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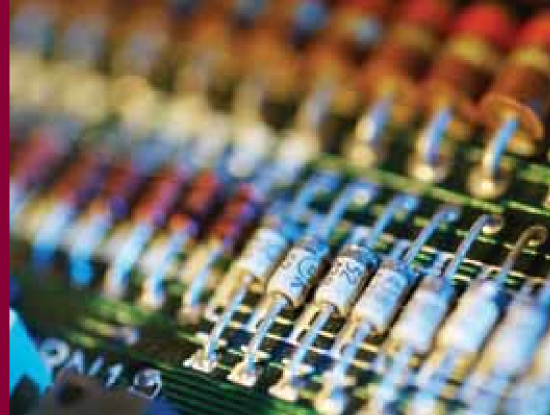
TICE Newsalert

for the Technology, Info-Comms and Entertainment Sectors



February 06

PwC Ireland TICE Tax Group

PwC is a leading provider of tax services to business in Ireland's Technology, Info-Comms and Entertainment Sectors. This group provides advice and news on Irish and international tax issues – and tax-related business issues – affecting TICE businesses in Ireland.

Our Dublin TICE group incorporates over 150 dedicated partners and staff who know the industry of their customers and who have access to our local and worldwide network of experts in areas such as audit and assurance, taxation, corporate finance, human resource consulting and business advisory services.

Finance Bill 2006

The publication of the Finance Bill 2006 sets out the government's proposed legislative changes to the taxation regime 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 various parliamentary stages before it is passed into law as the Finance Act, which must take place by 7 April next. Therefore, the opportunity to lobby the Department of Finance for changes in the provisions of the Finance Bill remains open.

We would strongly recommend that with regard to any of the matters identified below, specific advice in relation to your business's circumstances should be sought before any actions are taken.

Remittance Basis of Taxation

Following the December budget, the remittance basis of taxation was abolished in respect of foreign employment income of certain individuals arising from duties performed in Ireland.

This regime was seen as a significant incentive in attracting to this country many individuals with key skills critical in supporting inward investment to Ireland over recent years and in promoting the transfer of these skills to Irish workers. In light of the changes, the cost of employing individuals affected is set to significantly increase and there will be a greater challenge in attracting this talent in the future.

Since the budget announcement significant lobbying of government has taken place with a view to the modification of the proposed changes so that their impact would be felt in those areas where government believed the regime was no longer appropriate, while still allowing employers in certain sectors to use it to attract (and manage the cost of bringing) these key individuals / skills to Ireland. Disappointingly, there has been no change to the proposals in the Finance Bill.

Apart from the obvious implications outlined above, a number of other crucial areas are impacted by the new rules including the treatment of stock options granted to assignees / secondees and tax relief on employer and employee pension contributions. Efforts are continuing to get clarity on these points.

Disclaimer: This news bulletin is intended only to provide a general guide to the subject matter. Professional advice should always be taken before acting on any information contained in this guide.

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All employers with assignees / secondees in Ireland will need to prepare. The key practical implications of the changes are -

- Employment income attributable to duties performed in Ireland is subject to the PAYE system.
- While PAYE applies from 1 January 2006, a window to allow for necessary preparations for implementing the change is allowed up to 28 February 2006.
- All PAYE deductions relevant to the period from 1 January 2006 to 28 February 2006 must be collected and submitted by 31 December 2006.
- PAYE must be deducted from 1 March 2006 and returns submitted as normal by the 14th of the following month.

Revenue has been asked to provide guidance on the practical aspects of how employers will be expected to implement the new arrangements. As of now these and other clarifications have not been provided.

Subject to whatever guidance is ultimately issued by Revenue, and aside from the 'structural' implications of the new rules relating to cost / key skills, affected employers will need to review their current practical arrangements with a view to complying with the new rules, and, in particular, address the following questions –

- Whether the foreign employer should register for and operate Irish PAYE (in particular where foreign payroll withholding is already being deducted) or whether it is possible to move the employees to an Irish payroll. (It is important to note that employees on UK payrolls working in Ireland will also be affected).
- How income attributable to duties performed in Ireland is to be arrived at where duties are also carried out abroad, in particular where the split of duties between Ireland and abroad varies from month to month. (There is a requirement in the new rules that any apportionment of remuneration between Irish and foreign duties must be agreed in advance with Revenue for PAYE not to apply to all remuneration).
- What HR and administrative processes need to be introduced to track and capture the required information.
- What steps need to be taken to get relevant employees registered for Irish PAYE and have the necessary tax credit certificates issued.
- What steps, if any, need to be taken in relation to PRSI.
- Whether revised contractual arrangements are necessary where multiple functions and duties arise.
- How PAYE attributable to January and February of 2006 will be recovered from employees.
- How to operate PAYE in respect of bonuses to be paid in 2006 that are attributable, in whole or in part, to 2005.

We will keep you advised of developments on these issues, but recommend strongly that companies with employees on the remittance basis address the above questions without delay.

This change will have serious implications for a number of companies in the technology and info-comms sectors. Please do not hesitate to contact us if there are any particular issues you would like to pursue further.

Restrictions on Interest Relief

Section 247 interest relief can arise in cases where interest is paid, by an Irish company on loans used to capitalise or lend to qualifying companies (Irish or foreign), in circumstances where it cannot be treated as a trading expense. It is an important relief and one that is extensively used particularly where there is an Irish holding company in the group structure. During the course of 2005 the Department of Finance and Revenue made it known that they had encountered Section 247 borrowing transactions which eroded the Irish tax base and which they viewed as circular in nature. They viewed this as unacceptable and it was no surprise that the budget statement on 7 December last announced measures to restrict, from budget day, Section 247 transactions within a group where the principal purpose of the transaction was to generate a tax deduction. Bona fide transactions between related companies and the legitimate commercial use of Section 247 were not to be affected.

The Finance Bill proposes to legislate for these announced changes and denies **Section 247 relief** in circumstances where **related party borrowings** are used to acquire share capital of (or lend to) a company which immediately before the Section 247 loan was made was connected with the Section 247 borrower. However there are some important differences compared to the budget statement. Firstly the new anti-avoidance provisions only apply to transactions effected on or after 2 February 2006, and not 7 December 2005 as previously announced. In addition, the restrictions do not apply to third party Section 247 borrowings, although there are provisions which are designed to catch any back-to-back arrangements with the third party lenders. There are also two important carve-outs from the new anti-avoidance legislation.

The first carve-out protects situations where the Section 247 loan is being used to acquire **new share capital** of a company (or to lend to a company to acquire **new share capital** of another company) and the proceeds are used for the purposes of the trade or business of that company. However there cannot be an understanding or arrangement which would result in the proceeds of the loan being used, directly or indirectly, to repay the original provider of the Section 247 loan or any company connected with that original lender.

The second carve-out protects the use of Section 247 borrowings to acquire **new or existing share capital** of a company (or to lend to a company) in circumstances where the Section 247 loan proceeds are directly or indirectly generating interest income or dividends within the charge to Irish corporation tax. In those circumstances, to the extent that the Section 247 interest does not exceed the "matching" interest income or dividend income, it can be offset against the matching interest or dividend income of the original Section 247 borrower or any connected company within the charge to Irish corporation tax. In essence this carve-out allows Section 247 interest payments which would otherwise be disallowed to be offset against matching interest or dividend income even if this is

arising in another connected company. There are two additional points to note here. Firstly, if the matching interest income has itself been deducted for Irish tax purposes (e.g. by another Irish connected company) it will not count for the purposes of this carve-out. Secondly, Irish dividends will not count for the purposes of the carve-out as these are not within the charge to Irish corporation tax. However foreign dividends will qualify even if no Irish tax actually arises because of the availability of credit for underlying foreign taxes.

The legislation as drafted is quite complex and will almost certainly undergo some further refinements and elaborations as it goes through the select committee stages.

Tax avoidance – 10% Surcharge

The Bill introduces new powers for Revenue to apply a **10% surcharge** in cases where a **tax avoidance scheme** has been successfully challenged by Revenue or has led to a tax settlement. This is primarily aimed at flushing out hidden tax avoidance schemes being used by businesses and high net worth individuals. It also clears up the existing ambiguity over when interest on tax owed begins to mount. Interest will be applied by reference to when that tax would have been payable if there had been no avoidance.

However, the Bill also introduces an option for taxpayers to notify Revenue of the transaction concerned and its intended tax consequences. The taxpayer must make a protective notification to Revenue in respect of a transaction within 90 days of beginning a transaction. In such a case the taxpayer will be protected against both the surcharge and the interest, should the scheme later lead to a tax liability.

This new measure will apply to transactions undertaken after 2 February 2006. However, it will also apply to transactions before that date where they have the effect of reducing liabilities or causing repayments after that date.

Capital Duty

The Bill confirms the **abolition** of capital duty (previously 0.5%) with effect from budget day, 7 December 2005.

Film Investment Relief

The Bill proposes to increase the percentage of expenditure that is eligible for tax relief under section 481 to **80 per cent** for **all** qualifying films. Existing relief ranges from 55 per cent to 66 per cent, depending on the size of the film budget.

In addition, the overall ceiling on qualifying expenditure for any one film is increased from €15m to €35m. These new limits will come into effect by order of the Minister of Finance pending EU Commission clearance.

Patent Dividends

The Bill proposes an amendment to the section dealing with tax free distributions out of income from qualifying patent royalties.

Where a royalty is received by a company from a connected party there is now a requirement for the company to show that the invention was patented for bona fide commercial reasons and not primarily for the avoidance of tax.

A second amendment deals with franchising/licensing arrangements where the relationship between third parties includes patent royalties as well as other royalties and fees. A new requirement for matching amounts of R&D is introduced before such royalties can be distributed tax free. This is designed to ensure that the patent royalty is reasonable compared with other aspects of the relationship with the same third party.

These proposed amendments will apply for distributions made on and after 2 February 2006. However, it is likely that companies in the TICE sector making distributions out of patent royalty income already meet these requirements.

VAT Changes

The Package Rule

The Bill proposes to replace the package rule, whereby goods and services supplied together for a single consideration are chargeable at the highest rate of VAT applicable, with a new rule. Under the new rule, the Bill provides that where there is a composite supply which consists of a principal supply and one or more ancillary supplies, then the rate of VAT applicable will be that pertaining to the principal supply. In the case of multiple supplies, i.e. supplies consisting of a number of individual supplies for a single consideration, the consideration will be

apportioned between the various supplies and each supply will be taxed at the appropriate VAT rate. This would apply for example to the sale of a book coupled with a CD. However, Revenue may make Regulations specifying when supplies can be treated as composite or multiple, principal or ancillary and may also determine methods of apportionment of amounts. Until such Regulations are published it will be difficult to gauge the full impact of this proposed new rule.

Recovery of VAT on share issue costs

In relation to share issues, the Bill amends the First Schedule and Section 12 of the VAT Act to grant VAT deductibility where new shares, new debentures, or other new stocks are issued for the purposes of raising capital by a taxable person for his taxable business. This is in line with the recent European Court of Justice (ECJ) decision in the Kretztechnik case.

Deemed supplies of services

The Bill also introduces measures dealing with deemed supplies of services. In particular it raises the concept of self supplies of services in respect of the private use of business assets, the taxation of services supplied free of charge and the taxation of services diverted by a business to a non business use. The changes introduced arise out of the ECJ Hotel Scandic case and its impact on subsidised staff canteens. The taxable amount in the case of the private use of business assets or the supply of services free of charge will be the cost of thereof while the taxable amount where services are diverted to a non-deductible business use is the open market price of supplying those services.

The various provisions relating to self supplies of services only come into force when relevant regulations have been issued and to date regulations have only been issued in relation to an employer providing a subsidised staff canteen.

VAT Groups

An amendment is proposed to Section 8(8)(a) of the VAT Act which deals with VAT grouping. In the current situation, grouping is possible where the Revenue Commissioners are satisfied that to allow it would be expedient in the interest of efficient administration of the tax to do so. The amendment proposes a shift in emphasis to a situation "where it seems necessary or appropriate to them for the purpose of efficient and effective administration, including collection of the tax". While the Revenue have always had the discretion to allow VAT grouping, the wording of the proposed amendment appears to suggest that Revenue may take a more critical look at grouping situations in the future including perhaps compulsory group registration.

Pension Changes

As set out in the budget in December last, the Finance Bill introduces some changes in the pensions area. There have also been some new measures announced that had not been signalled at budget day.

Maximum pension fund of €5million

The Bill proposes for the maximum allowable pension fund at retirement to be €5million or, if higher, the value of the fund on 7 December 2005 (budget day). These limits will be increased in line with an earnings index from 2007. Any excess over the limit at retirement will be taxed at 42%. The limits above include the value of pension funds from all employments and pension plans in respect of periods of self employment. The measure will equally apply to the value of Public Sector Pension Schemes.

Maximum tax free lump sum of €1.25million

Individuals may be entitled to take a lump sum from a pension plan of up to 1.5 times Final Remuneration or 25% of the fund in certain cases. These rules still apply but if the lump sum to be taken is greater than €1.25million, the Bill proposes that the excess will be taxed under the PAYE system. The limit is inclusive of lump sums payable on retirement from all pension schemes the individual receives after 7 December 2005. Lump sums payable to survivors on the death of an individual are not caught by these limits. There is no provision in the legislation to increase the limit in line with earnings.

Approved Retirement Funds (ARFs)

An ARF is a post retirement savings vehicle that is available to certain individuals (e.g. the self- employed, Proprietary Directors or employees in respect of their Additional Voluntary Contribution schemes). The Bill proposes that from 2007 there will be an annual minimum deemed distribution from the ARF. The rate of the deemed distribution will rise from 1% of the value of the ARF assets in December 2007 to 2% in 2008 and 3% thereafter. Any actual distributions made by the individual will be deducted from the deemed distribution. The deemed distribution rules will only apply after age 60.

Indexing the earnings cap of €254,000

The Bill proposes that the personal tax relief limit in respect of pension contributions of €254,000 will be increased annually in line with an earnings index from 2007.

Increased contribution limits for those over 55

Under the terms of the Bill those who attain age 55 during a tax year can make personal pension contributions of up to 35% of their net relevant earnings/remuneration. Where an individual attains age 60 or more the relevant percentage for tax relief limits rises to 40%.

SSIA rollovers to pension products

The Bill contains measures to encourage SSIA holders with 'low' incomes to pay some or all of their maturing SSIA funds towards pension funds. The incentive will be available to SSIA holders whose gross earnings in the year before the maturity of their SSIAs was €50,000 or less and who were not 42% taxpayers. The first incentive proposed under the Bill is that the Exchequer will add €1 to each €3 made by the individual, subject to an overall limit on the Exchequer contribution of €2,500 per person. Secondly the Exchequer will add to the pension fund a proportion of the exit tax that would otherwise have arisen on the maturity of that part of the SSIA funds.

Restrictions on the use of pension scheme assets

The Bill proposes to introduce new rules to deem certain transaction to be treated as early distributions from the pension fund. In such cases the pension scheme must operate income tax on such deemed distributions from the fund. An example is where a pension scheme might use pension fund assets to buy a property which is used by the pension scheme member, or someone connected with him.

This treatment has already existed for Approved Retirement Funds (ARFs). A new measure is to be introduced to prevent an ARF from acquiring a property to be used by an ARF holder's business.

Contact details

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 contact within PricewaterhouseCoopers, or one of the following:

Joe Tynan, Partner, Technology and Info-Comms
+353 1 662 6399 joe.tynan@ie.pwc.com

Maureen Gutkin, Partner, Technology and Info-Comms
+353 1 662 6837 maureen.gutkin@ie.pwc.com

Feargal O'Rourke, Partner, Technology, Info-Comms and Entertainment
+353 1 662 6480 feargal.orourke@ie.pwc.com

George Reddin, Partner, Technology, Info-Comms and Entertainment
+353 1 662 6348 george.reddin@ie.pwc.com

Mary O'Hara, Partner, Human Resource Services
+353 1 662 6215 mary.ohara@ie.pwc.com

Dympna Donnelly, Director, Technology and Info-Comms, and Editor of Newsalerts
+353 1 662 6396 dympna.donnelly@ie.pwc.com

David Hughes, Director, VAT
+353 1 662 6194 david.hughes@ie.pwc.com