

# 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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## Selected highlights from the UK Budget 2006

On 22 March, the UK Chancellor of the Exchequer, Gordon Brown, delivered his Budget for 2006. Quite a number of tax changes were announced, and set out below is a summary of some of the changes relevant to the financial services industry.

### Changes to group relief rules following the Marks & Spencer decision

As you may recall, the European Court of Justice delivered its judgment in the M&S case in December 2005. Following on from that decision, the UK group relief rules are now being amended to allow a UK resident parent company to claim group relief for losses of a non-UK subsidiary which is resident in the European Economic Area (EEA), or of a permanent establishment within the EEA, so long as all possibilities of relief for the loss outside of the UK have been exhausted and future relief is unavailable. It seems that it will not be possible to surrender losses from an EEA resident parent to a UK resident subsidiary, or between EEA and UK sister subsidiaries with a common parent company.

### Establishment of Real Estate Investment Trusts

Legislation is being introduced to allow for the establishment of a corporate vehicle for tax efficient real estate investment. Broadly speaking, a Real Estate Investment Trust (REIT) is a corporate vehicle that will effectively be taxed only at the shareholder level, rather than being taxed at both the shareholder and company level. A 2% conversion charge on the market value of all assets passing into the tax exempt REIT will arise, but this may be spread over 4 years. The REIT will be required to distribute 90% of its profits, and there is a restriction on the existence of shareholders with more than a 10% interest in a REIT. There are also rules relating to the amount of interest expense that the REIT will be entitled to incur, with the tax exempt profits having to amount to at least 1.25 times the interest expense.

### Changes to taxation of leased plant and machinery

A new regime for long-term leases of plant and machinery (i.e. leases of greater than 5 years, or in certain cases greater than 7 years), is being

introduced. Under the new regime, the tax treatment will follow the economic reality of the financing arrangement, and the lessor will be taxed only on the finance element of the lease rental. The lessee will be entitled to a deduction for an equivalent amount and will be able to claim capital allowances. In general, the new rules will apply to all leases finalised on or after 1 April 2006, and transitional rules will apply to leases where the asset was under construction before 1 April 2006. Provisions are also being introduced such that lessors can elect that the new regime will apply to leases which are not long-term leases.

This is a broadly similar provision as that which was introduced in Ireland as section 80A TCA 1997 by Finance Act 2004 for short-term leases. Because of the different profile of capital allowances in Ireland and the UK, capital allowances are claimed in the early years of a UK lease, thus leaving unsheltered profits subject to tax at the latter end of the lease. This provision is an attempt to smooth the income from leasing over the term of the lease.

### Tax regime for securitisation companies

In UK Finance Act 2005, the issue of IFRS being adopted by securitisation companies, and the accounting volatility arising as a result, was dealt with by the temporary measure of allowing such companies to be taxed on the basis of accounting results produced by UK GAAP, as it applied for periods ending on 31 December 2004, for all accounting periods beginning on or after 1 January 2005 and ending on or before 31 December 2006.

This temporary measure is now being extended to accounting periods ending on or before 31 December 2007.

(In Ireland, Finance Act 2005 introduced a rule that provides that Irish securitisation companies are to be taxed on the basis of Irish GAAP as it applied at 31 December 2004, with a option for securitisation companies to elect to follow IFRS if they so wish. Unlike the UK, there is no end-date for this treatment within the Irish rules).

### Anti-avoidance rules

A number of changes to anti-avoidance measures are being proposed:

- **Extension and amendment to tax avoidance disclosure (TAD) rules**

In the UK, certain tax avoidance schemes have to be disclosed to Revenue within a period of time after being established. Currently the schemes to be disclosed are restricted to those involving employment arrangements or certain financial products and stamp duty land tax avoidance. There are also certain "filters" that exclude many of these arrangements from disclosure.

The revised TAD rules will apply to any arrangement where a main benefit is the avoidance of income tax, corporation tax or capital gains tax provided that one or more "hallmarks" exist. The proposed "hallmarks" include:

- "new and innovative schemes",
- "mass marketed tax products", and
- Hallmarks targeted at areas that Revenue consider to be "high risk" such as schemes intended to create losses to offset income or gains, and certain leasing schemes

This is a significant extension of the TAD rules, both in terms of the taxes covered and also by lessening the effect of the "filters" that currently exist. It remains to be seen how the new rules will work in practice. It is an interesting development in the area of disclosure of tax avoidance, particularly in the context of the introduction by Finance Bill 2006 of a voluntary disclosure regime in Ireland, which introduces a protective notification procedure for taxpayers, in respect of tax avoidance schemes.

- **Rules relating to capital losses**

A number of provisions are proposed to deal with perceived abuses of the rules in relation to capital losses.

The first of these broadly seeks to disqualify as an allowable loss any capital loss arising from arrangements whose main purpose, or one of whose main purposes, is to secure a tax advantage.

The second provision prevents the set off of gains and losses when there is a change of ownership of a company, where the main purpose or one of the main purposes of which is to secure a tax advantage involving the deduction of a capital loss from any chargeable gain.

Thirdly, Revenue is apparently concerned about the potential effect on the Exchequer of the large amount of capital losses potentially available to companies, and the possibility of the development of arrangements to utilise these losses in the future. Therefore, provisions are being introduced aimed at preventing schemes that are designed to convert income into capital gains that can be reduced by capital losses, and also at schemes whereby chargeable gains are created which can be reduced by capital losses and as part of the same scheme, the company or a connected company incurs expenditure that reduces its income.

- [Sale of leasing companies](#)

Provisions against the tax-driven sales of leasing companies are also proposed. Because of the profile of UK capital allowances in respect of plant and machinery over the term of a finance lease, those allowances are likely to exceed income in the initial years, with the corresponding losses arising being available for group relief. As time progresses, the lease rental receipts exceed the allowances, giving rise to taxable profits. The leasing company could then be sold to a group with tax losses such that the profits arising can be sheltered by means of group relief claims.

The proposed legislation provides that an accounting period will end on the change of ownership of the company, and in that accounting period, there will be a deemed income receipt equal to the excess of the book value of the leased assets over their tax written down value. In the subsequent accounting period, a corresponding deduction will be deemed to arise, thus eliminating the opportunity to shelter any profit with the losses of the acquirer.

- [CFCs and residence rules](#)

Where a UK resident company holds a 25% interest in a controlled foreign company (CFC), the UK company must pay tax in respect of its share of the profits of the CFC, subject to a number of exemptions which might apply to the CFC. Where a UK resident company migrates its residence and becomes resident in another territory under the terms of a double taxation agreement, the CFC rules still regard that company as UK resident, so it remains potentially chargeable to tax on the profits of the non-UK companies in which it holds an interest. However, this rule only applies to companies which became non-UK resident on or after 1 April 2002.

The new rules provide that with effect from 22 March 2006, companies which became non-UK resident before 1 April 2002 will now also be subject to the CFC legislation on the happening of certain, yet to be identified, events. This is an attempt to prevent such companies being used in tax avoidance schemes.

## **VAT - ECJ decision in FCE Bank case on branch to branch supplies**

Following on from the October 2005 publication of the Advocate General's opinion on the FCE Bank case, the European Court of Justice (ECJ) has recently released its judgement.

The ECJ judgement has confirmed the opinion of the Advocate General and concluded that FCE Bank plc (a UK bank) and its Italian branch constitute a single taxable person and the provision of services between the two parties does not constitute a supply for VAT purposes. The branch is not independent to FCE Bank plc and therefore there is no legal relationship between them.

A provision of services is only taxable if there is a legal relationship in which there is reciprocal performance between the service provider and the recipient. In this instance, the court determined that FCE Italy does not carry out an independent economic activity, in particular it does not bear any economic risk arising from its business.

- [Implications for Ireland and Revenue's approach to Irish branches \(of foreign companies\) part of an Irish VAT group](#)

Unfortunately the questions raised in FCE did not directly address the Irish Revenue's approach to transactions between Irish branches of foreign companies and their head office or Irish head offices with branches outside Ireland where the branch or head office is part of a VAT group. At present, Revenue follow the ECJ judgement and concur that the provision of services between the two parties does not constitute a supply for VAT purposes. However, if either is part of a VAT group, Revenue approach this differently and contend that supplies between the two parties do constitute a supply for VAT purposes. It will be interesting to see if Revenue review this stance in light of the FCE judgement.

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:

Enda Faughnan, Partner, Banking, Treasury, Securitization  
+353 1 662 6359 [enda.faughnan@ie.pwc.com](mailto:enda.faughnan@ie.pwc.com)

Jim McDonnell, Partner, Banking, Asset Finance  
+353 1 662 6836 [jim.mcdonnell@ie.pwc.com](mailto:jim.mcdonnell@ie.pwc.com)

Patrick Wall, Partner, Insurance, Investment Management  
+353 1 704 8602 [patrick.wall@ie.pwc.com](mailto:patrick.wall@ie.pwc.com)

John O'Leary, Partner, Banking, Insurance, Investment Management  
+353 1 704 8659 [john.oleary@ie.pwc.com](mailto:john.oleary@ie.pwc.com)

John Fay, Partner, VAT  
+353 1 704 8701 [john.fay@ie.pwc.com](mailto:john.fay@ie.pwc.com)

Mark Carter, Partner, Human Resource Services, Employment / Expatriate Tax  
+353 1 662 6548 [mark.p.carter@ie.pwc.com](mailto:mark.p.carter@ie.pwc.com)

Pierce Maloney, Director, Insurance, Banking, Editor of IFS Newsalerts  
+353 1 662 6833 [pierce.maloney@ie.pwc.com](mailto:pierce.maloney@ie.pwc.com)