Ireland joins revised OECD Agreement on international tax reform

Ireland's Minister for Finance remains confident that Ireland will remain an attractive location and 'best in class' when multinationals look to investment locations following agreement to the OECD tax proposals.

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Agreement

On 8 October 2021 agreement was reached between 136 countries including Ireland on a revised agreement for a two-pillar approach to international tax reform ("**the OECD Agreement**"). Amongst other things, Pillar One proposes a re-allocation of a proportion of tax to market jurisdictions, while Pillar Two seeks to apply a global minimum effective tax rate of 15%.

Ireland had previously indicated its support for Pillar One (which will initially apply to groups with global turnover above €20 billion and profitability above 10%) but had reservations in respect of Pillar Two and, in particular, the phrase "at least 15%" in the context of the minimum effective tax rate. Having secured the removal of "at least" in the text, Ireland confirmed its agreement to the proposal. Ireland has also obtained assurances from the EU Commission that it will not seek to impose a corporate tax rate above 15% at an EU level and that any directive will mirror the OECD proposals so will not result in EU companies being subject to additional tax costs. Our view is that a directive is not necessary, is not desirable and gives rise to Irish constitutional issues – as discussed in our submission here to the Irish Department of Finance on the OECD proposals.

Ireland's Minister for Finance, Paschal Donohue stated that the OECD Agreement:

"will provide the critical certainty for Government and industry and will provide the long-term stability and certainty to business in the context of investment decisions"

Impact on Ireland's favourable tax regime

Ireland has for many years been one of the most attractive locations for foreign direct investment ("**FDI**") across many industries. It has also been an attractive location for the establishment of holding companies of both listed and private multinational groups and for intellectual property onshoring.

One of the reasons for Ireland's popularity is its favourable tax regime (which extends far beyond the 12.5% corporate tax rate) and the fact that it is an onshore EU jurisdiction with an extensive network of double tax treaties and trade agreements. Notwithstanding the OECD Agreement, this continues to be the case.

12.5% Corporation Tax Rate

Importantly, Ireland has confirmed that there will be no change to the 12.5% corporation tax rate for multinationals and domestic businesses with revenues below €750million and therefore the vast majority of businesses in Ireland will be outside the scope of the OECD Agreement. The Irish Department of Finance has confirmed that this will mean that there will be no increase in the corporate tax rate for one hundred and sixty thousand businesses representing approximately 1.8 million employees.

Substance Based Carve-out

Minister for Finance, Paschal Donohue noted that a key aspect of the OECD Agreement was the *"recognition of the important role that research and development plays in the modern global economy and society"*.

This is a reference to the substance-based carve-out of 5% of the carrying value of tangible assets and payroll which will reduce the tax base on which the worldwide minimum 15% tax rate will be applied. In a transition period of 10 years, the amount of income excluded will be 8% of the carrying value of tangible assets and 10% of payroll, declining annually by 0.2 percentage points for the first five years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the last five years. This substance-based carve-out may support multinationals within the scope of Pillar Two of the OECD Agreement who continue to locate their employees and tangible assets in Ireland. While it may have been intended to address the concerns of countries seeking special treatment for research and development costs, the carve-out is not limited to this type of activity.

Other exclusions

The OECD Agreement also includes a number of other exclusions from the minimum 15% rate as follows:

- A *de minimis* exclusion for those jurisdictions where the multinational has revenues of less than €10 million and profits of less than €1 million;
- A limited exclusion for multinationals in the initial phase of their international activity;
- Government entities, international organisations, non-profit organisations, pension funds or investment funds that are Ultimate Parent Entities (as defined) of a multinational group or any holding vehicles used by such entities, organisations or funds; and
- International shipping activities.

Tax Reform

Certainty over the terms of the OECD Agreement and the technical details which are expected to be published in November 2021 will allow Ireland to reform its tax system to best accommodate the provisions of the OECD Agreement.

Ireland's negotiations on the OECD Agreement over recent weeks and months has demonstrated its commitment to retaining an attractive and stable environment for multinationals and it is expected that our implementation of the OECD Agreement and related tax reform will reflect this. We highlighted some of the necessary reforms in our above-mentioned submission to the Irish Department of Finance on the OECD proposals.

Summary Ireland's favourable tax regime

Corporation Tax on profits	12.5% on trading profits for companies (will continue post implementation of Pillar Two rules for unaffected companies) 25% on passive income and 33% on gains from disposal of assets
Sale of subsidiaries	The sale or disposal by an Irish holding company of shares in a subsidiary company resident in an EU Member State or a country with which Ireland has a double tax treaty should be exempt from Irish capital gains tax (otherwise chargeable at a rate of 33%) provided certain conditions are satisfied.
Dividend income	While Ireland does not have a full participation exemption in respect of foreign dividends, Ireland has a flexible system for granting foreign tax credits which can minimise or eliminate Irish tax on dividend income. Ireland provides for unilateral credit relief for foreign withholding tax and underlying taxes on dividends paid to an Irish resident company.
Repatriation of profits	There are a wide range of exemptions from dividend withholding tax (at a rate of 25% since 1 January 2020) on repatriations by an Irish company to its shareholders.
R&D incentives*	A company that incurs expenditure on R&D may avail of a tax credit of 25% on all R&D expenditure incurred (subject to certain conditions) in addition to the tax deduction of 12.5%. The combined effect of these provisions is that it is possible to obtain tax relief at an effective rate of up to 37.5% of expenditure on R&D. The Knowledge Development Box is a type of tax relief which applies to income from qualifying patents, computer programmes and, for smaller companies, certain other certified intellectual property. It is aimed at incentivising companies to undertake

	innovative activities in Ireland by providing an effective 6.25% corporate tax rate for profits generated from the sale or exploitation of certain intellectual property. Tax depreciation can be claimed on capital expenditure incurred by companies on the provision of certain “specified intangible assets”. The definition of specified intangible assets is widely drafted and includes software, patents and registered designs, trademarks, brands, domain names, copyright, etc.
Royalty payments	Limited royalty withholding taxes on payments out of Ireland (only in respect of patent royalties which is subject to certain exemptions).
Interest payments	Interest paid by an Irish resident company is subject to a 20% withholding tax. However, a number of exemptions are available as a matter of Irish law without needing to rely on Ireland’s extensive treaty network. For example, no interest withholding tax applies to interest paid: (a) to companies resident in an EU/tax treaty country; or (b) on listed bonds or commercial paper.
Stamp Duty	No capital duty or stamp duty is payable on share subscriptions in, or debt financing of, an Irish incorporated company. No stamp duty is generally payable by an Irish company on the acquisition of shares in non-Irish companies.
Tax on Exit	A non-Irish resident person without an Irish taxable presence disposing of shares in an Irish incorporated company will not have a liability to Irish tax unless the shares are unlisted and derive the greater part of their value from Irish land, minerals or exploration rights.
ATAD 1 and 2	Ireland is in the course of implementing the anti-tax avoidance directives, known as ATAD 1 and 2, with interest limitation and reverse hybrid rules to be introduced with effect from 1 January 2022.

* Subject to the possible impact of Pillar Two rules for affected companies.

Next Steps

There are many technical details in respect of the OECD Agreement to be resolved over the coming weeks. Model rules to give effect to Pillar Two will be developed by the end of November 2021. These model rules will define the scope and set out the mechanics of Pillar Two and they will include details on determining the effective tax rate on a jurisdictional basis and the relevant exclusions, such as the substance based carve-out.

The OECD Statement indicates that Pillar Two should be brought into law in 2022, to be effective in 2023. This timetable may be contingent on US President Joe Biden getting his tax reform package, which incorporates the OECD deal, through the US Congress. There is no clarity on what happens next if this fails.

What You Can Do in Response

There will be further negotiation of the detail of the proposals and taxpayers and their advisers should remain engaged with the process at an OECD and national level.

Rate differentials will remain between Ireland and the high tax countries. Ireland retains a compelling case for FDI based on its young, educated population, its global connectivity, its position as the only English speaking EU Member State, its business friendly environment and its common travel area agreements with the UK. In assessing any FDI project, you should include Ireland on the list of possible locations.