

IFS Newsalert

International Financial Services (IFS) - Ireland



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Finance Bill 2005

The publication today of the Finance Bill marks the most significant annual event in the tax calendar of business in Ireland. While there are many provisions of the Bill which may have an impact on your organization, set out below is a commentary on the highlights of the Bill which will have a particular impact on the financial services industry in Ireland.

It should be borne in mind that the information below is our initial interpretation of the draft legislation 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 is expected to take place in mid March.

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

IFRS

International Financial Reporting Standards (IFRS) came into force across the EU on 1 January 2005. This means that listed companies throughout the EU (including Irish listed companies) are now required to apply IFRS in their consolidated accounts. In addition, Irish companies have the option to prepare their individual entity accounts under either Irish GAAP or IFRS subject to a group consistency requirement.

The Finance Bill contains "enabling" provisions in relation to the use of IFRS accounts for tax purposes. As widely expected, the Bill provides that accounts prepared under IFRS will be an acceptable starting point for computing taxable trading profits. This means that profits reported in IFRS accounts will be taxable subject to any adjustment required under tax law. Accounts prepared under Irish GAAP will, of course, continue to be acceptable for tax purposes. This raises the prospect of companies with similar profiles in different groups having different levels of taxable profits as a result of adopting different accounting standards.

The Bill also includes changes to the taxation of gains and losses on financial assets and liabilities. To date such gains and losses have, with certain limited exception, been taxed or allowed only when realised. Going forward, unrealised gains and losses will be taxed or allowed when they are reflected in a company's profit and loss account. This is a fundamental change to the tax system and it will affect companies adopting IFRS as well as those remaining on Irish GAAP.

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Anti-avoidance provisions have been introduced to prevent intra-group transactions which use different accounting systems to create a tax advantage. This could arise in the perhaps limited circumstances where some companies in a group adopt IFRS while others remain on Irish GAAP. The Bill counteracts this by requiring that the taxable profits of both companies involved in such a transaction must be computed under Irish GAAP.

The Bill confirms that charges made in IFRS accounts relating to share-based consideration (e.g. share options granted to employees) will not be deductible for tax purposes.

The adoption of IFRS is likely to give rise to prior year adjustments in accounts arising from various changes in accounting policies. The Bill deals with the taxation of these prior year adjustments. In general the approach taken is to spread prior year profits and losses over a five year period for tax purposes. However, specific rules are introduced to allow a measure of relief for general bad debt provisions which are recharacterised as specific provisions on the changeover to IFRS. Transitional measures are also introduced to ensure that the change in the taxation of gains and losses on financial assets does not result in gains and losses being doubly taxed/allowed, or not being taxed/allowed at all, on the changeover to the new system. The approach taken is to spread the amounts involved over a five year period for tax purposes.

While the Bill is welcome in clarifying a number of tax issues relating to IFRS, it does not deal comprehensively with the subject and further clarification will become available when a Statement of Practice is issued by the Revenue later in the year.

Encashment tax abolished at bank retail branch level

In a move that will be warmly welcomed by the major retail banks, encashment tax has been abolished at retail branch level for individuals cashing foreign dividend and foreign interest cheques. For many years encashment tax at the standard rate of income tax (currently 20%) has had to be deducted (and paid over to the Revenue Commissioners) by banks who were cashing foreign dividend and foreign interest cheques for customers. The customer was taxable on the foreign dividend or interest at the marginal rates of tax with credit for the tax deducted by the bank. There were some major exemptions from encashment tax including where the customer was not resident in Ireland for tax purposes and, under a special arrangement with the Inland

Revenue, where the dividend or interest was being paid by a UK company. However, encashment tax did apply in a wide range of situations and where it did apply, the tax was extremely difficult to operate at the bank branch level. This was mainly because of the difficulty for the branch staff in identifying that the cheque presented by a customer was a foreign dividend or foreign interest payment to begin with. In many instances this was by no means obvious. In addition, and largely as a result of share schemes involving employees of major multinational companies, the level of foreign dividends or interest being cashed was very modest making the encashment tax very costly to collect relative to the yield.

The Finance Bill now proposes to eliminate these difficulties by abolishing the tax where a customer presents a foreign cheque for clearing and encashment at retail branch level. The tax remains for bank custodians who collect foreign dividends and interest on behalf of major funds clients. Encashment tax collected on such electronic payments has contributed the bulk of the take from this tax over the last number of years in any event so the Finance Bill move will not have significant exchequer implications. However its removal at bank branch level removes a major administrative headache for the retail banks.

Amendment to holding company legislation

The Finance Act 2004 introduced a range of measures designed to make Ireland more appealing as a holding company location following extensive lobbying by industry for a number of years. These measures included the important step of the introduction of an exemption from tax on capital gains arising on the disposal of shareholdings in trading companies in an EU territory or in a country with which Ireland has a double tax treaty.

As set out in IFS Newsalert Issue 1 (September 2004), this legislation was subject to EU approval before it became effective. This approval was granted in September 2004, at which time the Minister for Finance issued a Commencement Order, and confirmed that amendments to the legislation as required by the European Commission would follow in Finance Bill 2005. The Finance Bill now formalises the amendments to the original legislation, and as indicated when the approval was granted, these amendments involve the removal of restrictions to the applicability of the original legislation which were seen by the Commission as contravening State aid rules. These restrictions set value thresholds which had to be met in order for the exemption to apply (€15m for a 10% holding, and €50m for a 5% holding).

However the European Commission apparently felt that these thresholds could limit the use of the legislation by the domestic sector, thus favouring inward investors.

The amended provisions replace the thresholds mentioned above with a flat 5% shareholding requirement and no minimum value requirement. As indicated by the Commencement Order, the amendments confirm that the exemption applies to transactions entered into from the date of the publication of the original legislation in February 2004.

Asset pooling - Common Contractual Fund

The common contractual fund (CCF) was introduced about 12 months ago to allow pension assets to be pooled in a tax transparent structure. The changes in the Bill are designed to allow for a non-UCITS version of the CCF and extend the range of qualifying investors to include all forms of institutional investment.

The interest in creating larger asset pools is driven by a desire to achieve greater efficiency through improved reporting and elimination of dealing costs. Asset pooling is of particular interest to institutional money managers and multinational companies with multiple occupational pension plans. Some of the inefficiencies inherent in the need to maintain multiple pension schemes can be mitigated by pooling the assets of a number of pension funds in a single regulated vehicle. The CCF is designed to facilitate such pooling while ensuring that the tax treaty benefits normally enjoyed by pension funds are not disturbed. This is achieved by treating the intermediate vehicle, i.e. the CCF, as tax transparent. For tax purposes each investor in the CCF is treated as directly owning of the underlying investments while the CCF is treated as a regulated entity and is managed accordingly.

Pan-European pensions

As part of the EU's efforts to create a single market for financial services the Commission has called on all Member States to eliminate any tax discrimination against pension funds domiciled in other EU states. The Bill contains provisions extending the right to tax deductions for pension contributions to any scheme established in another EU Member State.

This is part of a package of measures designed to put Ireland at the forefront of developments in the creation of a single EU market for occupational pensions. The IORP Directive will be transposed into Irish law very shortly and this will allow for the creation of occupational pension

schemes for employees in any EU Member State. The tax changes will bring Ireland into line with the EU Commission's requirement to eliminate

tax discrimination that favours nationally based pension schemes. While there may be some time to go before true pan-European pension schemes emerge, these measures put Ireland in a strong position to compete as the market develops.

Change affecting the leasing industry

Existing legislation provides that Case I losses arising in a trade of leasing, to the extent created by specified capital allowances, may be ring-fenced to Case I leasing income.

Currently the ring-fence also prevents tax losses created by leasing capital allowances being surrendered by way of group relief. This issue is addressed in the Bill which provides that leasing losses incurred by one company may be surrendered to another group company in order to reduce leasing profits. This provision will be a welcome change for groups conducting their leasing activities in more than one company.

Stock lending and repo transactions

Under current legislation, an exemption from stamp duty applies to stock lending and repo transactions where the time period within which those transactions must be completed is 6 months. The Finance Bill introduces the welcome extension of this time period to 12 months. It is likely, on the back of this amendment, that a similar extension will apply to the period within which such transaction must be completed in order to avoid being treated as a disposal and reacquisition of the securities involved for corporation tax purposes.

Rate of tax on deposit interest received by individuals from EU banks

Currently, deposit interest earned by an Irish resident individual from a deposit in a foreign bank is subject to income tax at the individual's marginal rate of income tax. The Bill proposes an amendment to bring the taxation of such deposit interest income into line with the taxation of Irish-source deposit interest by taxing it at the standard income tax rate (currently 20%). This measure is being introduced to eliminate any discrimination between the tax treatment of deposits placed in financial institutions in Ireland on the one hand, and in other EU Member States on the other.

Amendments to the treatment of certain life assurance products

The Finance Bill provides for exit tax at 23% to apply to investment gains made under certain fixed term life assurance policies where the proceeds of those policies are rolled-over at the discretion of the policyholder. The Bill also provides that exit tax will apply where there is any transfer under a life policy from one fund to another at any time 5 years or more after the start of the policy, where that transfer is at the discretion of the policyholder. These provisions are sure to generate much discussion within the life assurance industry.

Revenue powers in relation to certain life assurance policies

In a move which was widely anticipated, the Bill seeks to increase the powers of the Revenue Commissioners to allow them to obtain information held by a life assurance company in respect of their policies and their policyholders.

This provision is designed to facilitate the investigation by Revenue of insurance policies, and its use is subject to Revenue being satisfied that there are suggestions that such policies may have been used by the policyholders concerned as an investment vehicle for untaxed funds. Any information obtained by way of this power may only be used to make a High Court application for an order to allow Revenue wider access of the information of such a life assurance company.

Publication of tax defaulters - increase in de-minimus level

Since 1983 Revenue may in certain circumstances publish the names of tax defaulters. Generally, publication will take place where the person did not make a qualifying voluntary disclosure to Revenue and the settlement (tax, interest and penalties) is in excess of €12,700. This limit was introduced in 1983 and has not been subsequently

increased. The Finance Bill proposes to increase this limit to €30,000 which will be indexed linked to the consumer price index every five years.

Introduction of a general Revenue offence

The Revenue have been put under some public pressure to increase the number of prosecutions for tax related offences and also to prosecute persons who have assisted others to evade tax. Under current legislation, a person will be guilty of a Revenue offence (which is a criminal offence) only if the person knowingly or willfully fails to properly comply with certain specific obligations of the Taxes Acts e.g. filing an incorrect tax return or failing to file a tax return. In addition, it is a Revenue offence to aid or abet another person to file an incorrect return in relation to any tax. On the basis that the Courts are likely to interpret this provision strictly it could only apply to those persons who actually assist in the preparation and filing of tax related returns e.g. tax advisers, accountants etc.

The Finance Bill proposes to significantly broaden the scope of a Revenue offence by the introduction of a general Revenue offence which applies to persons who knowingly evade or attempt to evade tax and to persons who knowingly assist others in the evasion of tax. Under the proposal amendment a person shall be guilty of a Revenue offence if the person is knowingly concerned in the fraudulent or attempted fraudulent evasion of tax either themselves or by some other person. In addition, a person shall be guilty of an offence if the person is knowingly concerned in or is reckless as to whether the person is concerned in facilitating the fraudulent evasion of tax.

This provision is similar to the common law offence of cheating the public Revenue which has been successfully used by the U.K. Inland Revenue to prosecute and imprison persons who have evaded UK tax.

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,
+353 1 662 6359

Partner, Banking, Treasury, Securitization
enda.faughnan@ie.pwc.com

Jim McDonnell,
+353 1 662 6836

Partner, Banking, Asset Finance
jjim.mcdonnell@ie.pwc.com

Patrick Wall,
+353 1 704 8602

Partner, Insurance, Investment Management
patrick.wall@ie.pwc.com

Pierce Maloney
+353 1 662 6833

Senior Manager, Insurance, Banking, Editor of IFS Newsalerts
pierce.maloney@ie.pwc.com