IRELAND

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1) The General Scheme of Corporation Tax in Ireland

Outline

Ireland has a somewhat unusual corporate tax regime with two rates of corporate income tax. Trading income is subject to corporation tax at 12.5%, and passive, i.e. non-trading income is charged to corporation tax at a rate of 25%. Capital gains are taxed at a rate of 33% with effect for disposals on or after the 6th of December 2012.

Given the differential in the tax rates, companies are usually keen to ensure that wherever possible income is treated as derived from trading activities. When it is not clear whether a category of corporate income is passive or trading in nature, reference should be made to case law in order to obtain guidance. It should be noted in this context that UK case law has persuasive but non-binding value in the Irish courts.

Such distinctions are particularly important as Ireland operates a system of self-assessment for companies which places the responsibility for making an accurate and timely tax return on the taxpaying company. This system operates together with a system of preliminary payments (payments on account of corporation tax) which effectively collects the majority of the tax due on corporate income throughout the period of assessment.

The tax rates

The background to the current corporation tax rates has its origins in the 1950's when Ireland introduced a number of tax incentives with the principle aim of encouraging industrial development and creating employment. These rules broadly

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provided that profits arising from increased export sales would be tax exempt and included tax incentives for businesses located in a defined geographical area, the Shannon Free Zone.

Following Ireland's accession to EU membership (in 1973) the export sales relief was regarded as contrary to EU law and was replaced in 1981 by a reduced rate of tax of 10% which was to apply to all manufacturing profits generated by new enterprises. This rate of tax also applied in the Shannon Free Zone. In 1987, and with the approval of the European Commission, this relief was extended to companies engaged in financial activities and operating in the newly established Irish Financial Services Centre.

All was well until EU law and tax policy again became an issue. The top rate of corporation tax in Ireland in 1996 was 36% and the soon to be published EU Code of Conduct for Business Taxation had identified the existence of preferential rates of tax (like the 10% rate) as one of the criteria for identifying a potentially harmful tax measure. Consequentially political pressure mounted on the Irish government to abolish these preferential rates of tax, which they agreed to do in 1996. However in a laudable Machiavellian manoeuvre the Irish government agreed that the removal of the 10% preferential rate would be accompanied by a new lower corporate tax rate of 12.5% applicable to all trading income from 2003, thus at a stroke meeting the criteria by abolishing the preferential rate whilst ensuring that Ireland would have the lowest rate of corporation tax for trading activities of all the (then) 15 member states in the EU.

The 12.5% rate remains in place today and provides Ireland with a considerable competitive advantage in attracting foreign investment. In the recent past the EU, and in particular France and Germany, have exerted considerable pressure on Ireland to increase the 12.5% tax rate. This has led to some tense exchanges between the three countries and many attribute Ireland's initial rejection of the EU Lisbon Treaty in the 2008 referendum to concerns over potential EU plans to interfere with the Irish corporation tax regime. These concerns centred on the possible removal of the power of the Irish government to veto EU tax changes together with the general move towards tax harmonisation in the EU.

Taxable amounts

Companies which are tax resident in Ireland are subject to corporation tax in respect of their worldwide profits and chargeable gains. Special rules apply to chargeable gains; these are grossed up and taxed at the 12.5% rate which results in an effective rate of 33% being applied to those gains.

Non-resident companies operating in the State through a branch or agency are subject to Irish corporation tax on trading income arising in the State and on income from property or rights owned or used by, or held by or for, a branch or agency in the State. A non- resident company trading through a branch or agency is also subject to corporation tax on chargeable gains but only to the extent that any gains relate to assets which, at or before the time of disposal, were used in or for the purposes of the trade, or held or acquired, or used by, or for, the purpose of the branch or agency. Non-resident companies which are not trading in the State are subject to capital gains tax on the disposal of certain assets located in the State i.e. where chargeable gains arise on assets consisting of land or minerals or mineral rights located in the State, or shares deriving the greater part of their value from land or mineral rights in the State. Non- resident companies are also subject to Irish income tax on certain Irish source income which is not associated with a trade, branch or agency in the State (e.g. rental income) at the basic income tax rate of 20%, although this may be reduced under Ireland's tax treaty network, or under EU directives.

Ireland has introduced a number of measures which make the country an attractive jurisdiction in which to locate a holding company. One of the advantages that Ireland has is the ability for multinational companies to effectively combine a tax-efficient holding company with an active business or "trading" activities taxed at the 12.5% corporate tax rate (e.g. manufacturing, sales/licensing, intellectual property exploitation, research and development, shared services, group procurement, treasury, etc.). Additional reliefs such as research and development or intangible amortization can reduce this rate further.

In many cases Irish holding companies receive only passive income such as dividends, interest and royalties and thus would be subject to the 25% tax rate. However, it will be seen that despite appearing to be passive income, foreign dividends can be exempt or subject to the 12.5% rate in certain circumstances. In addition, credit for overseas tax paid on foreign income may be available under Ireland's double tax treaty network to reduce any Irish tax payable. Where no treaty exists or treaty relief is inadequate, tax relief is also available by means of a unilateral tax credit. Often, in reality, the overseas tax paid exceeds the Irish tax due on the same income and thus there are surplus credits rather than additional tax to pay.

Reliefs for groups of companies

Group Relief - Losses

Ireland does not permit the filing of consolidated tax returns. Affiliated companies may, however, be able to avail themselves of the corporate tax "group relief" provisions to offset trading losses, excess management expenses and excess charges on income within a group of companies.

Irish tax legislation provides that two companies are deemed to be members of a group of companies for these purposes if:

- one company is a 75% subsidiary of the other company; or
- both companies are 75% subsidiaries of a third company

A company is considered a 75% subsidiary of another company if the parent company:

- owns at least 75% of the ordinary share capital; and
- is entitled to not less than 75% of the profits available for distribution to equity shareholders of the subsidiary company; and
- is entitled to not less than 75% of the assets available for distribution in the event of the liquidation of the subsidiary company.

Where a direct or indirect 75% relationship exists, and all the companies are resident in an EU Member State or a country with which Ireland has a double tax treaty (or a country with which Ireland has signed but not ratified a treaty) each of the companies will be deemed to be a member of the group. Companies which are, or whose 75% parent is, quoted on a stock exchange in any of these territories are also members of the group.

The following example demonstrates how the rules apply to multiple levels of company ownership:
Company A owns 80% of company B, and Company B owns 80% of company C (with the remaining 20% of each being held by non-group entities) Company C is not in the same group as Company A for group relief purposes as Company A only indirectly owns 64% of Company C.

The residence of the claimant and surrendering company is also a key area for consideration when determining when group relief is available. For accounting periods ending on or after 1 January 2012 both the surrendering company and the claimant company must be resident for tax purposes in an EU Member State or in Norway or Iceland.

Generally, group relief is only available when both companies are members of the group for the duration of the accounting period to which the claim relates. Where the accounting period of the surrendering company and a corresponding accounting period of the claimant company do not coincide, the profits and losses of the overlapping periods must be time-apportioned and group relief is given in respect of the profits or losses as apportioned to the period common to both accounting periods.

In addition, consortium relief may be available where Company A does not own more than 75% of Company B, but where together 5 or fewer consortium members own between them at least 75% of the ordinary share capital of Company B and together would satisfy the group relief test if their holdings were aggregated.

Group or consortium relief can be paid for on a euro for euro basis without incurring a tax cost.

Group Relief – Chargeable Gains

Where an appropriate relationship exists between the companies, chargeable gains reliefs will also apply to prevent gains arising in relation to assets transferred between group companies and to permit the transfer value for tax purposes to be one which results in neither a gain, nor a loss arising.

Broadly speaking the definition of a group for chargeable gains purposes is similar to that applicable for group relief purposes with a notable exception in that the 75% ownership test does not trace down through the group; it is satisfied or failed at each level within the group.

So in the example above with Company A owning 80% of Company B which in turn owns 80% of Company C, Company C is not a member of Company A's group relief group. It is however a member of Company A's chargeable gains group since Company C is an effective 75% subsidiary of company B, and Company B is an effective 75% subsidiary of Company A.

If the company acquiring an asset intra-group leaves the group within 10 years of the acquisition then the rules require that the previous transfer be amended to recognise the gain or loss which should have arisen at that point in time had the asset been transferred at its open market value. The tax arises in the period of the transfer, but is payable in the period of departure.

The Mergers' Directive may also apply if the entire branch is being transferred to an Irish company, and the claw-back period for relief granted under Ireland's implementation of the Merger's Directive is 6 years.

Group Relief – Stamp Duty

Stamp duty is applicable at a rate of 1% on the transfer of Irish shares, and 2% on most other property although a number of exemptions apply, e.g. in relation to intangible property or foreign shares. Where a transfer is not exempt stamp duty group relief is available on transfers within an effective 90% group, and as with the group relief rules relating to losses, (and unlike the ownership test applicable to chargeable gains group relief) the 90% test traces down through the group.

2) Establishing an Irish Holding Company

Establishing a Holding Company

There is no VAT liability on the formation of a holding company in Ireland.

No stamp duty or capital duty is payable on the issue of shares in an Irish company.

Following the formation of an Irish Holding Company, the shareholder needs to arrange for the subsidiaries to be passed to the new holding company. This can take place by means of a capital contribution or gift of the shares, or alternatively by means of a sale of the shares in the subsidiaries to the holding company in return for cash or the issue of new shares or a combination of both. The tax consequences of these disposals are discussed below and split between disposals by residents and by non-residents. This discussion also highlights where the tax treatment differs depending on the nature of the disposal.

Disposal by an Irish resident company to an Irish resident holding company

The disposal by an Irish tax resident company of shares in a domestic or foreign company to an Irish holding company is subject to corporation tax on chargeable gains unless the disposal qualifies for the participation exemption, group relief for gains or reconstruction relief. Where the parties are connected, and neither the reliefs nor the exemption are available, the transfer will be deemed to take place at the market value of the shares and will be taxed accordingly. Where a capital loss arises by virtue of the disposal in circumstances where a chargeable gain would have been exempt, i.e. where the participation exemption would have applied, the losses are not allowable and cannot be offset against gains on other disposals by the company.

Stamp Duty

Stamp duty is payable by the Irish holding company at the rate of 1% on the transfer of shares in an Irish company to it unless a specific exemption is available e.g. for re-organisations. The stamp duty calculation takes place on the greater of the consideration paid or the fair market value of the shares. Also, stamp duty is only payable on the transfer of foreign shares where the transfer is in return for Irish shares or Irish immovable property.

While many intra group reorganisations will be able to avail of either stamp duty group relief, or stamp duty reconstruction relief, not all will. Where stamp duty is levied on foreign shares purely by virtue of the fact that the consideration is the issue of new Irish shares, the trigger for the tax being the increase in the capital of an Irish capital company, this would seem to breach the Capital Duties Directive 2008/7/EC, a position Irish Revenue have acknowledged.

Disposal of shares by a non-resident company to an Irish Holding Company

Where the disposal of shares to an Irish holding company is by a non-resident company, different issues arise. As we have seen above, a non-resident company is subject to capital gains tax on the disposal of certain assets which are not associated with a trade, branch or agency in the State. If the disposal is of foreign shares there will be no tax consequences in Ireland. If the disposal consists of Irish shares then capital gains tax will apply if greater than 50% of the assets of the Irish company consist of Irish immovable property or Irish minerals or mineral rights. Revenue have taken the position that for the purposes of this test you compare the market value of the property with net assets of the company. However, this was a significantly greater issue in 2008 than it is now. If the majority of the assets of the company do not fall within these categories, there will be no capital gains tax consequences on the disposal of Irish shares by a non-resident company.

The stamp duty consequences will be the same as if the disposal was by an Irish resident.

Transfer of assets to Irish holding company

An alternative means of transferring ownership to the Irish holding company could involve the disposal of assets to it rather than shares. Where the transfer is of the whole or part of a business between two Irish or (subject to some conditions) two EEA companies and provided the following conditions are satisfied, the transfer will qualify as a reconstruction or amalgamation.

This means relief will be available for any tax on chargeable gains which would otherwise be due. The conditions are:

- the transfer takes place as part of a scheme of reconstruction or amalgamation;

- the transferor company must receive no consideration for the transfer (other than the transferee taking over liabilities of the business being transferred);
- where the transferor or transferee are not resident in the State at the time of the transfer then the assets being transferred must be "chargeable assets" (i.e. assets used for the purpose of the trade and which would be chargeable assets for the purposes of corporation tax on chargeable gains) in relation to the non-resident company

Assets transferred under this relief are deemed to be transferred for a consideration that secures neither a gain nor a loss for the transferor. In effect, taxation of the gain is deferred and the receiving company takes on the original acquisition date and cost of the assets transferred for any future disposal.

Where the transfer could qualify for reconstruction relief or group relief for gains then group relief takes precedence. This means that the degrouping charge if the entity leaves the corporate group with the asset within 10 years of the transfer will continue to apply. If the transaction is structured to prevent it occurring under these group relief rules e.g. by using a entity which is not resident in the EU, Iceland or Norway to break the chargeable gains group then there is no claw-back of the relief if the company is later disposed of.

In addition, where a company ceases to carry on a trade and another company immediately takes over that trade, the right to capital allowances and relief for losses may be transferred from one company to the other provided there is substantial common identity (not less than 75%) in the ownership of the trade before and after the transfer.

The relief does not extend to the transfer of trading stock between companies; trading stock is deemed to transfer between connected parties at market value although by joint election the parties can elect for it to transfer at the higher of original cost and the actual purchase price.

Relief from stamp duty is also available for schemes of reconstruction and amalgamation and the conditions to be satisfied broadly follow those for relief from corporation tax on chargeable gains.

3) Funding the acquisition

Pre-acquisition reserves

As a matter of Irish company law merger accounting is prohibited such that the full value of any non-cash consideration will be reflected in the share capital/ share premium accounts of the company issuing consideration shares.

If the assets subsequently fall in value the company may apply to the courts to reduce its capital in order to facilitate the payment of a dividend. This is unusual but becoming more common for groups which were reconstructed towards the end of the boom whose assets will now have significantly fallen in value. The Courts will only sanction such a reduction if they are comfortable that creditors will not be adversely affected. The High Court is currently refusing such an application by Aer Lingus until they make provision for their pension fund deficit although amusingly Ryanair have a separate (older) High Court injunction preventing the Aer Lingus board from contributing cash to the pension fund in respect of the deficit rather than in respect of their ongoing legal obligations.

Any distribution received by an Irish company out of pre-acquisition reserves of its subsidiaries will generally be accounted for as a reduction in the carrying value of those subsidiaries rather than as an item of income and as a result will not itself generate distributable reserves at the level of the Irish company.

While it may be possible to account for such a distribution to result in income recognition, if the directors of the Irish company wish to pay a dividend out of "pre-acquisition profits" of its subsidiary, they will be required to certify that payment of the dividend does not prejudice the rights of any person (normally taken to be creditors). The auditors of the Irish company would also be required to similarly certify that the distribution will not impact company creditors. Auditor certification is not unheard of, but is rare meaning that in practice dividends are not paid out of pre-acquisition reserves.

Any payment of a dividend by an Irish company in connection with the purchase of its shares may constitute unlawful financial assistance in the first instance but in many cases it will be possible for the directors of the company to "whitewash" the issue.

For these company law issues, as well as removing the purchasers' liability to stamp duty in relation to any subsequent share transfer it is not uncommon to have a Jersey/ Guernsey incorporated but Irish tax resident company.

Interest relief

Interest on borrowings used for non-trade purposes, such as the acquisition of shares in another company, may be deductible on a paid basis in certain circumstances. The rules governing such interest deductions are complex and contain many conditions, restrictions and exceptions. Given the detailed nature of these rules it is not intended to examine them in this paper but instead to inform the reader of the possibility of obtaining an interest deduction.

Some specific points are worth noting here. There is a general denial of relief for interest on inter-group borrowings used to finance the purchase of an existing group company. Thus interest on a connected party loan used to finance the acquisition of shares in a group company by an Irish holding company will not qualify for relief unless it falls within one of the detailed exceptions to the rule. There are also anti avoidance provisions within the Taxes Consolidation Act 1997 that seek to deny a tax deduction for interest where the sole or main benefit of a transaction giving rise to the interest expense is a reduction in the tax liability.

The absence of thin capitalisation rules in Ireland means that there is technically no restriction based on the debt/equity levels in an Irish company (although interest costs in excess of a commercial amount can recharacterised as dividends). Subject to the ability of an Irish company to offset the interest on such debt, this omission can encourage debt loading in Ireland.

Finally, provisions exist to recharacterise interest paid to non-resident 75% affiliates as dividends. Where such recharacterisation occurs then dividend withholding tax potentially applies. It should be noted however that non trade interest paid to EU resident 75% affiliates cannot be recharacterised under this heading and where such interest is paid to a non-EU affiliate the group should be structured so as to avoid such a recharacterisation.

In summary, limited opportunities for tax-efficient holding company financing still remain, e.g. for third-party borrowings and for purchases of unrelated companies. However it is important to note that there are strict rules applicable to the tax relief for financing costs and particular care is necessary in structuring to avail of such reliefs.

If the Irish holding company will only receive dividend income and chargeable gains on which there is no tax charge then the lack of a tax deduction in respect of the interest is a moot point except where and to the extent that any interest could be subject to a group relief claim.

Intangible assets

Ireland is keen to encourage high tech businesses to invest in the State and as part of this initiative Irish tax legislation permits companies, subject to certain criteria, to avail of a tax deduction in respect of capital expenditure incurred on the provision of "specified intangible assets" for the purpose of their trade ("an allowance"). The rules allow companies to use the accounting amortisation to establish the deduction for tax purposes or, alternatively, to elect to write off the expenditure incurred over 15 years. The maximum amount deductible in any given year is restricted to 80% of the income arising from managing, developing, or exploiting the specified intangible assets, including the sale of goods or services which derive the greater part of their value from such assets.

Funding costs associated with the acquisition of such assets may qualify for relief under general principles. In order to determine any available deduction funding costs are added to the allowance and the total is measured against the 80% restriction discussed above. Any excess allowance/interest is carried forward for deduction in subsequent periods as if the costs had been incurred in that subsequent period (and again subject to the 80% restriction).

Given the nature of the intangible allowance, it is not surprising that there are anti-avoidance provision which deny the deduction where the main purpose or one of the main purposes of the arrangement is to reduce or avoid tax. These rules also reduce the available relief to the extent that connected party expenditure on specified intangible assets exceeds an arm's length price.

Revenue are entitled to appoint an expert to assist with valuation issues associated with intangible assets. In an unusual addition to the tax law, and due to the sensitive nature of intangible assets, the taxpaying company will be informed of the identity of the expert and can object to the appointment on the basis that the company's trade could be damaged where information is disclosed to this expert. If Revenue are satisfied with the company's objection then the disclosure to this expert shall not take place.

Where specified intangible assets are transferred to an Irish holding company either intra-group or via a scheme of reconstruction or amalgamation such that the transfer takes place for chargeable gains purposes at no gain no loss then the allowance for intangible assets is not available to the acquirer. If the companies jointly elect to disapply the no gain no loss treatment then the acquirer shall be entitled to the allowance but there will be tax due on any chargeable gain where the assets have increased in value.

In addition, where the intangible assets at the date of the transfer have benefitted from an earlier allowance there may also be a write back of the allowance for the transferor; it may, however, be possible to avoid this write back by making an election.

Whilst the objective of the provisions relating to the transfer of intangibles between group companies is undoubtedly to prevent double relief, the reality is that where an asset has increased in value since it was acquired by the group, the intangible allowance cannot "pass" from the transferor to the transferee without a chargeable gain (and possibly also a write back of any allowance previously granted) arising on the transferor at that time whereas the tax relief for the transferee would only be available over time. In this situation it is therefore necessary for the taxpayer to evaluate the best course of action based on the actual values relating to the intangibles being transferred.

The definition of specified intangible assets is broad and includes the acquisition of, or the licence to use:

- patents and registered designs, design rights or invention
- trademarks and brand names,
- know-how,
- secret processes, formulae or other secret information concerning commercial, industrial or scientific experience,
- domain names, copyrights, service marks and publishing titles,
- authorisation to sell medicines, a product of any design, formula, process or invention (and any rights derived from research into same), certain computer software and or right to use/deal with computer software, and
- goodwill, to the extent that it directly relates to the assets outlined above.

The provision of incentives for research and development expenditure and relief for the acquisition of intangible assets have become key issues for high tech international companies. Ireland's regime leaves it well placed to compete for investment from these businesses.

4) Taxation of Income and Gains from shares

Disposal of shares

Under certain circumstances the disposal of shares in a subsidiary by an Irish holding company will be exempt from Irish capital gains tax. In order to qualify for this exemption the holding company must hold at least 5% of the ordinary shares for a continuous period of 12 months. If the first disposal occurs before the shares have been held for 12 months, but the 5% twelve-month test is subsequently met, then the earlier disposal is exempt.

On the occasion that an Irish company is gradually exiting its shareholding in another entity the final disposal, in order to be exempt, must take place within 2 years of this requirement last being satisfied.

The shares which are being disposed of must be in a company which is tax resident in an EU Member State or in a country with which Ireland has concluded a double tax treaty. Shares in a company which is tax resident in a country with which Ireland has signed but not ratified a treaty will also qualify for the relief. In all instances the shares must be in a trading company or the group must be a trading group. For these purposes the group constitutes the disposing company and its 5% subsidiaries but ignores entities above or to the side of the Irish entity in the corporate group. The trading requirement will be satisfied where trading constitutes greater than 50% of the activities. This relief is quite generous when compared to the equivalent UK relief and several relaxations of the potentially strict criteria apply e.g. the shareholdings of other members of the same group can be aggregated to meet the required holding. In addition, the disposal of shares in a non-trading company may qualify for relief provided that the group as a whole is a trading group. The relief may also apply to the disposal of assets related to shares e.g. convertible debt.

The relief is, however, not available where the greater part of the value of the shares derives from Irish real property or certain Irish natural resources.

Dividends paid by an Irish Holding Company

A typical concern for investors choosing a holding company location is the rate of withholding tax on outbound dividends. Dividends paid by an Irish holding company to its shareholders are exempt from Dividend Withholding Tax (DWT) where the recipient is an Irish tax resident company. Dividends paid to an Irish tax resident individual are subject to withholding tax of 20%.

Irish withholding tax on dividends, currently 20% is subject to a number of exceptions. Several of these exemptions relate to situations where an Irish holding company is controlled directly or indirectly by persons resident in an E.U. Member State, in a tax treaty country or in a country with which Ireland has signed but not ratified a tax treaty ("Qualifying Countries")

Situations where an exemption from withholding tax is available include when a dividend is paid;

1) to individuals resident in a Qualifying Country;
2) to a company resident in a Qualifying Country which is not controlled by Irish residents
3) to a foreign company under the ultimate control of persons resident in a Qualifying Country

4) to a non-resident company listed on a recognised EU stock exchange in a Qualifying Country or on a stock exchange approved by the Minister of Finance or a 75% subsidiary of such a listed company

5) to a non-resident company which is wholly owned, directly or indirectly by two or more companies which are listed on a recognised stock exchange in Qualifying Country or another stock exchange approved by the Minister for Finance

6) by an Irish subsidiary company to its parent in accordance with the conditions contained in the EU Parent Subsidiary directive.

It is possible to self-assess by means of a declaration that the recipient company meets the necessary criteria and this declaration must be repeated every 6 years. Relief may alternatively be available by way of pre-approval to pay the dividend gross or with reduced withholding tax under the provisions of a relevant tax treaty.

Dividends received by an Irish Holding Company

Dividends received by an Irish resident company from another Irish tax resident company are generally exempt from corporation tax. Anti-avoidance provisions ensure that this exemption does not apply when the profits out of which the distribution is paid were actually earned by the paying company whilst it was resident outside the state and controlled by persons in the state. In addition it is interesting to note that dividends received from an overseas incorporated company which is tax resident in Ireland are Irish source income and hence exempt and dividends received from an Irish incorporated company which is tax resident overseas are foreign source income.

Whilst dividends may typically be regarded as passive income the distinction between the 12.5% and 25% rates of corporation tax is modified in the case of foreign dividend income. In light of the FII GLO decision in the Court of Justice of the European Union, foreign sourced dividends should not be subject to a higher rate of tax than domestic sourced dividends. This has been interpreted as meaning that because Irish trading profits are taxed at 12.5%, trading profits received from EU or tax treaty companies by means of inbound dividends should also be charged at this rate. Thus, in order to determine the rate of tax applicable to foreign dividend income received in Ireland, it is necessary to look at the source of the payment and the nature of the profits used to make the payment. It is important to note that the FII case went back before the Court of Justice as C-35/11 in relation to whether the original Court decision related to the effective or nominal rate of tax applicable to foreign dividends. The Court confirmed that where credit is given for the effective rate, which in many cases will be other than the nominal rate, an exemption system for domestic dividends is not comparable to a credit system for foreign dividends and EU law is breached in November 2012. Irish tax practitioners expected a change to the Irish regime to be announced in Budget 2013 on 5 December 2012 but this did not happen. Changes to make the Irish regime EU law compliant are now expected to be included in the Finance Bill 2013 which will be released in early 2013.

Furthermore, the Haribo case c-436/08 makes clear that Ireland's exemption of domestic portfolio dividends while taxing foreign portfolio dividends, albeit perhaps at the 12.5% rate, is incompatible with the free movement of capital.

The source test is satisfied where dividends are paid by an E.U. resident company; a company resident in a treaty partner county; a company resident in a country with which Ireland has signed but not ratified a tax treaty or a company resident in a country which has ratified the Convention on Mutual Administrative Assistance in Tax Matters ("Qualifying Companies"). It is also satisfied where the company paying the dividend is quoted and its shares are regularly dealt on a recognised stock exchange in an E.U. country, a treaty country, a country with which Ireland has signed but not ratified a tax treaty, or in a country which has ratified the Convention on Mutual Administrative Assistance in Tax Matters. Finally the test is also satisfied where the dividend paying company is at least 75% owned by such a quoted company. Other stock exchanges may qualify as recognised stock exchanges if approved by the Minister of Finance.

As regards the nature of the profits, in order to qualify for the 12.5% corporate tax rate trading profits must be used to pay the dividend. It is permissible to look through tiers of dividend paying Qualifying Companies to establish if the dividend has its origin in trading profits. Amounts shall be treated as paid out of trading profits if:

i) 75% or more of the profits of the paying company are either trading profits of that Qualifying Company, or dividends received by it out of trading profits of lower tier subsidiaries which are Qualifying Companies and

ii) the aggregate value of the trading assets used by the dividend receiving company and all its subsidiaries is at least 75% of the aggregate value of all the assets of those companies. Loans between the companies and the ownership of each other's shares are not assets for the purpose of this test.

Where the tests are satisfied the entire dividend will qualify for the 12.5% rate despite the fact that the source of the dividend may not be 100% trading profit. n cases where the conditions are not satisfied and only part of the dividend is derived from trading, then the corresponding element of the dividend will be liable to tax at 12.5% with the balance taxable at 25%.

Where the Irish company owns (either alone or together with its associates) 5% or less of the shares and holds less than 5% of the votes in the foreign Qualifying Company then a corporate tax rate of 12.5% will apply. This is achieved by deeming the dividend in relation to such a holding to have been paid from trading profits.

In a case where a dividend would otherwise fall to be included in the trading profits of the Irish recipient company, this dividend is exempt from corporation tax. Thus foreign dividends which would be regarded as constituting trading income for an Irish portfolio investor company are not charged to Irish corporation tax.

All other dividend income is subject to tax at 25%.

It is necessary to claim the reduced rate of dividend taxation by including it with the relevant tax return. However, where the dividend has suffered a high rate of overseas tax (i.e. greater than 25%) it may be appropriate to forgo the 12.5% rate as no Irish tax will be payable even if the dividend is subject to tax at 25% plus any excess foreign tax credits could then be used against dividend income charged at the 25% rate.

Protective claims based on the decision in FII GLO should be considered where Irish tax was paid on EEA subsidiary dividends.

5) Double tax relief

EU issues

Dividends which meet the qualifying conditions in the Parent Subsidiary Directive are subject to withholding tax at 0%. EU dividends paid to an Irish company outside the Directive may be subject to withholding tax in the country of origin at the prevailing rate or at the relevant treaty rate. This withholding tax can be relieved in Ireland under the credit method provided a 5% shareholding exists. In addition relief will be available for underlying tax suffered by the foreign company or lower tier subsidiary where at least a 5% shareholding is established at each tier. If the 5% minimum shareholding is not satisfied, tax relief is not available under the Parent Subsidiary Directive. In this situation foreign withholding tax may be deducted in arriving at Irish taxable profits but there is no relief for any underlying tax. The latter domestic provision has recently been superseded by the decision in the Court of Justice of the European Union in the Haribo case (see below).

Bilateral treaty provisions

Under the tax treaty network double tax relief is available in Ireland in respect of withholding tax on income received in the form of dividends from foreign companies. Relief is also available for underlying taxes on the profits out of which those dividends are paid.

Unilateral credit relief

Tax relief for foreign tax on dividends received applies to dividends from a 5% or greater shareholding in a foreign company and extends to cover foreign withholding tax, underlying tax and foreign tax paid by lower tier subsidiaries. Typically the foreign rate will be in excess of 12.5% and therefore no further tax is due. Where the 5% holding requirement is not satisfied then foreign tax relief is available by means of a deduction in arriving at Irish taxable profits. However the recent Haribo case has clarified that where, as in Ireland, domestic portfolio dividends are exempt then foreign portfolio dividends relating to a less than 10% stake, should be either exempted or subject to credit relief for both underlying and withholding tax. This ruling supersedes the domestic provision. Thus either total exemption or relief for both underlying and withholding tax should be available in relation to dividends from shareholdings of less than 5%. This relief is not available for dividends from all countries as the ruling also held that Ireland is permitted to make such relief contingent on the existence of mutual administrative assistance between Ireland and the paying jurisdiction. Where the ruling does apply there is also a practical problem in that a portfolio shareholder is unlikely to be able to gain access to the information needed in order to reclaim underlying tax credits in relation to the dividend.

Tax pooling

Ireland also has a tax credit pooling system which enables high and low taxed dividends to be blended together to produce an average rate of tax credit for offset against tax due on foreign dividends. This prevents the loss of tax credits which exceed the Irish liability to tax by allowing such excess credits to be used against dividends where the foreign tax paid is less than the Irish rate. Pooling is only available where the Irish company controls directly or indirectly 5% of the voting power of the paying company. Due to the two tier corporate tax rate it is necessary to have separate pooling arrangements for dividends taxable at 25% and 12.5% as it is not possible to offset surplus foreign tax on dividends taxed at 12.5% against dividends taxed at 25%. Excess credits arising on dividends taxed at the higher rate can be used to offset tax due on dividends in either pool.

This factor has to be considered in terms of making an election for any particular dividend in that it may be preferable not to make the 12.5% election in respect of a dividend with a particularly high tax credit attaching, thereby allowing the excess credit be offset against any dividends taxable at the 25% rate with insufficient credits attaching. In reality Irish holding companies rarely pay tax on their foreign dividend streams, but have an onerous compliance obligation because of the need to identify the source profits at the level of each underlying subsidiary. Where the participation exemption applies it may be preferable to effect profit repatriation by means of share buy-backs provided that under local law such buy-backs constitute a capital rather than an income distribution. This avoids the compliance obligations associated with dividend streaming.

6) Other Issues

Deduction of costs

Generally the management expenses of the holding company are deductible for the purposes of calculating the holding company's taxable profit. This relief may extend to a deduction for interest on loans relating to the acquisition of shares.

Thin Capitalisation

Ireland does not have thin capitalisation rules per se but may characterise interest as non-deductible in certain cases. Ireland will generally look as to whether the interest rate is excessive rather than what the debt to equity levels are. Excessive interest on payments to connected parties, or profit dependent interest on all loans not issued by a securitization company are treated as distributions.

Controlled Foreign Companies

Ireland does not currently have controlled foreign company rules.

Transfer Pricing

Ireland introduced comprehensive transfer pricing legislation in the Finance Act 2010 and the new regime comes into effect for accounting periods commencing on or after 1 January 2011.

The legislation requires the use of the arm's-length principle in respect of associated party transactions and applies to domestic as well as cross border related party transactions. A welcome exemption from the new rules is available for small and medium-sized companies.

There were few transfer pricing provisions in Irish tax legislation before the introduction of the new rules but transfer pricing was nonetheless an important issue for Irish companies with an international dimension, e.g. for multinationals operating in Ireland and for Irish companies operating abroad. This was because transfer pricing legislation in overseas jurisdictions influenced the pricing of connected party cross border transactions carried out with Irish resident companies and it is therefore expected that the introduction of the new rules will not result in significant changes to the prevailing manner of pricing transactions in Ireland. In practice, any significant change to transaction pricing in Ireland is more likely to result from the ongoing work of the OECD in areas such as the transfer pricing of intangible assets.

The new transfer pricing rules apply to transactions entered into between associated companies where these involve the supply or acquisition of goods, services, money or intangible assets and only apply where such activities relate to trading activities within the charge to Irish tax at the rate of 12.5%. Thus activities that are non-trading or "passive" in nature and which are taxed at the higher rate of 25% are not subject to the new regime. This excludes items such as certain interest and some royalties but as noted above the transfer pricing rules in other jurisdictions are likely to influence the transaction value of such passive income where an Irish company is dealing with a related party overseas.

VAT

The extent of the holding company's activities determines its liability to VAT. Where the holding company merely owns shares then it will not need to register for VAT. This of course means that the VAT on inputs is not recoverable. In practice Irish Revenue have allowed holding companies form part of a Group VAT registration even though they themselves may not qualify for a VAT registration but the European Commission is challenging this position. Ireland is robustly defending its position. The Commission referred the matter to the Court of Justice in June 2010 with Ireland being among 7 States defending their VAT grouping rules

If a holding company does not form part of a VAT group care should be taken if the holding company receives services from abroad, e.g. overseas accountants, as this will impose a requirement to register and account for VAT on such services. Similarly if the holding company charges management fees then it will constitute a taxable person for VAT purposes.

Other issues

Generally the corporate tax regime in Ireland is focussed on actively promoting inward investment in the country and Ireland's reliance on such investment means that the government are particularly receptive to measures that will enhance the country's attractiveness to foreign investors.

The attitude of the Irish government to the concerns of multinational inward investors often results in the introduction of specific legislative measures to assist this element of the economy. As an example of this legislation was introduced in 2009 and extended in 2012 which permits certain companies to use US GAPP in the preparation of accounts for Irish companies until December 2020. The rule aims to facilitate the migration of companies to Ireland and the establishment of new businesses in Ireland and the provision is of significant benefit to US companies as it permits eligible companies to use US accounting principles without the considerable burden of also preparing accounts in accordance with IFRS/Irish GAAP. The rules provide for this special treatment to be available in relation to other internationally approved accounting standards with the approval of the Minister for Finance.