer pricing terms is the reference to SPFs performed "on behalf of" the CFC in relation to its ownership of assets or risks it bears.**

The relevant significant people functions (SPFs) or KERTs will differ depending on the nature of the assets held by the CFC. For example, there are different SPFs or KERTs associated with holding and managing loans advanced to group members in comparison with SPFs and KERTs related to holding intangible assets and managing the business risks related to intangibles.

¹ Which is currently confined to arrangements that would be taken into account in computing profits assessable under Case I or Case II.

The SPFs or KERTs related to the shareholder's decision to establish and capitalise the CFC are not the SPFs or KERTs that are the subject of the CFC regime. These SPFs relate to the position of the shareholder of the CFC and not to either the assets or the business risks undertaken in relation the management of the assets of the CFC itself.

The SPFs and KERTs in question for each CFC are those related to the assets of the CFC and the management of the CFC's business risks.

Step 3: Identify individuals who exercise the SPFs and KERTs and where they perform the SPFs and KERTs. Identify the entity they work for (or the role under which they perform the SPFs or KERTs)

Completing step 3 means:

- identifying individuals who have performed SPFs and KERTs,
- in Ireland, and
- on behalf of the CFC.

The individuals performing the SPFs could be doing so in the course of performing duties of employment for the CFC, under an assignment/secondment arrangement where they perform employment duties under the direction of the CFC, or as a member of the board of directors of the CFC. They could also be performing duties in these roles for persons other than the CFC but *on behalf of* the CFC.

The SPFs or KERTs that can trigger the CFC charge are those that are performed in Ireland on behalf of the CFC in relation to the assets of the CFC and the business risks it undertakes in relation to its assets.

In practice, for groups that have highly centralised decision making with a small management team that makes decisions on group wide policy it can be difficult to distinguish SPFs that lead to the formulation of a policy in relation to the acquisition and management of assets at the group level (that individual group members are expected to adhere to) and those which are performed on behalf of a CFC. This difficulty is especially acute for a CFC which has a narrow business focus and holds only one or 2 assets which are exploited and used in connection with business conducted with group members.

An Irish parent company can set the parameters according to which the business or part of the business of foreign group companies must be conducted. Where active decision making in respect of the asset or risk does not take place in Ireland, the fact that management of the assets and business risks of the CFC is carried on within parameters or guidelines set in Ireland would not of itself be sufficient to conclude that the SPFs or KERTs are performed in Ireland.

Step 4: Consider whether the CFC would not own the assets or have borne the risks which generate all or part of its undistributed income (from those assets) but for relevant Irish activities relating to those assets and risks

We have assumed that this aspect of the 'genuine activities test' is applied using transfer pricing concepts and principles. We have explored its application below using transfer pricing concepts in two scenarios.

Scenario 1: transfer pricing concepts and asset ownership - the CFC would not own the assets

The CFC could be said not to own its assets where the extent of the functions performed by those individuals performing SPFs and KERTs in Ireland is such that, from a transfer pricing perspective, the CFC is not considered to be the 'owner' of the assets it holds. Instead, the entity that performs the SPFs and KERTs is the 'owner'. Where there is essentially no oversight and management of the assets by the CFC, under a transfer pricing analysis, substantially all of the income from the CFC's assets could be allocated to the 'owner' under transfer pricing principles.²

Under this analysis, it would appear that the genuine activities test is failed because if relevant Irish activities are such that they result in the CFC not being regarded as the 'owner' of the asset, the relevant

² With the CFC perhaps remunerated for routine administrative functions performed by the CFC.

Irish activities must also be considered to be *instrumental* in generating that income. This is because, under transfer pricing principles, the analysis of whether an entity has exercised sufficient 'control' over an asset so as to be allocated profits that are attributable to 'ownership' of the asset includes the exercise by that entity of 'control' over the key business decisions that are instrumental in generating the income from the asset.

Scenario 2: SPFs performed in Ireland and elsewhere – bearing risks, SPFs and KERTs instrumental in generating income

It is possible that some of the SPFs related to the assets and the management of key business risks related to the assets of the CFC are performed in Ireland and some are performed elsewhere. For the purpose of the analysis that follows, we have assumed that, having weighed up the balance of such activities, the CFC is considered to be the 'owner' of its assets under transfer pricing principles. To this extent, it can be argued that the genuine activities test would be met because the CFC would be considered to be the owner of its assets even with the existence of relevant Irish activities.

However, the genuine activities test also requires consideration of whether or not the CFC would have assumed and managed the risks which generate all or part of its income but for relevant Irish activities. In circumstances where some SPFs are performed in Ireland and those SPFs in managing the key business risks are considered to be *instrumental* in generating [all or part of] that income, the genuine activities test is not met.

Step 5: the genuine activities test is not met, applying the CFC charge

The undistributed income is to be determined by reference to the amount that would be payable by persons dealing at arm's length (subsection (4)). It is assumed that, as outlined above, the arm's length principle as explored in the 2010 and 2017 OECD transfer pricing guidelines can be used to determine an appropriate methodology for attributing an amount of the undistributed income of the CFC to the company within the scope of the Irish CFC charge.

Scenario 1: Taking the assumed facts outlined above, the transfer pricing analysis is that the entity performing the SPFs in Ireland is considered under transfer pricing principles to exercise 'control' and to bear all the risks of ownership related to the CFC's assets such that it and not the CFC is considered to be the 'owner' of the CFC's assets. Under this analysis, substantially all of the undistributed income arising from these assets of the CFC could be attributed to the company that is within scope of the Irish CFC charge i.e. the controlling company or the chargeable company, as appropriate.

Scenario 2: Again, taking the assumed facts outlined above, applying transfer pricing under the arm's length principle (and drawing on the 2010 and 2017 OECD Transfer Pricing guidelines), the CFC is considered to be the owner of its assets but the activities performed by the SPFs³ should be remunerated under arm's length principles. An appropriate transfer pricing methodology should apply to determine just how much of the income of the CFC should be attributed to the Irish SPFs.

³ They have been assumed in this illustrative scenario to be instrumental in generating the income of the CFC.

Article 7(2) and Article 8(2) – Additional provisions and “Cash Box” companies

Additional provisions

We acknowledge that recital 12 of ATAD provides that, with a view to limiting the administrative burden and compliance costs, it is acceptable for Member States to exempt from CFC rules certain entities with low profits or a low profit margin that give rise to lower risks of tax avoidance.

We welcome the proposal to draft the Irish CFC legislation accordingly. We consider that including reliefs which are permitted under ATAD, Article 7(4) should provide a useful relief for groups with a number of subsidiaries which may have small amounts of profits or are engaged in low-margin activities.

“Cash Box” companies

We note that, in tandem with consideration of the protections that can be afforded under a CFC regime, Ireland’s policy makers are also considering whether additional provisions might be needed to target Cash Box companies with low economic substance.

The proposed CFC charge is based on the concept of non-genuine arrangements. It seeks to impose a CFC charge on the undistributed income of a CFC which arises from non-genuine arrangements.

In our discussion in earlier sections of this submission on the application of transfer pricing principles to computing the CFC charge, we suggest that, in circumstances where there is such limited substance in the CFC that it is not considered to ‘own’ its assets under transfer pricing principles, it is likely that substantially all of the undistributed income of the CFC should be assessed to tax under the CFC charge where the SPFs related to the assets and business risks of the CFC are located in Ireland. The CFC charge has applied where there is an essential purpose to secure a tax advantage.

The concerns expressed in the Feedback Statement relate to the possibility of Cash Box companies where there are no SPFs in Ireland. This perhaps could occur where an Irish group has capitalised a foreign CFC that invests cash in the market within investment guidelines or parameters that apply group wide to guide the conduct of group members and SPFs are conducted outside Ireland. As noted above, if in fact, the active decision making on the deployment of the cash resources of the company is done by SPFs in Ireland, the CFC Rules provide protection and permit Ireland to charge the profits to tax.

The recent economic crisis has meant that there is less scope than might have applied in the past for Irish groups to accumulate cash that is surplus to operations. The banking crisis and the greater difficulty in raising debt, the long running low interest rate environment combined with the continued focus of shareholders on achieving returns on capital invested means that businesses based in Ireland have limited scope in practice to raise or retain capital that is deployed in Cash Box entities.

The CFC framework is intrinsically linked with the transfer pricing regime – to the extent that the scope of transfer pricing is broadened out to bring income attributable to such activities within the scope of Ireland’s transfer pricing regime, the scope of charge under the CFC regime is reduced.

Case law on the application of freedom of establishment under the Treaty for Functioning of the European Union (TFEU) clearly provides that anti-abuse measures such as a CFC regime or other related measures must be proportionate in effect. They can only target arrangements which are not considered to represent genuine commercial arrangements or which exceed the standard relating to wholly artificial arrangements. This in effect limits the scope of ability to tax profits from “Cash Box” companies to the extent that those “cash box” companies have economic substance appropriate to the level of their activities. This principle has been clearly set out in recent judgments set down by the CJEU which considered, for example, German and French anti-avoidance provisions in the context of holding company activities.

The CFC regime also serves to supplement a number of protections which exist under Irish law. These can be summarised at a high level as follows:

- The right to subject to corporation tax in Ireland the profits of a foreign incorporated company which is actually managed and controlled in Ireland so that it is regarded as resident in Ireland for corporation tax purposes (and is regarded as a resident of Ireland under a double tax treaty, if relevant). Where it is resident in Ireland, the worldwide profits of the company are potentially subject to corporation tax.
- The right to subject to tax in Ireland activities of individuals which lead an Irish entity to be considered to be the agent of a non-resident company. Where a non-resident company is engaged in the conduct of a trade in Ireland through a branch or agency in Ireland, the profits attributable to that trade are subject to corporation tax in Ireland. Changes to Ireland's network of bilateral double tax treaties which will be implemented under the multilateral instrument (MLI) will serve to reinforce Ireland's right to tax profits arising to agents of non-residents operating in Ireland.
- Transfer pricing provisions currently provide scope to adjust upward the measure of profits (and reduce the level of losses) which would otherwise be taken into account in measuring the profits from a trade (or activity taxed under Case II). We understand that Ireland is to launch a consultation in early 2019 in relation to updating its transfer pricing regime to adopt the 2017 OECD transfer pricing guidelines with effect from 1 January 2020. Part of the matters to be addressed under that consultation will include the question of the scope of application of Irish transfer pricing provisions beyond transactions otherwise taxed under Case I or II. As required by ATAD, the CFC regime is designed so as to give priority to transfer pricing measures. Where such measures are considered to give Ireland the taxing rights it requires in relation to profits from cross border transactions, there should be a powerful and well understood basis for immediately taxing in Ireland under its transfer pricing regime, the profits arising from controlled related activities and significant people functions carried on by entities in Ireland.
- The scope of Ireland's capital gains exemption on disposal of significant shareholdings under section 626B is based on a test that limits the scope of the exemption to companies resident in tax treaty jurisdictions as well as applying a test that requires the company to be wholly or mainly engaged in the conduct of a trade or trades. By including this condition in its capital gains exemption regime, Ireland has included protections related to its ability to tax capital gains arising on the disposal on unwind of shareholdings in Cash Box companies with limited substance.
- Ireland currently taxes foreign dividends including those that are paid by a Cash Box company. Ireland plans to consult in 2019 on the possibility of extending its participation exemption regime to foreign dividends. Should Ireland decide to do so, it has scope (within the restrictions placed by EU freedoms) to frame the conditions for eligibility for a dividend exemption regime to restrict the application of the exemption and not to apply it to dividends from companies which do not carry on genuine economic activities.
- Efforts of the EU Code of Conduct Group to define a 'blacklist' of jurisdictions outside the EU that do not meet international standards for tax transparency and which have preferential regimes have meant that jurisdictions which offer nil rates of tax are introducing local economic substance requirements to ensure that they are not included on the blacklist and therefore do not face counter measures from EU Member States. These requirements apply to locally resident entities and are aligned with substance requirements for highly mobile activities such as those relevant to a Cash Box company. They are set out in the October 2015 OECD report under Action 5 of its Base Erosion and Profit Shifting (BEPS) plan. It can be expected that these developments will act to limit the scope for a Cash Box company with no economic substance to benefit from nil rates of tax to jurisdictions not on the EU blacklist.

In summary, we consider that Ireland's current regime already provides a strong balance of protections under which Ireland can assert its taxing rights over the profits arising to Cash Box entities.

As Ireland embarks on consultations which could see future changes to its transfer pricing regime and changes to the manner in which it taxes foreign dividends, Ireland’s policy makers have the opportunity to continue to assess the balance of protections afforded under the corporation tax regime as it evolves as a result of such changes. Ireland can also benefit from international developments under which nil tax jurisdictions are moving to align their tax regimes to require local economic substance before taxpayers can benefit from their tax regimes.

We recommend that no action is taken for now to introduce new measures that target “Cash Box” companies until a deeper understanding can be formed of:

- the operation in practice of the CFC Rules,
- the shape and scope of Ireland’s future transfer pricing regime,
- the taxation of foreign dividends has been decided upon, and
- the still evolving trend of economic substance requirements being introduced by ‘nil’ tax jurisdictions has matured.

Recital 12 – Exempt period

Our comments in relation to the proposed grace period provisions are outlined in the table below.

Suggested approach	KPMG comments
<p><i>“A potential option could be to allow a grace period in the form of a conditional exemption:”</i></p>	
<p>(1) <i>In this section –</i> <i>“exempt period”</i> has the meaning given to it by <i>subsection (3)</i>; <i>“relevant time”</i> has the meaning given to it by <i>subsection (3)</i>; <i>“subsequent period condition”</i> has the meaning given to it by <i>subsection (4)</i>.</p> <p>(2) <i>[CFC charging section] shall not apply in relation to an accounting period of a controlled foreign company where –</i></p> <p>(a) <i>the accounting period ends during an exempt period,</i></p> <p>(b) <i>the subsequent period condition is satisfied, and</i></p> <p>(c) (i) <i>the assets held and risks borne by the controlled foreign company at any time during the exempt period are equal to or less than the assets held and risks borne at the relevant time, or</i> <i>(ii) the arm’s length value, in the functional currency of the controlled foreign company, of the assets held and risks borne by the controlled foreign company at any time during the exempt period does not exceed such value of the assets held and risks borne at the relevant time.</i></p> <p>(3) <i>An exempt period shall begin when a company first becomes a controlling company in relation to a controlled foreign company (in this section referred to as the “relevant time”) and shall end 12 months from the beginning of the exempt period.</i></p>	<p> Given that the scope of the CFC charge is limited to undistributed income of the CFC, a test that is framed by reference to the value of the assets of the CFC does not appear to fit with the chosen framework. The appreciation in market value of assets held by the CFC which are in the nature of capital gains are not in scope of the CFC charge. Such increases should not operate to exclude the CFC from the exempt period relief.</p> <p>We suggest that the restriction on the relief should be focused on assets acquired ‘on behalf’ of the CFC by reason of relevant Irish activities in line with the overall framework for the CFC charge.</p> <p> We suggest that it would be more practicable to align the exempt period with the end of the relevant accounting period of the parent so that the exempt period should include the 12 month accounting period that begins after the end of the accounting period in which the CFC was acquired. This would allow groups to review and adjust the management of CFCs as required in line with typical business reorganisation plans which target completion of relevant projects and plans by accounting period end.</p>

Suggested approach	KPMG comments
<p>(4) <i>The subsequent period condition shall be satisfied where –</i></p> <p>(5) <i>the controlled foreign company ceases to be regarded as a controlled foreign company in accordance with Chapter 1, or</i></p> <p>(6) <i>the controlled foreign company charge does not apply,</i></p> <p>(7) <i>in the first accounting period of the controlled foreign company beginning immediately after the exempt period.</i></p> <p>(8) <i>Where the accounting period of a controlled foreign company begins but does not end during an exempt period, the undistributed income of the controlled foreign company which arises during the exempt period, as determined on a just and reasonable basis, which would otherwise be subject to the controlled foreign company charge under [CFC charging section], shall be exempt from such charge.</i></p> <p>(9) <i>This section shall not apply in relation to a controlled foreign company where –</i></p> <p>(a) immediately before the relevant time the controlled foreign company was not carrying on a business except where the controlled foreign company is incorporated or formed at the relevant time for the purpose of controlling one or more companies and an exempt period begins in relation to one or more of such companies at such time, or</p> <p>(b) a controlling company was subject to this Part in relation to the controlled foreign company on the date the provisions of this Part came into effect.</p> <p>(10) <i>This section shall not apply in relation to a controlled foreign company where -</i></p> <p>(a) any arrangements are entered into,</p> <p>(b) as a consequence of such arrangements subsection (2) would, apart from this subsection, apply, and</p> <p>(c) it would be reasonable to consider that the main purpose, or one of the main purposes, of the arrangements is to secure that subsection (2) applies</p>	

Article 7(2) and Article 8(2) – Connected company undertaking SPFs

We have reviewed the approach outlined below and the proposed definitions. Although they are described in the section of the Feedback Statement that refers to a connected company carrying on SPF activity related to a CFC of an Irish parent, we have assumed that the meaning of the defined terms below apply equally (where relevant) to the CFC charge itself and to the provisions related to the definition of undistributed income.

This understanding of the scope of application of the defined terms underlies the comments set out below which cross refer to comments we have made in response to other sections of the Feedback Statement.

Suggested approach

KPMG comments

“An approach could be adopted to extend the CFC charge to an entity that carries on SPF activity relating to a CFC of an Irish parent company.” “This approach could involve the following definitions:”

“SPF” means a significant people function or a key entrepreneurial risk-taking function as construed in accordance with the OECD Report;

“the OECD Report” means the Report on the Attribution of Profits to Permanent Establishments of the Organisation for Economic Co-operation and Development dated 22 July 2010.

“relevant Irish activities” means SPFs performed in the State on behalf of a controlled foreign company group, where such SPFs are relevant to –

- (i) the economic ownership of the assets included in the relevant assets and risks of the company or companies in the controlled foreign company group,**

or

- (ii) the assumption and management of the risks included in the relevant assets and risks of the company or companies in the controlled foreign company group;**



In the section of this document on the CFC Charge, we have explored the meaning of SPF and the manner in which it could be construed when applying transfer pricing concepts and principles to:

- applying the ‘genuine activities’ test,
- computing the CFC charge in scenarios where it is assumed that arrangements related to a CFC have failed the tax advantage and genuine activities tests.

In our exploration of the application of the definitions opposite to these tests and to the computation of the CFC charge, we have assumed that:

- the reference to the OECD 2010 branch report is a means to provide a basis for construing the term SPF but is not otherwise intended to require the taxpayer to assume that the controlling company (or the connected company) form a single entity with the CFC such that the CFC is considered to be a branch of the controlling company (or connected company). Instead, the understood approach to the computation of the CFC charge is to identify those individuals who perform the SPFs and, once identified, to identify ‘relevant Irish activities.’
- When ‘relevant Irish activities’ have been identified, the taxpayer is then expected to apply transfer pricing principles (and draw upon relevant guidance which may be found in the 2010 and 2017 OECD Guidelines) to

Suggested approach

KPMG comments

“An approach could be adopted to extend the CFC charge to an entity that carries on SPF activity relating to a CFC of an Irish parent company.” “This approach could involve the following definitions:”

“controlled foreign company group” means the controlled foreign companies, taken together, of a controlling company;

compute an arm’s length amount of income that can reasonably be said to be attributed to the relevant Irish activities for that CFC.

We suggest that it is important to both explain this approach in guidance and to support this explanation with illustrative examples drawn from scenarios that apply to different sectors of business in Ireland.



We suggest it would be useful to include a definition of ‘controlling company’ so as to better link the manner of operation of the definition of ‘undistributed income’ of a single CFC with the CFC charge which is applicable to a ‘controlled foreign company group’.



We suggest that the definition of ‘connected company’ that is applied should exclude companies who might be said to be ‘connected’ merely because they are partners in an investment partnership but they are not engaged in the management of the partnership business.



In the previous section on the CFC Charge, we have outlined our understanding of the logic that is applied in computing the controlled foreign company group CFC charge. It is important that guidance is used to illustrate for taxpayers the manner in which the computation and assessment of the charge can be traced from the CFC, the SPFs relating to its assets and risks and the group based charge which is assessed on the Irish parent or its connected company. In Appendix I, we have suggested some illustrative examples that seek to explore our understanding of what a controlling company means.

Article 7(1)(b) - Definition of undistributed income

We have set out in the table below our comments on different aspects of the proposed definition of undistributed income.

In making our comments, we have assumed that the approach to the definition of undistributed income applies in all circumstances where the CFC charge is computed and that is it not confined to the circumstances where a holding company is interposed. We have suggested some changes to the legislative measures (to better achieve the understood intention of the measures) as well as some points of interpretation which could usefully be included in guidance.

Suggested approach

KPMG comments

“The following definition could be considered for undistributed income, to ensure that interposing a holding company and the payment of a dividend to such a holding company would not be effective in circumventing a CFC charge:”

- (1) **For the purposes of this Part, the undistributed income of a controlled foreign company for an accounting period shall be its distributable profits for the accounting period as reduced by any relevant distributions made in respect of the accounting period.**



We suggest that the following matters should be included in guidance. They are points of interpretation that can arise when seeking to identify the starting point for the application of this definition which is the meaning of ‘**distributable profits**’:

- Where there is a loss for the accounting period such that the undistributed income in the financial statements for the period can be said to be ‘nil’, no CFC charge applies.
- The meaning of distributable profits generally takes its meaning under local company law applicable to the CFC. Notwithstanding that capital receipts which are contributed to the CFC may be considered to be available for distribution under the laws applicable to the CFC, such receipts should not be considered to form part of undistributed income of the CFC as they are not income in character. These might include, for example, share subscription proceeds, informal capital contributions, sums recognised in share premium.
- Undistributed income for an accounting period does not include retained earnings related to prior accounting periods. The distributable profits for the period is generally the profit after tax figure in the profit and loss account or income statement of the company’s financial statements for the period (excluding profits in the character of capital gains).
- Undistributed income comprises accounting profits for the period which are recognised in the profit and loss account or income statement of the CFC. Sums which are

Suggested approach

KPMG comments

“The following definition could be considered for undistributed income, to ensure that interposing a holding company and the payment of a dividend to such a holding company would not be effective in circumventing a CFC charge:”

- (2) **For the purpose of subsection (1), the distributable profits of a controlled foreign company for an accounting period shall be the amount included in the accounting profits of the company which, notwithstanding any prohibition under the laws of the controlled foreign company’s territory of residence or otherwise, are available for distribution to members of the company and which can reasonably be attributed to relevant Irish activities undertaken by a controlling company or a company connected with the controlling company for that accounting period.**

unrealised profits of the period should not be regarded as profits available for distribution. Profits recognised in the Statement of Recognised Gains and Losses (STRGL) including unrealised movements on fixed asset revaluation reserves, valuation movements on assets held in pension schemes and unrealised valuation movements on certain derivatives should not be considered to form part of undistributed income of the period.



As discussed in earlier sections of this document, we suggest that undistributed income should be expressly defined to exclude:

- capital receipts, non-income profits or profits in the character of capital gains,
- income which would be exempt from corporation tax if received by an Irish resident company,
- Irish source income that is exempt from income tax under the Income Tax Acts in the hands of the CFC,
- profits attributable to the conduct of a trade in Ireland through a branch or agency in the State.



As suggested in our response to earlier sections in the Feedback Statement on the CFC Charge, detailed guidance should be provided to support the computation of an amount of profit ‘*which can reasonably be attributed to relevant Irish activities undertaken by a controlling company or a company connected with the controlling company*’. We have set out in Appendix II to this document some case study scenarios which seek to illustrate how such attribution might be done using the arm’s length principle.



We are concerned as to the potentially very broad scope of charge applicable to undistributed profits of a CFC that cannot be distributed due to legal prohibitions which apply in circumstances that are outside the control of the taxpayer. These include prohibitions on making distributions that are applied under company creditor protection or solvency requirements,

Suggested approach

KPMG comments

“The following definition could be considered for undistributed income, to ensure that interposing a holding company and the payment of a dividend to such a holding company would not be effective in circumventing a CFC charge:”

- (3) For the purpose of subsection (1), a relevant distribution for an accounting period means an amount determined by the formula – $A \times B/C$
- where –
- A is the amount of the distribution made in respect of the accounting period,
 - B is the distributable profits for the accounting period as construed in accordance with *subsection (2)*, and
 - C is the amount of profit, before taxation, shown in the profit and loss account of the controlled foreign company for the accounting period, and where -
 - (i) such amount is distributed to –
 - (I) a person who is, by virtue of the laws of a relevant Member State, resident for the purposes of tax in a relevant Member State which imposes a tax that generally applies to distributions receivable in that territory, by persons from sources outside that territory, or
 - (II) persons resident in the State,
 - (ii) such amount is paid or payable during the accounting period or within 9 months after the end of the accounting period, and

the tax referred to in clause (I) has been paid and has not been and does not fall to be repaid, in whole or in part, to the controlled foreign

exchange control or currency control regulations, regulatory requirements, etc. We suggest that, at a minimum, in such scenarios, the taxpayer should be in a position to apply for relief to defer collection of the tax on the charge for the period until such time as the prohibition on distribution is removed.



We suggest that the definition of B and C are aligned to both refer to distributable profits for the period so that no amount of undistributed income can be left in scope of the CFC charge if, in fact, the entirety of the undistributed income of the CFC for the accounting period is distributed (in a manner that meets the relevant distribution test).

In workings set out below this table, we have illustrated what we believe is the unintended consequences of the interaction of the proposed definition of B and C and have suggested how this might be addressed by a change to the definition of C to refer to profits available for distribution instead of pre-tax profits.



As the intention of the CFC charge is to tax ‘currently’ on the controlling company (or connected company) an amount which is equivalent to undistributed income of CFCs that meet certain criteria where the charge applies, we understand that the intention of the provisions is not to include in the scope of the CFC charge income which is actually distributed to an Irish resident company (or company resident in an EU Member State which generally taxes foreign distributions) once the distribution is paid or payable within a defined time period.

Guidance would be welcome to confirm that these measures can apply to reduce the CFC charge for a distribution paid to a company resident in an EU Member State where:

- an EU Member State generally taxes foreign distributions but provides for a participation exemption where the shareholder meets certain conditions e.g. holds a minimum percentage interest in the CFC for a minimum period of time, etc.
- the amount is distributed through a chain of companies within a single jurisdiction and the

Suggested approach

KPMG comments

“The following definition could be considered for undistributed income, to ensure that interposing a holding company and the payment of a dividend to such a holding company would not be effective in circumventing a CFC charge:”

company or any other person on the making of a claim or otherwise.

- (4) For the purpose of this section, a distribution made in respect of an accounting period shall be regarded as being made out of the distributable profits of that period to the extent of that profit and, in relation to any excess of the distribution over that profit, out of the most recently accumulated distributable profits.**

payment and receipt is ignored for local tax purposes because the distribution is paid or payable between members of a single fiscal unity or tax consolidated group.

- the reference to ‘tax referred to in clause (1)’ having been paid does not mean that tax has actually to be paid on the distribution by the recipient in circumstances where the general regime of the EU Member State taxes distribution test affords a participation exemption for the particular distribution.



We understand that the intention of the reference to ‘*the tax referred to in clause (1)*’ being repaid in whole or in part is to prevent the general regime of an EU Member State meeting the criteria in circumstances where a tax, is actually paid by the recipient of the dividend from the CFC but is then repaid in whole or in part.



Guidance would be welcome to confirm that the procedures that are commonly used by Irish resident taxpayers to evidence that a foreign dividend is paid from profits of a particular period can be used to evidence that a distribution is made out of the undistributed income of the CFC for an accounting period (e.g. in the same manner as taxpayers currently use dividend declarations or other resolutions made by the company to track distributions paid under the close company provisions or in tracing dividends to the underlying profits from which they are sourced under measures which afford relief from double tax).

Illustration of suggested change to definition of ‘C’ in the relevant distribution formula

Take a company with pre-tax accounting profits of 1,000, accounting taxation charge of 50 and profit after tax (PAT) which is considered to be the accounting profits available for distribution of the period of 950. Assume 60% of the PAT accounting profits of the period i.e. 570, is considered to be reasonably attributed to the activities of SPFs in Ireland.

Assume that all of the distributable profits of 950 is paid as a dividend to the Irish resident parent company.

The relevant distribution formula: **A** is the distribution, **B** is the distributable profits of the period which is assumed to be the PAT amount and **C** is the pre-taxation amount shown in the profit and loss account.

In this illustrative scenario, A is 950, B is 570 and C is 1,000. Where the entire amount of the distributable profit is paid as dividend to the Irish parent, the relevant distribution is 541.5 which still leaves $570 - 541.5 = 28.5$ within the scope of the CFC charge.

The manner of operation of the formula means that a tax charge in the accounts of the CFC for the period reduces profits available for distribution but is not taken into account in calculating the relevant distribution amount which reduces the taxable CFC amount. If 'C' was defined to refer to the distributable profits for the period instead of the pre taxation amount, a distribution of the entire profits available for distribution would reduce the CFC charge to Nil.

The formula would operate so that the relevant distribution amount would be 570 and would offset in full the potential CFC charge.

Miscellaneous Definitions

We have no separate comments to make on the miscellaneous definitions set out below. Our comments on the operation of the provisions which reflect the use of these provisions in the context of the CFC charge are included in earlier sections of this submission.

Suggested approach

“A number of definitions are suggested which are essential to the operation of the CFC rules in practice.”

“arrangement” means-

- (i) any transaction, action, course of action, course of conduct, scheme, plan or proposal,
- (ii) any agreement, arrangement, understanding, promise or undertaking whether express or implied and whether or not enforceable or intended to be enforceable by legal proceedings, and
- (iii) any series of or combination of the circumstances referred to in paragraphs (i) and (ii)

whether entered into or arranged by one or two or more persons –

- (I) whether acting in concert or not,
- (II) whether or not entered into or arranged wholly or partly outside the State, or
- (III) whether or not entered into or arranged as part of a larger arrangement or in conjunction with any other arrangement or arrangements,

but does not include an arrangement referred to in section 826;

“relevant assets and risks” means the assets which a controlled foreign company has, or has had, and the risks which a controlled foreign company bears, or has borne, where those assets or risks would not have been employed or undertaken but for SPFs performed in the State or by a company resident in the State on behalf of the controlled foreign company;

“tax advantage” means-

- (i) a reduction, avoidance or deferral of any charge or assessment to tax, including any potential or prospective charge or assessment, or
- (ii) a refund of or a payment of an amount of tax, or an increase in an amount of tax, refundable or otherwise payable to a person including any potential or prospective amount so refundable or payable,

arising out of or by reason of an arrangement, including an arrangement where another arrangement would not have been undertaken or arranged to achieve the results or any part of the results, achieved or intended to be achieved by the arrangement.

Other issues



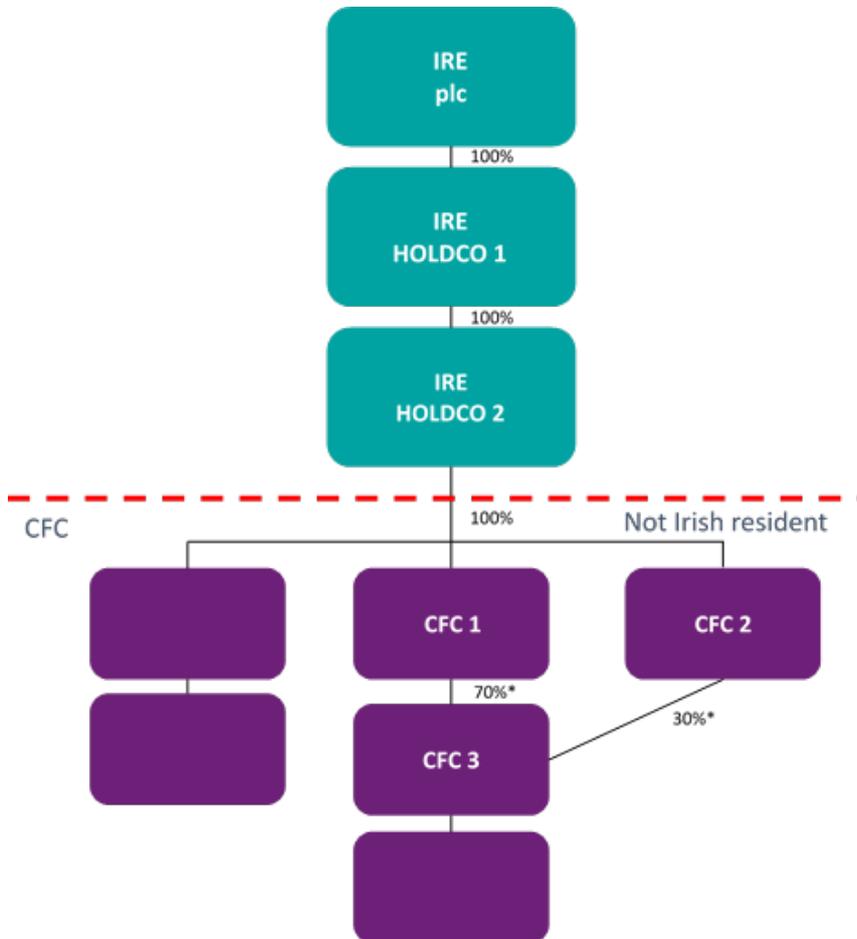
Other issues

We suggest that effective date for the CFC Rules is to apply the provisions to the first accounting period of the CFC that begins on or after 1 January 2019.

Taking together our comments and suggestions in the earlier sections of this submission, we have set out in Appendix I a number of examples which illustrate our understanding of the meaning of 'control' as it applies under the CFC Rules. In Appendix II, we have used examples to set out our interpretation of various tests applying under the provisions including the tax advantage and genuine activities tests.

Appendix I

Meaning of Controlling Company – scenario 1



*Percentage rights to share capital, profits available for distribution and assets upon winding up.

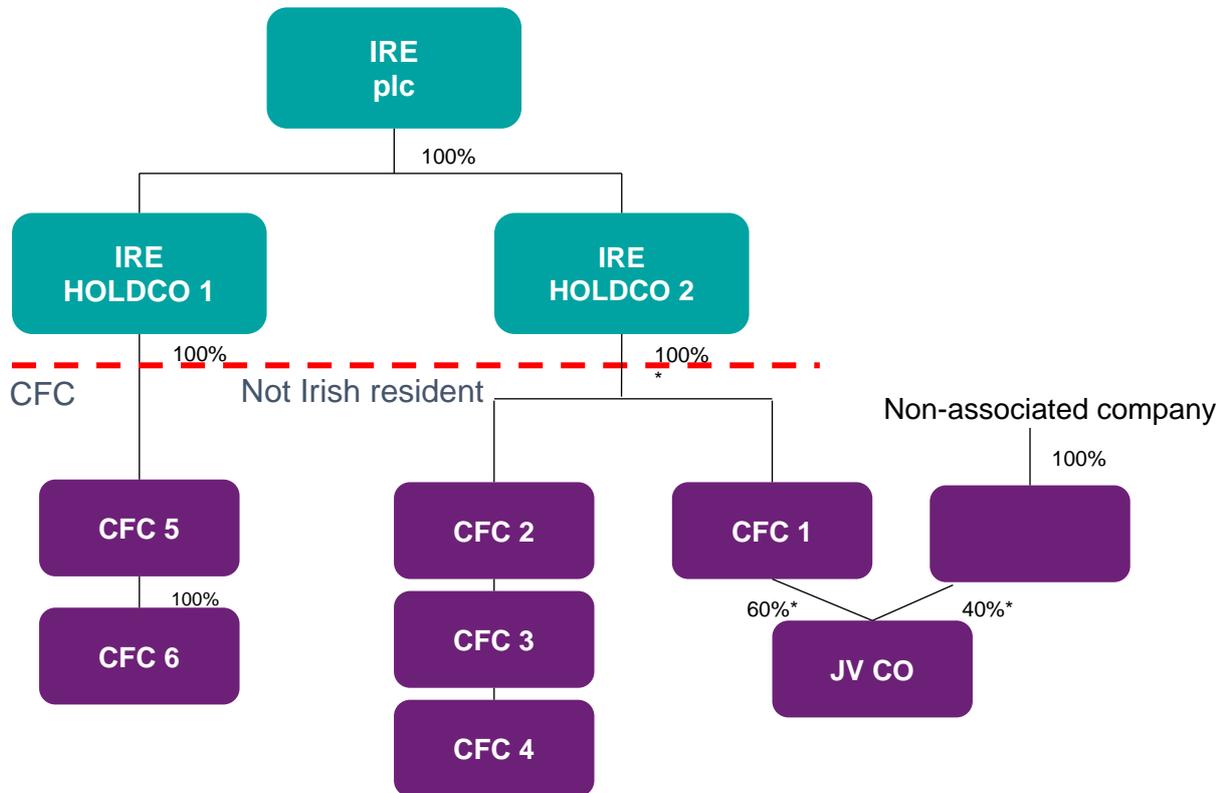
Who is a controlling company?

A 'controlling company' is not defined in the Feedback Statement. It is assumed to mean a company that controls directly or indirectly a CFC or CFCs.

Any one of IRE plc, IRE HOLDCO 1 and IRE HOLDCO 2 could be a controlling company in relation to the non-resident CFCs. Each of these companies could also be said to be a 'connected company' of the other two Irish companies.

IRE HOLDCO 2 is considered to be a controlling company in relation to its 100% direct holdings in CFC 1 and CFC 2. IRE HOLDCO 2 is considered to hold aggregate rights of 100% in CFC 3, being 70% held indirectly and attributed to it as a result of its holding in CFC 1 and 30% held indirectly and attributed to it through its holding in CFC 2.

Meaning of Controlling Company – scenario 2



*Percentage rights to share capital, profits available for distribution and assets upon winding up.

Who is a controlling company?

A 'controlling company' is not defined in the Feedback Statement. It is assumed to mean a company that controls directly or indirectly a CFC or CFCs.

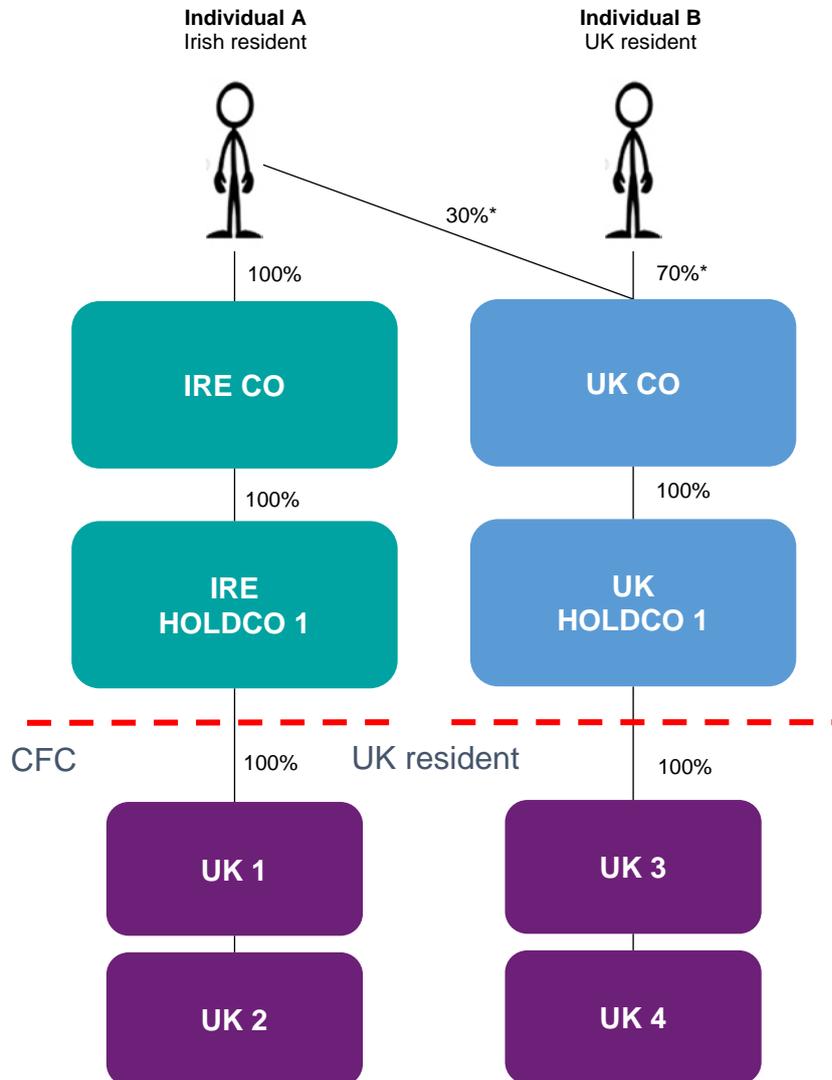
IRE HOLDCO 2 is a controlling company in relation to each of CFC 1, CFC 2, CFC 3 and CFC 4. It is also a 'connected company' in relation to IRE plc and IRE HOLDCO 1. IRE HOLDCO 2 is a controlling company in relation to JV CO as the rights of CFC 1 in JV CO are attributed to it. CFC 1 owns 60% of the shares in JV CO.

A non-associated company owns indirectly 40% of the shares in JV CO. Its holdings in JV CO are not attributed to any member of the IRE plc group.

A CFC charge in relation to the undistributed income of JV CO is limited to IRE HOLDCO 2's proportionate share of the aggregate shareholding in JV CO. As IRE HOLDCO 2's aggregate share is 100% x 60%, in this example, the CFC charge assessable upon IRE HOLDCO 2 is limited to 60% of the otherwise assessable amount related to JV CO.

Rights of 25% associated companies are attributable and aggregated in determining 'control' but the charge to tax under the CFC legislation is capped at level of proportionate shareholding rights.

Meaning of Controlling Company – scenario 3



*Percentage rights to share capital, profits available for distribution and assets upon winding up.

Who is a controlling company?

A 'controlling company' is not defined in the Feedback Statement. It is assumed to mean a company that controls directly or indirectly a CFC or CFCs. Connected company is not defined. It is assumed to mean a company under common 50% control.

Individual A and B are individuals. A is resident in Ireland and B is resident in the UK.

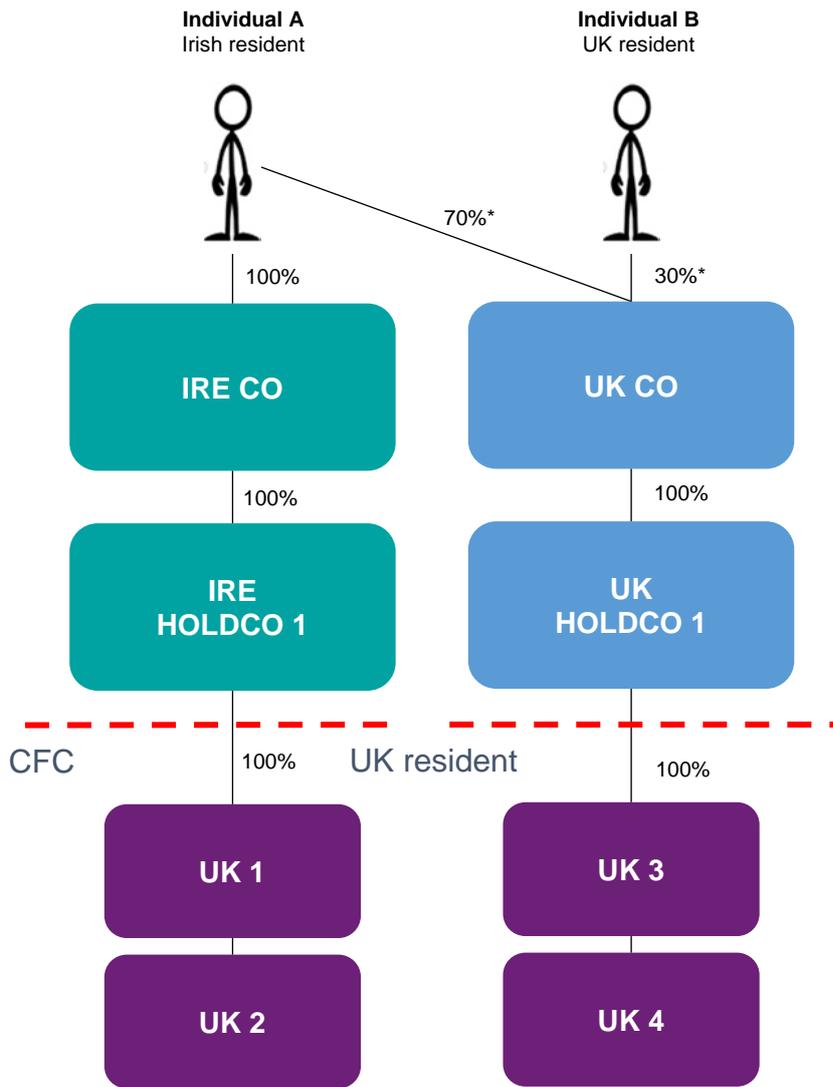
UK CO is considered to be an associated company of IRE CO as Individual A, being a third person, holds greater than 25% of the share capital and voting rights in both companies. IRE CO and UK CO are not connected companies as they are not held by a third person under a 50% common control relationship.

In identifying companies that 'controlled' by IRE CO under the CFC Rules, the rights of associated companies (including rights held by UK CO) are attributed to IRE CO. IRE CO is considered to be a controlling company, not only of UK 1 and UK 2 but also of UK CO, UK HOLDCO, UK 3 and UK 4.

Rights of 25% associated companies are attributable and aggregated in determining 'control' but the charge to tax under the CFC legislation is capped at level of proportionate shareholding rights.

If we assume that Individual A or IRE CO perform SPFs in Ireland in respect of the UK CO, UK HOLDCO, UK 3 or UK 4, the CFC charge that might apply to the undistributed income of these CFCs is limited to IRE CO's proportionate aggregate shareholding rights in the CFCs. As IRE CO does not hold any shareholdings in these companies, the proportionate CFC charge is reduced to nil.

Meaning of Controlling Company – scenario 4



*Percentage rights to share capital, profits available for distribution and assets upon winding up.

Who is a controlling company?

A ‘controlling company’ is not defined in the Feedback Statement. It is assumed to mean a company that controls directly or indirectly a CFC or CFCs. Connected company is not defined. It is assumed to mean a company under common 50% control.

Individual A and B are individuals. A is resident in Ireland and B is resident in the UK.

UK CO is considered to be an associated company of IRE CO as Individual A, being a third person, holds greater than 25% of the share capital and voting rights in both companies. IRE CO and UK CO are ‘connected companies’ as Individual A holds 70% of the share capital and voting rights in both IRE CO and UK CO.

In identifying companies that are 'controlled' by IRE CO, the rights of associated companies (including rights held by UK CO) are attributed to it. IRE CO is a controlling company, not only of UK 1 and UK 2 but also of UK CO, UK HOLDCO, UK 3 and UK 4.

Rights of 25% associated companies are attributable to and aggregated in determining 'control' but the charge to tax under the CFC Rules is capped at the level of proportionate shareholding rights.

The CFC charge that might apply to the undistributed income of the CFCs owned by UK CO, being UK 3 and UK 4, is limited to the proportionate aggregate shareholding rights of the controlling company, IRE CO, and the 'connected company', UK CO but only where there are SPFs related to the CFCs in Ireland. If it is assumed that there are no SPFs in Ireland, whether carried out by Individual A, IRE CO or UK CO, there is no CFC charge.

If we assume, in the alternative, that Individual A or IRE CO perform SPFs in Ireland in respect of UK CO, UK HOLDCO, UK 3 or UK 4, IRE CO can be said to be a 'chargeable company' as it is a controlling company. The CFC charge that might apply to the undistributed income of these CFCs is limited to the proportionate aggregate shareholding rights held by IRE CO in the CFCs. In this example, it is assumed that the proportionate shareholding of IRE CO in these companies is nil. The CFC charge is reduced to nil.

Appendix II

In this appendix, we have described a range of illustrative examples drawn from soundings taken from businesses operating internationally through CFCs. The case study scenarios are suggested to explore the meaning of tests such as *'the essential purpose being to obtain a tax advantage'* as well as the *'genuine activities'* test. The examples are grouped together under different headings below.

Tax advantage test: the meaning of essential purpose

1. Investment in the Far East

Scenario 1

A decision has been made by an Irish resident parent that the group should expand its operations into the Far East. It is proposed that the group's operations in the Far East will ultimately extend throughout a number of countries in the region. In exploring tax incentives that are available to attract investment into different jurisdictions, the group identifies a number of opportunities to establish new CFCs which could take advantage of:

- A tax holiday in Singapore available to companies establishing in an enterprise zone which carry out headquarter type activities for companies in the region. This includes the possibility of availing of the deferred taxation of offshore receipts arising to the Singaporean company until the receipts are repatriated to Singapore.
- The offshore exemption in Hong Kong in respect of receipts arising from a non-Hong Kong source.
- Availing of reduced taxation and employment withholding taxes for expatriate employees based in the companies.

Notwithstanding that the CFCs when established could potentially avail of a range of tax advantages including tax exemption and deferral of tax (whether corporate income tax or payroll taxes for employees) the essential purpose for the business activities of the CFCs is not to secure a tax advantage but to expand the operations of the group in the Far East region.

The activities of the CFCs operating in these jurisdictions are therefore considered to have satisfied the essential purpose test.

2. Investment in the United Kingdom (UK)

Scenario 2

An Irish group has manufacturing facilities in Ireland and in the UK. Concerned that the event of Brexit could mean delays in making delivery of its product to UK markets, it decides to expand its production operations in the UK. The product manufactured in the UK should be capable of meeting current customer delivery timelines without risk of delays arising where the UK leaves the EU. The additional investment in manufacturing production facilities is expected to be eligible in the UK for an accelerated entitlement to capital allowances on plant and machinery.

Although the investment may avail of a UK tax advantage compared to an equivalent investment in Ireland, the essential purpose of expanding production capacity is to protect against loss of business which could otherwise arise where Brexit gives rise to delays in the delivery of goods manufactured in Ireland to UK customers.

The arrangement has satisfied essential purpose test.

3. Investment in the United States of America (US)

Scenario 3

US tax reform measures enacted at the end of 2017 mean that, for limited period of time, taxpayers investing in tangible assets used for business purposes in the US may be entitled to a 100% accelerated depreciation entitlement. An Irish parent group which is engaged in manufacturing activities in Ireland

decides to take advantage of the accelerated depreciation regime and increases its investment in production facilities in the US.

Although the company's investment in production facilities in the US means it is able to secure a tax advantage related to this investment this is only one of the main benefits of the investment which has the essential purpose of expanding the company's manufacturing capacity in the US.

The company has satisfied the essential purpose test.

4. Expansion by acquisition of third party groups - funding the acquisition with intra group debt

Scenario 4

In order to extend its market presence in the UK and US (two of its most important customer markets) an Irish head quartered group decides to pursue a strategy of expanding through acquiring third party groups. The Irish parent company enters into negotiations with the group's bankers and other potential lenders to arrange for debt facilities to be made available to a group member designated as the acquisition vehicle should an acquisition opportunity arise.

Having agreed the terms of purchase with third party vendors, the Irish parent establishes a new CFC in the UK in the case of the UK acquisition and capitalises it with a mixture of capital and debt to enable that CFC to fund its acquisition of the third party target group. The tax advantage associated with deducting interest expense on debt whether in the UK or US acquisition is no different whether the group is funded from Ireland or elsewhere. There is therefore no comparative tax advantage in relation to this aspect of the transaction.

The group establishes a low taxed CFC which will be capitalised from Ireland and will advance intragroup loans to the US and UK acquisition vehicles.

Although these arrangements could be said to realise a tax advantage in respect of the low rate of tax on income arising to the intra group lender company, the essential purpose has been to fund a third party acquisition and the test is satisfied.

5. Intra group funding – using resources available in foreign group subsidiaries

Scenario 5

An Irish group parent decides to expand internationally by making an acquisition in Germany. Unlike UK group members, Irish group members do not have cash surpluses available to fund the acquisition. The Irish parent decides that the acquisition should be funded where possible from cash surpluses available in UK subsidiaries of the group. Distributions are paid from UK operating companies to the UK local holding company for the UK group and that company uses the cash and borrowings drawn down from third party banks to fund the acquisition of the German group from a third party.

The interest expense borne on the acquisition by the German acquisition vehicle is deductible in Germany and the UK lender is remunerated on arm's length terms for funding provided to the German acquisition vehicle. There is possibly a tax advantage in the tax rate differential between taxing the interest income in the UK and the rate of deducting the expense in Germany. The essential purpose, however, is to expand the group by making an acquisition in Germany.

The essential purpose of the tax advantage test is considered to be satisfied.

6. Undistributed profits and capital gains

Scenario 6

The subsidiary of an Irish parent is a Bermudan company. It holds intangible assets which are under development and which are not yet available for use in the business of the group. The company does not have undistributed income for the period.

If unrealised gains or realised capital gains were reflected in the accounting profits of the period, they are excluded from the scope of charge as they are not undistributed income.

7. Intermediary holding company and capital gains/dividend income

Scenario 7

An Irish group seeks to expand its operations in Latin America. It establishes an intermediary holding company in another EU Member State where there are longstanding commercial links with countries in Latin America (possible examples could include the Netherlands, Spain and Portugal). In addition to the long standing trading links between these countries, the holding company regime in those countries is more favourable compared to the Irish holding company regime for investment in Latin American subsidiaries including companies resident in Brazil, Argentina and Costa Rica. Dividend income and capital gains arising from the foreign subsidiaries may benefit from a tax advantage as compared to such receipts received by an Irish holding company.

In the case of capital gains reflected in undistributed accounting profits of the intermediate holding company, such profits are outside the scope of the CFC Rules.

Dividend income may or may not be subject to a higher effective tax rate as compared to dividends received in Ireland after claiming underlying double tax credit relief. Even where the effective tax rate test is not met, the tax advantage test is considered to be satisfied as the essential purpose for acquisition and holding by the intermediary company of the shares in the Latin America subsidiaries was to expand the group's presence in Latin America and establish a regional holding company to manage those operations.

Financial services examples

8. Leasing

Scenario 8

An Irish based aviation leasing group identifies the opportunity to lease to a new airline client which is opening up new routes in South East Asia. The Irish group decides that a Singaporean subsidiary will be the most efficient location to establish a leasing relationship with the new customer. The lease arrangements for the new customer are entered into by the Singaporean leasing subsidiary of the Irish group.

The Irish company performs an effective tax rate calculation on the income of the Singaporean lease services company and each of the special purpose leasing companies established by the Singaporean company to determine whether or not the effective tax rate borne on the leasing profits is greater than that which would have been borne by an Irish company. It finds that due to the timing of allowances available under the Singaporean regime as compared to the Irish regime that less tax is payable in the period on the profits of the Singaporean company than would have been paid on the profits of the Irish company due to the timing of the availability of local allowances. Notwithstanding that the effective tax rate for the period is lower than that which was applied in Ireland over the lifetime of the lease it is expected that the profits will be subject to a tax rate that is greater than half of that which would apply to the Irish operations.

These subsidiaries have been established with the essential purpose of providing leasing facilities to a third party airline.

It is considered that the Singaporean CFCs have met the essential purpose test.

9. International funds

Scenario 9

An Irish based collective investment undertaking is exempt from tax in Ireland on income and gains arising to the fund. Within its investment parameters, the fund decides to acquire new assets to add to the portfolio of assets under its management. It acquires a new investment asset through establishing a CFC in the country where the asset is located. This investment structure is well understood in the market where the asset is located so that the fund can satisfy itself that appropriate commercial, legal and tax compliance risks associated with the investment can be managed by using a locally tax resident CFC to make the investment in the asset.

This CFC is a special purpose entity (SPE) and is a 100% subsidiary of the fund. It will acquire and hold the asset and earn income from the asset. Interest incurred on debt finance advanced by the fund will be

deducted by the asset owning SPE and paid to the fund. When the asset is disposed of, the profits on disposal of the SPE will be realised by the fund and will be tax exempt.

Had the asset been held by the fund, income and gains from the asset would have been tax exempt in Ireland. There is therefore not a tax advantage from an Irish comparator perspective.

Using a local investment SPE may also achieve local tax savings for the fund as compared to making a direct investment.

As the essential purpose of establishing the CFC and making the investment using a local company is to acquire the asset in accordance with its investment parameters, the essential purpose test is considered to be satisfied by the Irish fund.

10. Insurance

Scenario 10

In similar circumstances to those of the fund in the example above, an insurance company is acquiring international assets to meet its obligations to invest in certain classes of assets under savings products offered to its policy holders or to underpin underwriting risks arising in its business. Returns which are realised by the insurance company on these investments will be paid out to the policy holders. When the investment in the CFC is held as part of its pension related business the returns will be tax exempt in Ireland.

There may not be a tax advantage from an Irish comparator perspective when the position of making the investment directly is compared to the position arising from investing using a CFC.

Using a local investment SPE may also achieve local tax savings for the insurance company as compared to making a direct investment.

Notwithstanding that the insurance company establishes foreign special purpose companies to acquire assets locally which could achieve local tax savings, the essential purpose is considered to be investment in assets to meet the requirements of its insurance business.

The essential purpose test is considered to have been met.

11. Captive insurance

Scenario 11

An Irish parent company decides to establish a group captive insurance company which insures a variety of business risks for the members of the group. On a group wide basis, the use of the captive insurance company has achieved commercial benefits in relation to the management of the group members' insurance risks. The premia paid by group members to the captive insurance company are priced on an arm's length terms.

The insurance company is regulated and has appropriate management and economic substance in the foreign jurisdiction to meet its regulatory requirements.

The captive insurance company would not meet the effective tax rate (ETR) test. This could be because it is resident in a jurisdiction with a tax rate that is nil or is substantially lower than the Irish rate. It may also fail the ETR test because of timing differences between the timing and recognition of its taxable profits and the measure of its profits under Irish tax principles.

The essential purpose test is considered to have been met.

12. Reinsurance subsidiary

Scenario 12

An Irish insurance company decides to establish a reinsurance company to reinsure some of its risks and those of other group members. On a group wide basis, the use of the reinsurance company has achieved commercial benefits in relation to the management of the group's insurance risks. The premia paid by the Irish parent and group members to the reinsurance company are priced on an arm's length terms.

The reinsurance company is regulated and has appropriate management and economic substance in the foreign jurisdiction to meet its regulatory requirements.

The reinsurance company would not meet the effective tax rate (ETR) test. This could be because it is resident in a jurisdiction with a tax rate that is nil or is substantially lower than the Irish rate. It may also fail the ETR test because of timing differences between the timing and recognition of its taxable profits and the measure of its reinsurance profits under Irish tax principles.

The essential purpose test is considered to have been met.

13. Debt issuing activities

Scenario 13

The group establishes a special purpose subsidiary to raise debt from the markets. The essential purpose for the activities of the subsidiary is to raise debt from the market using a company that is subject to a legal regime that is well understood by the target investors. The company is also located in a jurisdiction with low costs associated with raising debt and which has an exchange which meets the requirements related to the holding and, where, required transfers of debt between investors.

The subsidiary is subject to tax at a lower rate than in Ireland and fails the ETR test.

The essential purpose of the subsidiary is to raise debt in a cost effective manner for the group. The essential purpose test is considered to be satisfied.

14. Management of intangible assets – essential purpose test is met

Scenario 14

The group has established a company that holds and manages intangible assets and exploits them through licencing the intangible assets to group members. The intangible assets could include brands and marketing related intangibles or technology rights, for example.

The CFC is subject to a low ETR and has undistributed income from intra group royalties.

The CFC is managed and controlled in its jurisdiction of residence. In the case of the company that holds brands and marketing intangibles, it has a number of local employees who conduct the business of the company locally and manage the routine day to day spending on supporting, developing and protecting the assets it holds. These include activities such as managing marketing campaigns and brand development budgets as well as support activities related to branding, managing the licencing of the intangibles with group members and the compliance of group members with group brand use and marketing protocols.

An important factor in the location decision for the activities was the availability of a labour pool of skilled talent with the requisite language skills and market experience to manage international marketing and brand development activities day to day. Some of the SPFs related to the DEMPE functions associated with the brand and marketing intangibles are performed in Ireland.

In the case of the company holding technology related intangible assets, it has a number of local employees who conduct the business of the company locally and manage the routine day to day development and exploitation of the technology assets. These include monitoring development activities and R&D activities conducted by group members, licencing intangibles to group members and managing legal compliance in relation to the asset use as well as taking appropriate legal actions to protect the technology rights.

An important factor in the location decision for the activities was the availability of a labour pool of skilled talent with the requisite technical, legal and compliance skills to manage an international activity in relation to the technology rights. Some of the SPFs related to the DEMPE functions associated with the technology rights are performed in Ireland.

Although one of the main benefits from the set up and operation of the intangible asset operations of the company could be said to be obtaining the tax advantage of a low tax rate, the essential purpose of the arrangements is to conduct business activities in a location where the group was satisfied that there was a

business and legal environment to protect and enforce protection assets related to the assets held by it and access to a pool of skilled workers with expertise in the conduct of international activities of this type.

Genuine Activities Test

Irish parent - low taxed intra group financing and holding of intangible assets – exploring the genuine activities test – assumption made that the essential purpose test is failed

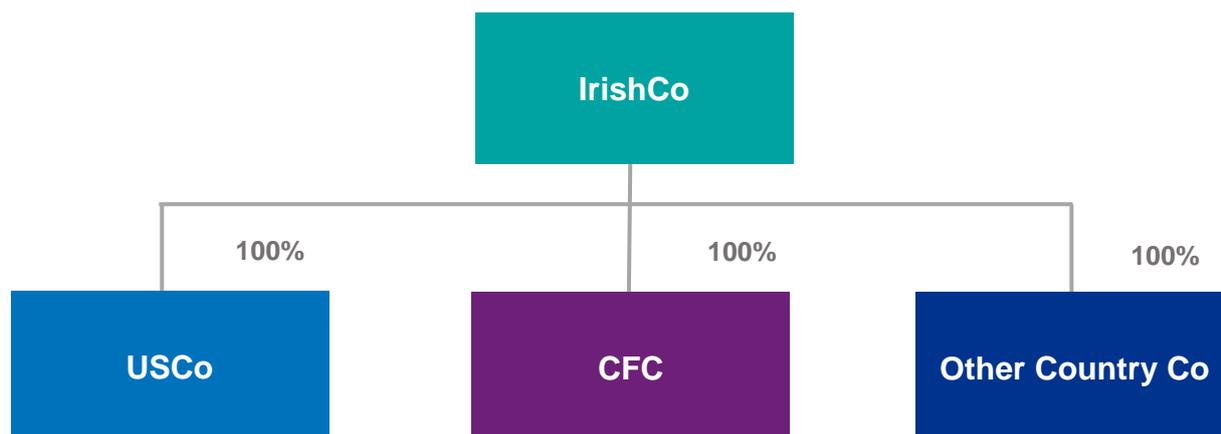
Scenarios 15 and 16

In order to explore the operation of the genuine activities test, **for illustrative purposes in the examples below, it is assumed that the essential purpose test is failed.**

In the examples below, we have used two illustrative scenarios which describe arrangements within an Irish parent group related to the business and assets of a low taxed subsidiary, a CFC.

Functions which are considered to be SPFs are performed by an Irish group member in relation to the business and assets of a CFC. The examples explore how transfer pricing principles can be applied using the concept of SPFs and KERTs and the exercise of control functions in order both identify the SPFs and KERTs and to identify an amount of profits generated through the assets and risks of the CFC business which are linked to the SPFs / KERTs or controlling functions performed by the Irish parent.

The following simplified corporate group structure is relevant to both examples:



Example: Luxembourg financing subsidiary

Scenario 15

Assume that the CFC is based in Luxembourg and resident in Luxembourg for corporate income tax purposes ('LuxCo'). In this example, LuxCo is performing intra group financing activities e.g. the advance and administration of loans to group entities in foreign territories.

LuxCo is taxed on a low effective corporate income tax rate which fails the ETR test. It is considered to be a CFC from an Irish tax perspective. The Irish parent must consider whether income should be included as taxable income of IrishCo under the CFC charge.

For the illustrative purposes of this example, it is assumed that the essential purpose test is failed. IrishCo must include taxable income under the CFC rule if *non-genuine arrangements* are in place.

LuxCo controls the decision to lend and the terms on which monies are advanced to group companies. It does more than exercise stewardship functions but it carries out its intra group lending activities with the benefit of significant support and analysis done by group management based in Ireland.

In the case of these intra group lending activities, the relevant KERT is the decision whether to lend the money and on what terms. Where such decision making is done in Luxembourg (not in Ireland) the arrangements are considered to meet the requirements of the genuine activities test.

If the IrishCo support arrangements to LuxCo arise in the course of a trade taxed under Case I, Irish transfer pricing principles should require IrishCo to reflect this pricing adjustment in its taxable Case I income. This might be done by LuxCo paying a service fee or commission to the loan origination team based in Ireland.

What if the genuine activities test is failed?

In circumstances where the genuine activities test is not met, and Ireland's transfer pricing regime does not extend to these arrangements, the application of transfer pricing principles under the CFC Rules should see an equivalent amount of profits taxed under the CFC Rules where the arrangements fail the non-genuine arrangements test. This is because the CFC charge taxes an amount that would be payable by persons dealing at arm's length in relation to those activities.

Example 16: Bermudan IP subsidiary

Scenario 16

Assume that the CFC is based in Bermuda ('BermudaCo'), is not resident for corporation tax purposes in Ireland and owns intangible assets ('IP') that is exploited by the group. BermudaCo is subject to a nil rate of tax on its profits in Bermuda. It is a CFC.

It is assumed for illustrative purposes under this example that the essential purpose test is failed. IrishCo must include taxable income under the CFC charge if *non-genuine arrangements* are in place.

BermudaCo licenses its IP to group entities.

Example 16(a)

Most of the SPFs relating to the DEMPE are performed by employees of IrishCo.

BermudaCo has a board of directors which exercises control over key decision-making in relation to the ownership and development of the IP but there are also SPF's related to the exploitation of the IP based in Ireland.

If BermudaCo is not considered to meet the genuine activities test (e.g. the Irish SPFs are considered to be instrumental in generating the income of the company), transfer pricing apply to determine the amount of the undistributed income of the company that can reasonably be attributed to the Irish Co SPFs. While under transfer pricing principles to IrishCo, BermudaCo should earn an appropriate return for its ownership of the IP, some of the profit is attributable under the CFC charge based on an arm's length amount payable for the SPF's related to the exploitation of IP based in Ireland as determined under OECD transfer pricing principles.

If the IrishCo arrangements arise in the course of a trade taxed under Case I, Irish transfer pricing principles should require IrishCo to reflect this pricing adjustment in its taxable Case I income. The CFC charge would not apply where the pricing adjustment is already made under the Irish transfer pricing regime.

Where Ireland's transfer pricing regime does not extend to these arrangements, the application of transfer pricing principles under the CFC charge should see an equivalent amount of profits taxed under the CFC charge where the arrangements fail the non-genuine arrangements test. This is because the CFC charge taxes an amount that would be payable by persons dealing at arm's length in relation to those activities.

Example 16(b)

It is assumed that the SPFs described above related to the IP held by BermudaCo are not performed in Ireland by IrishCo but they are performed, instead, in the US by USCo which is a fellow subsidiary of BermudaCo. In this instance, as there are no SPFs performed by the Irish controlling company (or a connected company) in Ireland but instead by another group member in the US, no income should be charged under the Irish CFC Rules.

The pricing impact of the functions performed by USCo in relation to the business and assets of BermudaCo is a matter to be addressed under the US transfer pricing regime.

© 2018 KPMG, an Irish partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in Ireland.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are registered trademarks of KPMG International Cooperative (“KPMG International”), a Swiss entity.