Irish Finance Bill 2013 contains good news for US MNCs

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In brief

The Irish Finance Bill 2013, which was published on February 13, and is expected to be ratified into law by late March, contains numerous provisions that should benefit US multinational corporations (MNCs) that operate in Ireland or are looking to invest in Ireland.

The Bill includes a number of measures announced as part of the 2013 Budget in December. Many of the key provisions are intended to enhance the attractiveness of Ireland's intangible property (IP) and research and development (R&D) tax credit regimes.

While the introduction of a new real estate investment trust (REIT) regime also is positive, additional changes would be required for the regime to become an attractive structure for holding international real estate. We expect enhancements in this area following the Bill's enactment.

In detail

Real estate investment trusts (REITs)

REITs are the internationally recognized collective investment structure for holding commercial and residential real estate. Finance Bill 2013 would create a new REIT regime in Ireland.

The legislation closely follows the UK REIT regime and includes a number of improvements the UK has made since REITs were first introduced there in 2007. For example, there is no entry charge into the regime (for existing real estate companies), the company can be listed on a recognized stock exchange in any European Union (EU) Member State (although it must be resident and incorporated in Ireland), and there is a three-year grace period before a new REIT must comply with the following technical conditions:

- At least 75% of the REIT's (or group REIT's) aggregate income must derive from carrying on real estate rental business,
- The REIT must conduct a real estate rental business consisting of at least three properties, none of whose market value is more than 40% of the total market value of the properties constituting the real estate rental business,
- The REIT must satisfy certain financing requirements; for example, the profits from its rental business must be at least 1.25 times its finance costs; and
- The REIT must distribute to its shareholders at least 85% of its rental profits each year.

The REIT tax regime is relatively straightforward. While the normal stamp duty rate (2%) applies to Irish real estate transfers into a REIT, the REIT itself is exempt from tax on rental income and on any capital gains arising from real estate disposals. However, distributions out of the REIT to shareholders are subject to dividend withholding tax at 20% rate, subject to exceptions for residents of countries that have tax treaties with Ireland and tax-exempt investors such as pension funds.

For non-resident shareholders the REIT regime carries one particularly attractive feature. Capital gains generated by the REIT do not have to be distributed to shareholders and, if retained and reinvested by the REIT, must be reflected in its share price. The non-resident investor can then dispose of the REIT shares free of Irish capital gains tax (CGT). This would not be available if the non-resident investor held the real estate directly. It does appear, however, that disposal of the REIT shares would be subject to a one percent stamp duty.

Foreign Account Tax Compliance Act (FATCA)

The Minister for Finance announced as part of Budget 2013 that Ireland had concluded negotiations with the United States on a bilateral Intergovernmental Agreement (IGA) for FATCA. The agreement was signed and published on December 21, 2012. The agreement is expected to reduce the FATCA compliance burden by simplifying the compliance process and minimizing the withholding tax risk.

Under the agreement, Irish financial institutions will be required to report annually to the Irish Revenue details of financial accounts held by US persons. The Irish Revenue will then exchange this information with the US tax authorities, who will provide to the Irish Revenue information on Irish account holders in US financial institutions.

Implementation of the IGA will require supporting regulations. The Finance Bill contains provisions that would enable Ireland to introduce these regulations. We expect a first draft of these regulations in the coming months.

Investment limited partnerships

The Bill confirms the tax transparency of Irish regulated investment funds structured as investment limited partnerships under the Investment Limited Partnership Act, 1994. Previously, such funds were regarded as opaque under Irish tax legislation. The change would provide the Irish funds industry with an opportunity to broaden its offerings to, for example, private equity funds and alternative investments.

With the Alternative Investment Fund Managers Directive (AIFMD) coming into force in July 2013, many global fund managers wish to locate investment funds in regulated jurisdictions that will facilitate the international distribution of their funds. Ireland is already the leading global alternative funds centre, and the changes should further enhance Ireland's reputation in that regard.

Other proposed legislative changes in this area include the introduction of a new corporate fund vehicle that would qualify for certain US tax elections.

Taxation of dividend income

The Bill would provide an additional credit for tax on certain foreign dividends received by Irish companies. This change is a direct result of the final European Court of Justice (ECJ) decision in the Franked Investment Income Group Litigation Order case last November. Here the ECJ concluded that it is contrary to EU law for domestic tax laws in European countries to discriminate in their corporate tax treatment of foreign dividends whereby domestic dividends received are subject to a lower rate of corporation tax than dividends received from a foreign company.

Irish tax law currently exempts from corporation tax dividends received from Irish resident companies, while dividends received from foreign resident companies are taxable in Ireland at 25% or 12.5% with credit for foreign tax.

The Finance Bill's additional foreign credit would allow increased double taxation relief when the existing credit for foreign tax on the relevant dividend is less than the amount that would be computed by reference to the nominal rate of tax in the country from which the dividend is paid. The credit would apply to certain dividends received from companies resident in EU or European Economic Area (EEA) treaty-partner countries.

Practically, this would benefit Ireland's holding company regime and should reduce the risk that dividends received in Ireland from lower-tax jurisdictions in EU/EEA countries with a double tax treaty would be subject to incremental tax.

R&D tax credit regime

The Bill would increase from €100k to €200k the amount of qualifying R&D expenditure that is excluded from the incremental basis for calculating the tax credit. Thus the first €200k of qualifying expenditure on R&D would be eligible for a tax credit without reference to the base-year expenditure (if any) in 2003.

Another key enhancement introduced in Finance Bill 2013 is a decrease in the threshold that a company must reach to use the R&D tax credit to reward 'key employees'. Under current law, an individual must devote at least 75% of his or her time to R&D activities to qualify as a 'key employee'. The Finance Bill would decrease this threshold to 50%, which would provide more flexibility in utilizing the R&D tax credit to attract and retain key R&D talent.

In addition, as part of the Finance Bill documentation, the Irish government has issued a consultation paper for review of the R&D tax credit regime. The consultation paper invites companies and other interested parties to submit written submissions on a number of issues, including potential enhancements to optimize the structure and design of the regime. Given the importance of the R&D tax credit to US MNCs operating in Ireland, we expect significant interest in potential regime enhancements.

Intangible asset regime

The Bill also introduces an improvement to the intangible assets amortization regime. The new provisions would preclude the clawback of tax amortization claimed on intangible assets when the asset is disposed or ceases to be used for more than five years after it was first acquired or created. The clawback period currently is ten years, so the decrease to five years is positive for taxpayers.

Other measures of interest

- The capital gains tax rate would increase from 30% to 33% for disposals made on or after December 6, 2012.
- Enhancements to the existing corporate tax relief for start-up companies would enable companies to carry forward credits arising in the first three years of activity for use in subsequent years.
- Enhancements to the carried interest provisions would enable companies involved in innovation activities to access investment from venture capital funds.
- The Bill also includes a scheme of accelerated tax amortization for the aviation sector for capital expenditure incurred on industrial buildings or structures used for the 'MRO' trade (maintenance, repair, and overhaul). Qualifying structures would be able to amortize over seven years.

The takeaway

The Bill's changes are broadly positive for US MNCs and investors.

In particular, the FATCA developments should help reduce the compliance burden in this sector, while the introduction of an Irish REITs regime offers more choice to asset managers as they acquire real estate portfolios.

Other notable provisions include the additional FTC that would be available on the receipt of certain dividends, as well as the continued focus on enhancing Ireland's innovation offering through the R&D tax credit and IP regimes.

Let's talk

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