Finance Act 2019 and other relevant tax updates for corporate treasurers

Introduction

On 22 December 2019, Finance Bill 2019 was signed into law by the President. Below is a brief overview of some of the key changes being introduced into Irish law on foot of this of relevance for corporate treasurers, namely:

1. Introduction of hybrid mismatch rules;
2. Updates to Irish transfer pricing rules;
3. Transposition of EU Mandatory Disclosure rules into Irish law; and
4. Other technical amendments of note;
    a. Amendments to the section 110 securitisation regime;
    b. Codifying existing practice relating to the tax treatment of stock borrowing and repurchase arrangements;
    c. Clarifying the tax treatment of impairment losses on foot of the introduction of IFRS9

In addition to the above, other recent tax developments of note to corporate treasurers include:

1. Future changes to Irish interest deductibility rules;
2. OECD proposals for a global minimum tax rate

Hybrid mismatch rules

Finance Act 2019 contains provisions to transpose the anti-hybrid rules that were largely contained in the EU's second Anti-Tax Avoidance Directive ("ATAD2") and that were required to be introduced by 1 January 2020.

The transposition of these rules had been the subject of a public consultation launched by the Department of Finance in November 2018, as well as a feedback statement in July 2019 which responded to submissions made by interested parties.

Broadly, the anti-hybrid rules apply to transactions between "associated enterprises" and aim to prevent taxpayers from exploiting differences in countries' tax systems by obtaining a double deduction for the same expense or by securing non-taxation of income that has been deducted for tax purposes elsewhere. The two key ways in which the anti-hybrid rules achieve this are by either disallowing the expense deduction by the payer or by imposing taxation on the income in the hands of the recipient. The anti-hybrid rules will apply to payments made or arising on or after 1 January 2020. For corporate treasurers, the use of certain financial instruments for cross-border intragroup financing may still be efficient from a tax perspective going forward, although a careful assessment of the impact of these rules on intra-group financing flows is critical.

Irish transfer pricing rules

Much anticipated changes to Irish transfer pricing rules were included in Finance Act 2019. The changes represent a significant broadening of the scope of the rules and also align them with the latest OECD principles.

The new rules include the formal adoption of the latest (2017) version of the OECD Transfer Pricing Guidelines and broadens the scope of transfer pricing in Ireland to cover the following:

a. Non-trading transactions (exemption for some Irish domestic transactions, subject to certain anti-avoidance rules);

b. Bringing within scope arrangements that had previously been considered grandfathered (i.e., pre- 1 July 2010 arrangements when Ireland first introduced specific transfer pricing rules);
c. Capital transactions for computations of capital allowances and chargeable gains (where the market value is over €25 million); and
d. Transactions within SME groups (with transfer pricing documentation requirements for SMEs on hold, subject to ministerial order).

Importantly, in relations to financial transactions, the new Irish rules (introducing the 2017 OECD Guidelines) require that taxpayers consider whether they could and would have taken on the levels of debt that may be introduced through intra-group financing. In other words, it will be necessary to consider the debt capacity of Irish borrowers as part of the transfer pricing analysis.

The updated transfer pricing rules apply for chargeable periods commencing on or after 1 January 2020 and, in respect of claims for capital allowances, where the related capital expenditure is incurred on or after 1 January 2020.

The new rules introduce more prescriptive transfer pricing documentation requirements, namely the need to prepare a Local file (revenue threshold of €50 million) and a Master file (revenue threshold of €250 million) in line with Annex I and II of Chapter V of the 2017 OECD Transfer Pricing Guidelines. These documents may be requested by Irish Revenue in the course of an audit and the taxpayer has 30 days to provide. There is higher rate of penalty for taxpayers who fail to comply with a request to provide transfer pricing documentation to Irish Revenue. In particular, failure to provide a Local File within 30 days of request will incur a penalty of €25,000 plus €100 per day thereafter. Failure to provide other information on transfer pricing arrangements to a Revenue officer when requested, will incur a penalty of €4,000.

In addition to the new Irish rules, in February 2020, the OECD also released its final guidance on the transfer pricing aspects of financial transactions. This is the first consensus guidance to taxpayers and tax administrations as to how to price intra-group financial transactions (including loans, guarantees and other financial instruments).

These changes, as well as a general increase in detailed transfer pricing audits by the Irish tax authorities, mean this will continue to be an area of increased focus and one which corporate treasurers and their tax colleagues need to be attuned to.

EU Mandatory Disclosure rules

The EU Tax Intermediaries Directive (the "Directive", or "DAC 6") is effective from 25 June 2018, being transposed into Irish law on foot of the passing of Finance Act 2019. In line with the Directive, the Finance Act requires intermediaries, or taxpayers in certain circumstances, to disclose certain "reportable cross border arrangements" with characteristics referred to as "hallmarks" to Revenue. Details of disclosable arrangements taking place from 25 June 2018 need to be maintained between now and 1 July 2020 to be disclosed to Revenue on 1 August 2020, with any further disclosable arrangements generally being required to be disclosed within 30 days of the first step of such arrangement being undertaken. Failure to adhere to these requirements can attract various penalties including potentially a charge of €500 per day per disclosable transaction.

The obligation to disclose such arrangements can fall to a number of different parties depending on the specific circumstances. In many instances, the obligation may lie with the tax advisor. However, there will be certain circumstances where the taxpayer will be required to make the disclosure themselves.

The breadth of potentially disclosable transactions is very broad and could require disclosure of routine transactions with no tax avoidance motive (for example, a branch/permanent establishment deducting tax depreciation in both the head office and branch jurisdiction). As such, corporate treasurers (in conjunction with their tax colleagues/advisors) need to be atuned to whether any cross-border financing arrangements could come within the remit of these disclosure requirements, as well as potentially the migration of any treasury functions or assets from another jurisdiction into Ireland.

Other technical amendments of note

In addition to the above, there were also a number of smaller technical amendments introduced in Finance Act 2019:

a. **Section 110 securitisation regime:** While the new transfer pricing rules and requirements will apply to such entities, there is an important exclusion in respect of profit participating notes issued by such entities. This prevents a direct conflict in legislation and instead, additional anti-avoidance provisions were introduced and also provisions to broaden the definition of a "specified person" to strengthen the protections against abuse of the regime.

b. **Stock borrowing and repurchase agreements:** Finance Act 2019 has introduced legislation in respect of the Irish tax treatment of stock borrowing and repurchase agreements. Previously, the tax rules governing such transactions had been contained in Statements of Practice. In substance, both stock borrowing and repurchase agreements are a form a short-term lending and are generally reflected in the accounts of participants as such. The new legislation aims to ensure the tax treatment follows the substance of such transactions where they are concluded within 12 months or less (being a short-term loan) where specified criteria are met.

c. **Tax treatment of impairment losses:** A new provision was introduced into Irish tax law with respect to IFRS 9, clarifying that impairment losses calculated on foot of either IFRS or Irish GAAP will be deductible for Irish corporation tax purposes for accounting periods beginning on or after 1 January 2018.

Future changes to interest deductibility rules

Under ATAD, Member States were required to introduce interest limitation rules which broadly provide that excess borrowing costs will only be deductible up to 30 per cent of a taxpayer's tax adjusted earnings before interest, tax, depreciation and amortisation (EBITDA) to take effect from 1 January 2019.

However, Member States that have national targeted rules for preventing BEPS which are equally effective to the interest limitation rule in the ATAD are granted a transitional period from implementing the rules dealing with interest deductibility in the ATAD. Any such Member State may continue to apply those existing, targeted rules until the end of the first fiscal year following the publication of the agreement between the OECD Member States on a minimum standard with regards to BEPS Action 4 (which deals with interest deductibility) or at the latest, until 1 January 2024.

Although the Department of Finance had initially stated in 2016 that it viewed Ireland as a jurisdiction that already has strong targeted anti-avoidance rules and that the implementation of the interest restriction rules should therefore be deferred (in the Department's view) to 2024 in the case of Ireland, this was subsequently refuted by the European Commission culminating in infringement provisions being issued against Ireland in July 2019. It has been accepted by the Department of Finance that the introduction of an ATAD compliant interest restriction rule will be brought forward. Although no changes were introduced in Finance Act 2019, it is expected these rules will be updated to be in compliance with ATAD as soon as possible and therefore could feature in the next Finance Bill towards the end of 2020. Such changes will evidently have an impact on intercompany financing involving Irish entities and the form such changes take should be monitored by corporate treasurers in the coming months.

OECD proposals on global minimum tax rate

In May 2019, the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) Action 1 agreed on a Programme of Work (POW) for addressing tax challenges arising from digitalisation of the economy. The POW is divided into two pillars:

a. Pillar One addresses the allocation of taxing rights among jurisdictions and considers various proposals for new profit allocation and nexus rules; and

b. Pillar Two (also referred to as the 'GloBE' proposal) seeks to develop rules that would provide jurisdictions with a right to 'tax back' where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation.

The GloBE proposal is based on the premise that, in the absence of a co-ordinated and multilateral solution, there is a risk of uncoordinated, unilateral action- both to broaden the tax base and to protect the existing tax base - with adverse consequences for all jurisdictions.

The GloBE proposal has the objective of taxing cross border income at minimum tax rates, consistent with principles of design simplicity to minimise compliance and administration costs and the risk of double taxation. The four parts of the GloBE proposal are:

a. an **income inclusion rule** that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;
b. an **undertaxed payments rule** that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at or above a minimum rate;
c. a **switch-over rule** to be introduced into tax treaties that would permit a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to an effective rate below the minimum rate; and
d. a **subject to tax rule** that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate.

These rules would be implemented by way of changes to domestic law and tax treaties and would incorporate a co-ordination or ordering rule to avoid the risk of double taxation arising where more than one jurisdiction seeks to apply these rules to the same structure or arrangement.

Critically, these proposals have much broader application that just digital companies and depending on the scope of what is finally agreed have the potential to impact tax efficient financing of multinational groups.

Conclusion

The impact of international tax reform on intercompany financing and corporate treasurers has been closely followed by interested parties. A particular area of concern has been the proposed interest deductibility restriction rules and the concern that such provisions may unduly influence the manner in which intercompany financing is provided.

Whilst the agreed interest deductibility restrictions under the EU ATAD will no doubt impact some multinationals, any adverse effect in Ireland may be minimised by a number of relieving options available to Member States on implementation.

What is potentially of greater importance for groups that utilise dedicated treasury or finance companies in favourable locations is the updated transfer pricing rules and hybrid rules recently introduced in Finance Act 2019 as well as the OECD proposals regarding a minimum tax rate.

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