International Tax Update

April 2019

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Introduction

1 Maples Group Tax Offering Expansion

1.1 The Maples Group Tax team has expanded and now offers legal tax advice from offices in both Ireland and Luxembourg. Our long standing Irish tax expertise is now complemented by the addition of our Luxembourg colleagues. Both Ireland and Luxembourg are well established as European jurisdictions of choice for cross-border tax and complex multi-jurisdictional transactions, as well as having reputations for stability and efficiency.

1.2 As clients examine how best to maintain and enhance their European presence and access to its markets in light of continuing developments with Brexit and the OECD’s Base Erosion and Profit Shifting project ("**BEPS**"), many have chosen Ireland or Luxembourg as jurisdictions in which to operate. The Maples Group's Luxembourg tax offering will build on the firm's highly successful Irish legal practice.

1.3 The Maples Group also offers tax compliance and tax reporting services in Ireland, Luxembourg and a number of other jurisdictions in which we operate.

2 Tax Update Summary

2.1 Implementation of international tax measures is the focus of this update. Both Ireland and Luxembourg are implementing changes required under the EU Anti-Tax Avoidance Directive ("**ATAD**") and BEPS. We examine the introduction of controlled foreign company ("**CFC**") rules, exit taxation, the interest limitation rule and anti-hybrid rules.

2.2 Ireland is engaged in a series of consultations on implementation of the ATAD rules on interest limitation and hybrids. The hybrid measures are to be included in Finance Bill 2019 and while Ireland continues to seek to defer implementation of the interest limitation rules, it is possible that they could be introduced as early as 2020.

2.3 The €1.6 billion assessment levied on pharmaceutical company, Perrigo, by the Irish Revenue Commissioners ("**Irish Revenue**") is of understandable interest to multinationals based in Ireland but, in reality, is based on a very specific set of facts.

2.4 If you have any questions on issues considered in this update, please contact the Maples Group Tax team or your usual Maples Group contact for further assistance.

3 EU ATAD – Interest Limitation Rule

3.1 The interest limitation rule in ATAD requires, broadly, EU Member States to limit tax deductions for net borrowing costs to 30% of a taxpayer’s earnings before interest, tax, depreciation and amortisation deductions ("**EBITDA**").

Ireland

3.2 When ATAD was first adopted by the EU Council in July 2016, Ireland took the position that existing Irish rules on interest limitations were "equally effective" to the ATAD restrictions. This would allow Ireland to defer adoption until 1 January 2024 under the terms of ATAD. However, more recent official statements from the Irish Department of Finance suggest that such a derogation may not be available. For that reason, the Government has announced that the introduction of the rules may occur earlier than previously indicated, and possibly as early as 1 January 2020. The interest limitation rules are particularly relevant for Ireland's securitisation industry and Irish Section 110 companies which rely on the ability to deduct interest payments. It will also be relevant to the aircraft leasing sector, certain investment fund structures and the multinational sector generally.

3.3 Interested stakeholders were invited to give their views on implementation of these rules. The Maples Group Tax team has worked with the Irish Debt Securities Association ("**ISDA**"), the Irish Funds Association and certain individual clients to prepare responses to the consultation.

Luxembourg

3.4 By contrast, Luxembourg adopted new interest limitation rules with effect from 1 January 2019. Intragroup financing companies should not be impacted by the 30% EBITA interest limitation rule as only "excess borrowing costs" (i.e. above interest income earned) are taken into account. Conversely, the use of "profit participating loans" that cause excessive interest expense to accrue above 30% EBITDA will likely be caught in the new interest limitation rule. The interest limitation rule does not apply to the following:

(a) Standalone entities (not part of a consolidated group);

(b) Financial undertakings as defined, including AIFMs, UCITS, other funds and most banks;

(c) Pension funds;

(d) Securitisation vehicles subject to EU regulation;

(e) Grandfathered loans with no change to terms since 23 June 2016;

(f) Infrastructure project financing; and

(g) Exempt income, and expenses related to such exempt income, are not taken into account for the computation of EBITDA.

3.5 Exceeding borrowing costs can be carried forward indefinitely and excess interest can be carried forward only five years. A Luxembourg company that is a member of a consolidated group for financial accounting purposes may deduct in full its exceeding borrowing costs, if it can prove the ratio of its equity to its total assets is equal to or higher than the equivalent ratio of the group. There is a 2% variance that still applies when comparing the Luxembourg company to the consolidated group. Fiscal unity groups will also be able to apply the 30% EBITDA test at the fiscal unity level (pursuant to the Luxembourg 2019 Budget announcement).

3.6 It is likely that Ireland will seek to ensure that its rules have several of the same features and exclusions available under ATAD and already implemented in Luxembourg.

4 EU ATAD – Anti-Hybrid Rules

4.1 The cross border anti-hybrid rules seek to counter tax outcomes that exploit differences in tax treatment between jurisdictions e.g. where the same instrument generates a payment which is deductible in one jurisdiction but not taxable in another jurisdiction. ATAD requires these measures to be implemented in all Member States by 1 January 2020 (except for reverse hybrid rules which must be implemented by 1 January 2022).

4.2 The implementation of the anti-hybrid rules will be particularly relevant for groups which include entities availing of US check-the-box elections and may affect businesses which make use of certain structured capital market instruments. As a general point, in Ireland the view has been taken to date that investment fund entities themselves should not be within the scope of the anti-hybrid rules on the basis that they are generally not liable to tax.

Luxembourg

4.3 Luxembourg introduced anti-hybrid rules to intra-EU hybrid mismatches in 2019. By "intra-EU", this means hybrid instruments or entities involving two or more EU Member States. A "hybrid mismatch" is defined by differences in the legal characterisation of a financial instrument or entity between the taxpayer and a party in another Member State, or when the commercial or financial relations between a taxpayer and a party in another Member State, gives rise to the following consequences:

(a) A deduction of the same expenses or losses occurs both in Luxembourg, and in another EU Member State ("double deduction); or

(b) There is a deduction in Luxembourg without a corresponding inclusion of the same income in taxable net revenues in the other EU Member State ("deduction without inclusion").

The "tax advantage" of the hybrid payment is neutralised as follows:

(a) In the event of a double deduction, the deduction is only allowed in the EU Member State where the payment is sourced; and

(b) In the event of a deduction without inclusion, the EU Member State of the payer shall deny the deduction.

4.4 Going forward into 2020 with further provisions being introduced under ATAD, the particular Luxembourg focus should be on both hybrid instruments and entities that involve both an EU Member State and a non-EU Member State (e.g. CPECs and the US).

Ireland

4.5 In an Irish context, the process is still the subject of a consultation between the Irish authorities and industry, which is focusing on which entities the anti-hybrid rules should apply to, and how several technical matters in ATAD will be implemented. In this regard, the Irish Revenue has reviewed existing anti-hybrid regimes in other EU countries, with a view to ensuring that Ireland's regime is both compliant and certain.

5 EU ATAD – Controlled Foreign Company Rules

Ireland

5.1 Prior to ATAD, Ireland had very limited CFC rules. However, ATAD compliant CFC rules were introduced in Finance Act 2018 with the legislation taking effect for accounting periods beginning on or after 1 January 2019. The CFC rules implemented in Finance Act 2018 reflect the consultations and feedback provided by industry bodies and businesses in Ireland, including Maples, and it is hoped that the guidance which follows from Revenue will assist businesses in applying these rules.

5.2 Of the two available frameworks under ATAD, Ireland chose to adopt the "Option B" model. Option B focuses on CFC income which is diverted from Ireland. Broadly, CFC income is that which arises to a non-Irish resident company from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage. CFC income is attributed to the controlling company or a connected company in Ireland where that controlling or connected company has "significant people functions" ("**SPF**") in Ireland. The CFC charge is based on an arm's length measurement of the undistributed profits of the CFC that are attributable to the SPF.

5.3 The introduction of CFC rules represents a significant change in Ireland's corporation tax landscape and will be relevant to many clients.

5.4 Whether a CFC charge is imposed on an Irish controlling company will depend on the extent to which the CFC is regarded as having "non-genuine arrangements" in place. A CFC will be regarded as having non-genuine arrangements where:

(a) The CFC 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 or SPF being undertaken in Ireland in relation to those assets and risks; and

(b) It would be reasonable to consider that the relevant Irish activities were instrumental in generating that income.

5.5 The concept of SPF is not defined in the Irish implementing legislation but must be construed in a manner consistent with the use of that term in the OECD report. If there is no SPF in Ireland to which the management of assets and business risks can be attributed, no tax will arise under the new CFC rules.

5.6 The CFC charge applies to the undistributed profits that have been diverted to the low-taxed CFC pursuant to non-genuine arrangements. The rate of Irish tax chargeable will depend on the nature of the income. In Ireland, trading income is taxed at 12.5% and non-trading income is taxed at 25%. A credit is available for any foreign tax paid by the CFC on its undistributed income.

Luxembourg

5.7 The Luxembourg CFC regime is comparable to the Irish regime in that both countries chose the "Option B" model focusing on transfer pricing and, in particular, on the SPF, rather than the passive income model of applying the CFC regime. The Luxembourg regime targets undistributed income of CFCs arising from non-genuine arrangements which were put in place for the essential purpose of obtaining a tax advantage.

5.8 Luxembourg's CFC regime applies if the controlled entity or permanent establishment satisfies both the "control test" and the "effective tax rate" ("**ETR**") test. The control test is fulfilled if a Luxembourg company or the Luxembourg permanent establishment of a foreign company, by itself or with an "associated enterprise," owns more than 50% of the issued capital, voting rights, or profit rights of the CFC. An "associated enterprise" is defined as any entity that has 25% or more common ownership, either directly or indirectly, of voting, profits, or issued capital with the Luxembourg entity. The ETR test is satisfied if the CFC actually pays corporate taxes less than 50% of Luxembourg's corporate income tax which comes to 9% for 2019 and 8.5% for 2020 and beyond (Luxembourg's corporate income tax is currently 18% and should be reduced to 17% beginning 1 January 2020).

5.9 If both the ETR and control tests are satisfied, the taxpayer must include in its tax base its pro-rata share of undistributed income of the CFC provided both these conditions are fulfilled:

(a) It is a "non-genuine arrangement"; and

(b) It was put in place for "essentially for the goal" of obtaining a tax advantage.

The "non-genuine arrangement" test focuses on whether the CFC would not have obtained the assets or risks which generate the income, but for the fact that another related company's SPF are linked to those risks and assets. The test to determine if it was put in place "essentially for a goal of obtaining a tax advantage" should also be satisfied if there are no documentable justifiable reasons for the set-up of the CFC or permanent establishment, such as a reasonable economic or business purpose.

6 EU ATAD Compliant Exit Tax Introduced

6.1 Luxembourg enacted the EU compliant exit tax rules in 2014, so the ATAD 1 amendments to Luxembourg's exit tax only added the possibility of paying any exit taxes in instalments when the transfer occurs into another EU Member State with which Luxembourg has an agreement to recover taxes.

6.2 Ireland required more substantive amendments to introduce the appropriate exit tax regime. The Finance Act 2018 has introduced an ATAD compliant exit tax which replaces the existing Irish exit tax regime which applied where a taxpayer moves assets or migrates its tax residence out of Ireland. While the introduction of such an exit tax was required under ATAD, the surprise to industry came in the timing of implementation with Financial Resolutions passed by the Irish Parliament on 9 October 2018 bringing the regime into immediate effect from midnight of that day.

6.3 Exit tax will now be levied at 12.5% on any unrealised gains where a company migrates or transfers assets (including IP assets) out of the charge to Irish tax, including where a company ceases to be tax resident in Ireland or where a company that is resident in another Member State transfers assets from an Irish permanent establishment to another territory.

6.4 The new provisions allow exceptions for temporary transfers of assets for the purposes of financing securities or where the assets are given as security for a debt, provided the assets are returned to the company or permanent establishment within 12 months. Equally the exit tax will not apply where the assets which are disposed of remain within the charge to Irish tax, such as where the assets continue to be used as part of a trade or permanent establishment in Ireland after the relevant transaction or where the assets consist of Irish land or mining and exploration rights.

6.5 The new Irish ATAD compliant exit tax does not affect the ability to avail of the participation exemption where there is a deemed disposal of shares held in trading companies under an exit tax event. This should ensure that the Irish holding company regime remains attractive for structuring transactions.

7 OECD Multilateral Instrument

7.1 Both Ireland and Luxembourg participated in the recent signing ceremony of the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**") with representatives of over 70 other jurisdictions.

7.2 In broad terms, the MLI is a legal instrument which will update tax treaties around the world automatically, and without the need for bilateral negotiation for each treaty.

7.3 The Irish legislative measure setting out Ireland's choices under the MLI was signed into Irish law on 23 October 2018. The MLI provides a mechanism for countries to transpose BEPS recommendations into their existing bilateral tax treaties.

7.4 The MLI was ratified by Ireland through the Finance Act 2018 and Ireland formally deposited its Instrument of Ratification with the OECD on 29 January 2019. The MLI will come into force in Ireland on 1 May 2019. At that stage, the treaties that will be modified by the MLI will be those treaties to which Ireland is a party, and where Ireland's treaty partner has already ratified the MLI (i.e. before 29 January 2019).

7.5 Irish Revenue are currently identifying these treaty partner countries and working out the relevant dates by which the MLI impacts on the affected provisions of the treaties concerned will come into effect. These dates will be identified on its website on a periodical basis and will be updated to take account of subsequent ratifications by other treaty partner countries. Irish Revenue has confirmed that they will provide guidance on the impact of the MLI on covered treaties.

7.6 On 14 February 2019, the Luxembourg Chamber of Deputies voted to approve the MLI. The MLI is anticipated to enter into force in Luxembourg in autumn 2019 and would impact on withholding tax benefits as of January 2020.

7.7 In both a Luxembourg and Irish context, the MLI will impact the use of tax treaties in international structures with a new "principal purpose test" ("**PPT**") that may deny tax treaty benefits, such as reduced or eliminated withholding taxes, if there is not a sufficient business purpose (non-tax reasons) for the treaty claimant to be located in the tax treaty jurisdiction in question.

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7.8 In corporate structures involving Luxembourg or Ireland, there should be strong business and other "non-tax" drivers in choosing Luxembourg or Ireland. Tax treaty benefits should be considered secondarily and only after valid business planning and economic substance is taken into account.

7.9 The PPT has raised concerns among the international tax practitioner community in light of its somewhat subjective language. If "one of the principal purposes" is to obtain treaty benefits, the PPT could be triggered and thus be used to deny the tax payer of any treaty benefits it would otherwise be entitled to under the relevant treaty. However, the OECD itself has helpfully provided examples where the PPT test may be satisfied based on valid and non-tax related business reasons provided, broadly, that sufficient business purpose and economic substance is in place. The Maples Group made submissions to the OECD in this regard during the public consultation process having consulted with clients. Whether the PPT is satisfied should be analysed on a case-by-case basis and is primarily facts driven.

7.10 The Maples Group is advising several clients on the impact of the MLI on their structures.

8 EU Case Law – Beneficial Ownership Cases

8.1 On 26 February 2019, the ECJ ruled on six joined cases concerning the payment of withholding tax on dividends and interest by Danish companies. The cases included where dividends were paid by a Danish company to a Luxembourg tax resident holding company, owned indirectly by private equity funds. Interest was also paid by a Danish company to a Cypriot parent company, which made payments to a company in Bermuda, which in turn made payment to a US company.

8.2 While the Danish subsidiary paying the interest or dividends up to the holding companies took the position that the dividends or interest were exempt from relevant Danish taxes under the EU Parent Subsidiary Directive ("**PSD**") and the EU Interest and Royalties Directive ("**IRD**") respectively, the Danish tax authorities challenged the exemptions claiming the EU tax resident holding companies were not the "beneficial owner" of these payments. The ECJ focused the analysis on whether the arrangements were "wholly artificial", whether there was an abuse of the EU law, and in the case of the interest payments, if the EU tax resident holding company was the "beneficial owner" of the interest payment received. The ECJ did not rule on the outcome but sent the cases back to the Danish courts for a factual determination based on its guidance.

8.3 The judgments will be extremely important in terms of the application of the IRD and PSD, but also on the interpretation of terms such as “beneficial owner” and “abuse of rights” in international structures.

8.4 The ECJ first considered the meaning of “beneficial owner”. It stated that in this context it must have an EU law meaning rather than one based on the domestic law of each Member State. It stated it refers to “an entity which actually benefits from the interest paid to it" and not merely a "formally identified recipient". Accordingly, the test is aligned with some of the OECD concepts outlined in tax treaties.

8.5 Although Denmark did not have an appropriate anti-abuse law in its domestic provisions, the ECJ held that it was still entitled to deny the benefits of Directives where there is an abusive scheme. Indeed it stated that the Member State "must refuse to grant the benefit of the provisions of EU law where they are relied on not with a view to achieving the objectives of those provisions but with the aim of benefitting from an advantage in EU law although the conditions for benefiting from that advantage are fulfilled only formally".

8.6 The Court provided significant guidance on the factors that may indicate an abuse of rights including an inability to economically use interest, rapid onward payment to non-EU entities, and the absence of actual economic activity.

8.7 The decisions represent a development of existing EU concepts, which were previously seen in VAT avoidance schemes. They also appear to break with the traditional understanding of cases involving the exercise of EU freedoms under the EU Treaty of Rome, such as the important EU Cadbury Schweppes case. There is a broad interpretation given to the term “beneficial owner” and an application of the abuse of rights principle. This may impact structures which are vulnerable to allegations of acting merely as a conduit.

8.8 It is important, however, to note that the decision should not impact generally structures involving domestic exemptions, which are not reliant upon the EU Directives. In such cases, absent changes to the domestic law of the paying jurisdiction, the position should not change.

9 Perrigo €1.6 billion Irish Tax Assessment

9.1 On 29 November 2018, Irish Revenue issued a notice of amended assessment to Perrigo Pharma International ("**Perrigo**") which assessed an Irish corporation tax liability against Elan Pharma International Limited ("**Elan**") of €1.636 billion (not including possible interest and penalties). As this is the largest tax assessment in the history of the Irish State, it has attracted the interest of many international parties seeking further information about the Irish tax system.

9.2 Broadly, the assessment relates to the sale by Elan of certain IP related assets. Elan classified this as a trading transaction and subject to corporation tax of 12.5%. However, the assessment by Irish Revenue is based on their view that the transaction should have been categorised as a capital transaction attracting capital gains tax at 33%.

9.3 Perrigo filed an appeal with the Tax Appeals Commission ("**TAC**") on 27 December 2018. Separately, in February 2019 it has also filed for an Irish legal remedy known as "judicial review" with the Irish High Court. In the judicial review, Perrigo is challenging the ability of Irish Revenue to issue the assessment. Judicial review has been increasingly used in Ireland to challenge or pre-empt the ability of Revenue to take certain actions.

9.4 As a practical matter, the judicial review is likely to take a significant time to be resolved. Only after that can the TAC commence hearing Perrigo's appeal against the tax assessment. It is not unknown for tax cases of this nature to be appealed all the way to the Irish Supreme Court. Ultimately, it may be a number of years before a final decision is reached.

10 Focus on a Maples Group Tax team member

In each update we will introduce a member of our global Tax team.

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Fun fact!

Ted plays senior Gaelic football for leading Dublin club Ballyboden Wanderers and was once placed second in the Irish National Ski Championships!

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