

# IFS *Newsalert*

International Financial Services (IFS) - Ireland



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## PwC Ireland Financial Services Tax Group

PwC is a leading provider of tax services to business in Ireland's IFS sector. This group provides advice and news on Irish and international tax issues - and tax-related business issues - affecting IFS businesses in Ireland. Specialisms within the group include banking, treasury, asset finance, securitization, insurance, and investment management.

For issues relating to this Newsalert please contact your usual PwC contact or the specialists listed at the end of this article.

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## Finance Bill 2007

The publication today of Finance Bill 2007 sets out the government's proposed legislative changes to the taxation regime in Ireland. In this IFS Newsalert, we set out the highlights of the Bill as it impacts on the financial services sector in Ireland.

It should be borne in mind that the information below is our initial interpretation of the draft legislation published in the Finance Bill. These provisions are subject to clarification and amendment as the Bill passes through the parliamentary stages before it is passed into law as the Finance Act, which must take place by 6 April next. Therefore the opportunity to lobby the Department of Finance for changes in the provisions of the Finance Bill remains open.

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## Direct taxes

### New double taxation relief for foreign branches of Irish companies

A major change in the double taxation relief crediting rules will enable Irish companies with foreign trading branches to significantly enhance the tax credits they can currently avail of. This will greatly facilitate financial service companies who wish to use the EU passport by headquartering banking and insurance operations in Ireland and then branching into foreign countries. Up until recently foreign tax credits could only be offset against the Irish tax arising on that same item of income.

Finance Act 2004 introduced a limited form of cross crediting or pooling of foreign taxes where the foreign tax related to a dividend exceeded the Irish tax on the dividend. In those circumstances the excess may be offset against the Irish tax on any other foreign dividends received in the same accounting period. Last year's Finance Act extended the pooling of foreign taxes where trading interest income, which had been subject to foreign withholding taxes, was received from affiliate companies in the EU or tax treaty locations. However pooling did not apply at all to foreign branches of Irish companies, which appeared illogical and inconsistent and placed Ireland at a serious disadvantage with many of our competitors (notably the Netherlands and Luxembourg) who had participation exemptions in place for foreign branch operations.

The new measures in the Finance Bill will allow any excess foreign tax credits which arise in relation to a foreign trading branch (e.g. because the foreign tax rate exceeds the Irish tax rate) to be pooled and be credited against Irish tax arising on branch profits in other countries (e.g. where the Irish tax rate is higher than the foreign tax rate of the foreign branch) in the year concerned. Importantly this treatment will also



apply to branch tax which up to now has not been creditable in Ireland as the tax had been suffered in a non-treaty country.

The Bill also provides that the new crediting arrangements will apply to foreign branch income generated by Irish branches of an EU company.

These amendments are very welcome. Apart from making the branch situation consistent with the position for dividends from foreign subsidiaries, the changes will improve considerably Ireland's commercial competitiveness in attracting in headquarter type financial services operations.

The new relief will apply for accounting periods ending on or after 1 January 2007

### **Treatment of certain interest payments to group companies**

Interest payments by an Irish company, other than a licensed bank, to a group company (75% direct or indirect relationship) resident outside the EU in a country with which Ireland does not have a double tax treaty, has to date been deemed to be a distribution for tax purposes. The consequences of this are that such interest is not deductible for tax purposes and may be liable to dividend withholding tax (DWT). Section 45 of the Bill provides a change whereby a company paying such interest in the ordinary course of its trade may make an election with its tax return each year that this interest would be tax deductible and would not be liable to DWT. This provision will apply in respect of interest paid on or after 1 February 2007.

Prima facie, this change appears extremely positive, particularly for Irish treasury companies carrying on cash pooling operations, and is one that has been sought by the Financial Services Industry for a number of years. However on closer examination of the legislation dealing with this area, there is a sting in the tail in that it seems that interest payments to group companies resident outside the EU in non-treaty countries will still be liable to interest withholding tax at the standard rate of income tax (currently 20%). If the interest withholding tax legislation remains unamended, the proposed change in Section 45 is unlikely to be of benefit except in limited circumstances, because while the Irish company paying the interest would be entitled to a tax deduction at the trading rate (currently 12.5%), the non-resident recipient of the interest will be liable to Irish income tax deducted at source at a rate of 20%. Interest withholding tax can however be eliminated in certain limited circumstances including where the interest is paid on a "quoted Eurobond" or on a "wholesale debt instrument" or where the interest is "short" interest (i.e. it is not "annual" interest).

### **Matching of foreign currency assets and liabilities**

Where a company is perfectly matched in a foreign currency, i.e. where foreign currency denominated assets (held for trading purposes) are funded by foreign currency share capital, an election can be made to have this respected for tax purposes. This provision was introduced by Finance Act 2006 but at the time it was regarded as having some shortcomings. Finance Bill 2007 attempts to deal with two of these as follows:

- it extends the provision to companies with a non-Euro functional currency;
- it ensures better timing of the matching of gains and losses by providing that foreign currency movements on the share capital are taken into account for tax purposes over the period during which the related foreign currency denominated assets are held.

### **Offshore funds in EU or tax treaty countries**

Finance Bill 2007 changes the tax treatment of certain offshore funds established in the EU or OECD countries with which Ireland has entered into a double tax agreement. The legislation follows on from the recent Revenue statement relating to transparent entities potentially qualifying as offshore funds and thereby benefiting from the tax effective fund regime.



Essentially, investments in offshore funds will be subject to the comparable tax treatment that applies to Irish regulated funds (which taxes income at 20% and capital gains at 23%), to the extent that they are subject to an equivalent regulatory regime that applies to Irish funds.

Going forward, income and capital gains from unregulated offshore investment structures will now be subject to tax at an individual's marginal tax rate and 20% respectively.

The section, as currently drafted, also excludes from the 20%/23% tax regime certain regulated companies and unit trusts. We would expect this to be captured into the final draft of the legislation.

### **Personal portfolio investment funds**

Finance Act 2002 introduced legislation seeking to put to an end to the perceived abuse of the taxation regime introduced for Life Assurance Policies in Finance Act 2001. It was felt that these policies were being used as 'wrappers' for direct personal investments i.e. the policy would be used by an individual effectively to hold a direct investment (such as property) thereby entitling them to the favourable tax regime of gross roll-up within the fund and only 23% tax on exit without the fund having any element of collective investment. The individual policyholder in effect had the ability to influence the investments that the policy invested in.

Finance Bill 2007 introduces similar legislation for "Personal Portfolio Investment Undertakings", applying to both Irish and offshore fund investments, to counteract investors putting personal assets in a fund structure and thereby benefiting from a 20%/23% on the investment under the gross roll-up regime, rather than paying tax at marginal income tax rates. With effect from 1 February 2007, tax will be applied at the rate of 43% to the income and gains paid out of the fund rather than the normal exit tax of 20% and 23%. Potentially, a tax rate of marginal income tax plus 23% could apply in the case of investments in offshore funds, where the payment is not correctly included in the investor's tax return.

The additional tax applies where the investor and/or persons connected with or acting on their behalf influence the choice of some or all of investments made by the fund.

### **Life assurance products - Exit taxes**

Finance Act 2006 introduced a special "Exit Tax" charge, which applies every 8 years for most policies but every 12 years for regular premium policies not exceeding €3,000 annually. This 12 year rule is now abolished by Finance Bill 2007, so Exit Tax will apply after 8 years for all policies. The change also applies to foreign life assurance products.

### **Special Savings Incentive Accounts "SSIAs"**

Finance Bill 2007 provides the Revenue with additional powers to facilitate them requesting information from SSIA managers in relation to SSIA cash flows.

Finance Act 2006 introduced a special provision to allow tax relief on SSIA monies reinvested by lower earners in pension schemes. Finance Bill 2007 provides for a claw back of the tax benefit where the person withdraws funds from the pension scheme within one year.

## **VAT**

### **Treatment of financial services companies engaging in hire purchase transactions**

Currently, financial services companies that engage in hire purchase transactions are not entitled to any measure of VAT deductibility or bad debt relief in respect of those transactions. The transfer of goods by a financial services company under a hire purchase contract is ignored for VAT purposes. The provision of finance is an exempt activity. Following a challenge by the European Commission to the Irish position, the



Finance Bill proposes changes in this area. With effect from 1 May 2007 financial services companies will be treated as taxable persons in respect of hire purchase transactions. This will enable those providers to a measure of VAT deductibility and also to bad debt relief in cases of defaults on repayments. Any subsequent sale of repossessed items will be treated as taxable sales by the financial services company. This provision should be of significant benefit to financial services companies engaging in hire purchase transactions.

### **Transfer pricing between connected parties**

Finance Bill 2007 transposes the provisions of Article 80 of the recast Sixth VAT Directive which deals with transactions between connected parties. The provision gives the Revenue the power, where they consider it necessary or appropriate to ensure the correct collection of tax, to make a determination that the amount on which tax is chargeable on a supply of goods or services, is the open market value of that supply where the recipient of the goods or services does not have full deductibility entitlement. This provision could have major implications for the financial services sector, particularly in the area of cross-border supplies of services e.g. supplies of head office support from overseas to Irish based subsidiaries of multinational companies.

## **Stamp Duty**

### **Abolition of stamp duty on mortgages**

As announced in the budget, Finance Bill 2007 confirms the abolition of stamp duty on mortgages and also on transfers of mortgages with effect from 7 December 2006.

### **Intermediary relief for stock exchange members**

As promised by the Minister for Finance, the system for stamp duty on dealings in Irish shares by member firms has been reviewed. Finance Bill 2007 introduces a new Intermediary Relief to replace the existing market maker, member firm and closings reliefs. The concept of Intermediary Relief is closer to the UK stamp duty legislation for dealers in UK shares.

The new relief will exempt Intermediaries from stamp duty on share purchases made on the Irish and London stock exchanges, provided the purchase is not in connection with an "excluded business" as defined in the legislation. The relief will be available to member firms of the Irish and London stock exchanges that are recognised by those exchanges as Intermediaries. An Intermediary is defined as a person carrying on a bona fide business of dealing in securities (including security derivatives).

No amendments have been made to the existing stock borrowing / stock repo reliefs.

### **Relief for clearing houses**

The Finance Bill also introduces a new relief for transfers of shares to and from Clearing Houses, also known as Central Counterparties. Clearing Houses are entities which enable member firms to maintain anonymity when trading on exchanges by settling trades against the Clearing House. Transfers of shares in specified circumstances to and from Clearing Houses will be exempt from stamp duty.

## **General items of interest**

### **Group relief for foreign losses**

Following on from the ECJ ruling in the Marks & Spencer case, the Irish group relief legislation is being amended to include certain foreign losses. The Bill provides for the off-set of trading losses of foreign subsidiaries resident for tax purposes in an EU country or an EEA country with which Ireland has concluded a double tax treaty against the taxable income of the Irish parent in certain circumstances.



A number of conditions must be satisfied in order to avail of the relief, including a requirement that the losses must not otherwise be available for relief, and that the loss would be available for relief under Irish rules if the surrendering company were Irish resident.

The provisions apply in respect of accounting periods ending on or after 1 January 2006, with apportionment where an accounting period begins before, and ends after, this date.

### **Preliminary corporation tax**

Three changes have been introduced in Finance Bill 2007 in relation to preliminary corporation tax.

- The small company threshold has been increased by €100,000 to €150,000.
- No preliminary corporation tax payment is required where the corporation tax liability in the first year in a start-up situation is €150,000 or less.

The above provisions apply in respect of preliminary corporation tax due on or after 6 December 2006.

- When considering from a group perspective the adequacy of preliminary corporation tax payments, overpayments of preliminary corporation tax by members of a group can now be re-allocated against underpayments by other group members (excluding small companies). This should reduce the amount of interest on underpayments of preliminary tax which might otherwise arise.

The above provision applies in respect of accounting periods ending on or after 1 February 2007.

### **R&D tax credits**

As announced in the Budget, the threshold year on which incremental expenditure for R&D is based has been fixed at 2003 for years up to and including 2009. This provision applies in respect of accounting periods commencing on or after 1 January 2007.

In addition to the existing provisions in relation to R&D undertaken by universities, expenditure by companies on sub-contracting R&D to unconnected parties (who do not claim a tax credit in respect of the expenditure) will qualify up to a limit of 10% of qualifying R&D incurred by the company in any one year. This provision applies as respects accounting periods ending on or after 1 January 2007 in respect of expenditure incurred on or after that date.

### **Extension of dividend withholding tax exemption**

There are currently a number of exemptions available from dividend withholding tax (DWT). One such exemption applies where the distribution is paid to a non-resident company whose shares are substantially and regularly traded on a stock exchange in an EU or treaty country or is a 75% direct or indirect subsidiary of such a company. Finance Bill 2007 extends this exemption such that it applies to distributions received by non-resident companies whose ultimate parent's shares are quoted and regularly traded on the Irish stock exchange.

### **Relevant contracts tax**

The definition of "principal contractors" who are obliged to deduct will be extended from 1 May 2007 to cover those in a business which includes "the development of land". This amendment potentially extends the RCT provisions to a much broader range of companies involved in property development than might be apparent. Clarification on this point will be required.



If you have any comments on the content of this publication, or have any other issues you would like to raise, please contact your usual tax contact within PricewaterhouseCoopers, or one of the following:

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