

NewsAlert

International Tax Services – Ireland

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For issues relating to this news alert please contact your local international tax services advisor, Christoph Schreiber at +49 69 9585 6300 or the specialists listed at the end of this article.

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2008 Finance Bill

The publication on January 31 of Finance Bill 2008 sets out the Irish government's proposed legislative changes to the taxation of dividends received by Irish companies from EU/tax treaty residents. The changes are effective as of January 31, 2008.

Dividends paid to Irish Companies by EU or treaty resident companies

Background

Over the past few years Ireland has introduced a number of measures designed to enhance its position as a holding company location. These measures include a wide ranging exemption from capital gains tax on the disposal of qualifying shareholdings together with the introduction of a new onshore pooling system to enable taxpayers to maximise the benefit of tax credits associated with foreign dividends. These changes have had a positive impact on Ireland's standing as a holding company location for foreign investors. However, as a consequence of Ireland's low 12.5% tax rate on trading income, concerns were expressed that Ireland was effectively taxing the profits of Irish owned foreign trading subsidiaries at a differential rate of 25% upon repatriation as a dividend.

Following the European Court of Justice judgement upholding the UK's differential treatment of non-UK source dividends in the Franked Investment Income Group Litigation case, Ireland has moved to deal with the Court's statement that its conclusion was subject to a condition that the tax rate on foreign dividends would not exceed the effective tax rate on domestic dividends.

Revised tax treatment

With effect from January 31, 2008, all dividends received by Irish companies from both EU and double tax treaty resident companies will now only be liable to Irish corporation tax at 12.5% provided they meet the qualifying conditions set out below. Like before, a credit will be given in the Irish tax calculation for any foreign withholding taxes suffered and any underlying taxes attributable to the profits from which the dividend is paid. As in almost all cases dividends paid to Ireland by such companies are likely to have borne tax at a higher rate than Ireland's trading rate, the introduction of this measure should facilitate the flow of such dividends back to Ireland without an incremental Irish tax liability.

Qualifying conditions

Dividends must be sourced from the trading profits of EU or treaty resident companies, being either the profits of the dividend paying company itself or such profits paid up to it as dividends by its lower tier subsidiaries. Where dividends are paid partly out of such trading profits and partly out of non-trading profits the dividend will be apportioned and the constituent parts taxed at 12.5% and 25% accordingly.

However, an enhanced treatment is available where such trading income in total constitutes 75% or more of the dividend paying company's profits for the period and the aggregate value of the consolidated trading assets of the recipient company and all of its effective 5% subsidiaries is not less than 75% of the aggregate value of all of the consolidated assets of those companies, measured at the end of the period for which the dividend is paid.

Where these conditions are met the entire dividend will be considered to have been paid out of trading profits and taxed at 12.5%. For example, if 80% of the income out of which a foreign company pays a dividend back to its Irish parent is from trading sources as described, and the asset test is met, the entire dividend will be taxed at 12.5% in Ireland. However, if only half the dividend-paying company's income is trading income, then half of the dividend paid to the Irish parent company will be taxed at 12.5% and half will be taxed at 25%.

Impact on onshore pooling

There will also be separate pooling of foreign tax credits arising from trading dividends and non-trading dividends. Excess credits from a "trading dividend" (taxed at 12.5%) or from a non-trading dividend (dividend taxed at 25%) may be set off against another trading dividend with insufficient credits, however, it is not possible to set-off excess trading dividend credits against tax on non-trading dividends with insufficient credits.

Portfolio investors

Where portfolio corporate investors – shareholders that hold 5% or less of the share capital and voting rights of a company – receive a dividend from a company resident in the EU or a tax treaty country that dividend will be automatically deemed to have been paid out of trading profits and hence subject to tax at the lower rate of 12.5%.

Summary

For Irish companies receiving dividends from overseas, the halving of the tax rate on dividends will mean that no incremental Irish tax should be payable on dividends from its EU or treaty resident trading subsidiaries. Indeed the extension of this provision beyond the EU to our treaty partner countries was a welcome development that can only serve to broaden Ireland's appeal as a holding company location. With no minimum shareholding required, it is anticipated that the new legislation will also be attractive to portfolio, venture capital and private equity investors and will assist the easy flow and repatriation of funds around Irish held subsidiaries thus further enhancing Ireland's reputation as a favourable holding company location.

For more detailed information, please do not hesitate to contact your tax services team:

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