Bulletin

Irish Finance Companies – A Guide To Tax Issues

Background
Specific tax legislation was introduced a number of years ago to encourage the use of Ireland as a jurisdiction for locating finance vehicles. That legislation coupled with a stable and well developed company law and regulatory regime has resulted in Ireland gaining a leading position as a jurisdiction for the location of issuing vehicles that are used in the context of securitisation transactions. It is important to note however that the regime is not solely confined to securitisations in the classical sense and there can be advantages to using an Irish tax resident vehicle in a wider range of finance transactions.

Overview of tax regime
The relevant legislation is now set out in Section 110 of the Taxes Consolidation Act, 1997 ("section 110").

Section 110 effectively provides that where the relevant company falls within its ambit, its profits will be calculated as if it were carrying on a trade. As a result, expenses such as funding costs, payments made under hedging swaps and payments to services providers are generally deductible. The deducibility position is indeed bolstered by two further specific statutory provisions. First the normal distribution rules are modified to the extent that they apply to section 110 companies. Subject to a specific exception (which is generally not an issue in the context of international transactions), the general provision which re-characterises interest as a distribution does not apply to interest payable in respect of a debt obligation of a section 110 company in circumstances where the rate of interest payable (i) is to any extent dependent on the results of the company's business or any part of it or (ii) represents more than a reasonable commercial return for the use of the principal. The second statutory provision deals with the deductibility of bad or doubtful debts and allows for a specific deduction in respect of such amounts to the extent they are not otherwise deductible under general principles.

Notwithstanding the fact that profits are calculated on the assumption that the section 110 company is carrying on a trade for tax purposes, the taxable profit of that company is subject to tax at the higher corporation tax rate of 25%. The general principle is that the amount of income falling within the charge to corporation tax is to be computed in accordance with generally accepted accounting practice. However, in light of the possible mismatches that could arise if IAS principles were to be applied, the legislation is drafted so that the default position is that the company's income is to be calculated using "old Irish GAAP" (i.e. accounting practice as applied assuming a period of account ended on 31 December 2004). A company is however free to elect out of this treatment and instead apply current accounting principles.

The net effect of the rules set out above and with proper structuring is that it is possible to reduce the taxable profits arising in a section 110 company to a minimal amount.

Conditions which must be satisfied to avail of section 110
Only a "qualifying company" can avail of the provisions of section 110. A qualifying company is defined as a company:

i. resident for tax purposes in Ireland;
ii. which either acquires qualifying assets from a person or has entered into an arrangement with another person and that arrangement itself is a qualifying asset;
iii. which carries on in Ireland a business consisting of the management and/or holding of qualifying assets;
iv. which apart from activities ancillary to that business, carries on no other activities in Ireland;
v. in relation to which the market value of qualifying assets on the day it first acquires assets is not less than €10 million; and
vi. which has notified the Irish tax authorities of its status.

There is also a further limitation that a company will not be a qualifying company if it carries on any transaction otherwise than by way of bargain made at arm's length although that rule is subject to the point noted above in respect of excessive or results dependent interest. It is important to note that it is only necessary to deliver a notification in the prescribed form to the tax authorities. No clearance or other form of ruling is required. In relation to the definition of "qualifying asset" for these purposes, that definition is effectively tied into a wide definition of "financial asset". Further, the definition of "qualifying asset" has recently been expanded so that it includes not only the direct holding of a "financial asset" but also the holding of an interest in a financial asset through a partnership. The definition of financial asset itself is extremely broad (see attached schedule) with the result that the circumstances where the section 110 regime may be availed of is wide.

Overview of other tax issues

(a) Withholding tax

(i) Basic Rule

The general principle is that an Irish resident company must operate a 20% withholding tax on all payments of "yearly" interest. There are a number of exceptions from this withholding obligation relevant to section 110 companies.

(ii) Quoted Eurobond Exemption

The exemption most likely to be relevant in these circumstances is the "quoted Eurobond" exemption. In order to avail of this exemption, the interest must be paid on a "quoted Eurobond" which is a security:

1). issued by a company;
2). quoted on a recognised stock exchange - there is no specific definition of what constitutes a recognised stock exchange for these purposes with the result that an issuer has some degree of flexibility when choosing an exchange or market on which to list the relevant notes; and
3). carrying a right to interest.

No further conditions apply if the interest payments are being made by or through a paying agent outside of Ireland. If that is not the case, the relevant notes need to be either held in a recognised clearing system or the recipient of the interest must deliver a certificate of non residence.

(iii) Section 110 exemption for payments to persons in EU/Double Tax Treaty countries.

An exemption is also available in circumstances where interest is paid by a section 110 company to a person resident in a country with which Ireland has a double tax treaty or in a member state of the EU (other than Ireland). Unlike a normal treaty relief application, there is no specific documentary evidence that must be received by the paying company to establish where the recipient is resident. However it is normal to put in place some mechanism under which the company could obtain a confirmation from the recipient of its status, if necessary.

(b) Stamp duty

There is a specific exemption from stamp duty on the issue and transfer of notes issued by a section 110 company. Stamp duty considerations also apply to the acquisition of assets by the section 110 company, especially if those assets are Irish situate.

(c) VAT

The activities of a section 110 company would generally be treated as "exempt activities" for VAT purposes. Therefore, it will have limited ability to recover any VAT charged in respect of taxable services supplied to it. It should be noted however that the provision of investment management services to a section 110 company is generally exempt from VAT. In addition, to the extent that the section 110 company makes supplies for VAT purposes to a person belonging outside the EU, it may be entitled to recover a portion of any VAT suffered by it.

Schedule

"Financial asset" includes:-

a) shares, bonds and other securities;
b) futures, options, swaps, derivatives and similar instruments;
c) invoices and all types of receivables;
d) obligations evidencing debt (including loans and deposits);
e) leases and loan and lease portfolios;
f) hire purchase contracts;
g) acceptance credits and all other documents of title relating to the movement of goods;
h) bills of exchange, commercial paper, promissory notes and all other kinds of negotiable or transferable instruments;
i) greenhouse gas emissions allowance; and
j) contracts for insurance and contracts for reinsurance.

For further information please contact:

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