TSG 07/20

Tax Strategy Group
International Financial Services

1. Introduction

1.1 The international financial services sector continues to make a major contribution to the Irish economy in terms of employment and corporation tax yield. *Finance Dublin* estimates that employment in the international financial services sector now stands at over 22,000. When certain support services are taken into account this figure rises to over 26,000. The corporation tax yield from the sector totalled €1,118 million in 2006.

1.2 The banking sector, employing over 10,000, is the most significant employer. On the funds side some 9,000 are employed. Insurance sector employment stands at just over 3,000. Total assets held by foreign banks in Ireland grew by 27% in 2006; the total net asset value of Dublin domiciled funds grew by 25%; and in the insurance sector, total sales were up more than 30% on the previous year.

1.3 This growth continues the strong performance of the sector since the ending of the special tax measures for IFSC companies on 1 January, 2006 and the migration of these companies to the general 12½ % corporation tax regime. Assisting this transition were a range of measures introduced in last year's Budget and Finance Act 2007 including:

- the extension of double taxation relief pooling and the unilateral credit relief provisions of the tax code to branch structures
- alleviating one element of double taxation by treating as a distribution an annual interest payment to associated companies in non-EU/Treaty countries
- foreign currency matching amendments to remove a previous timing mismatch, thereby allowing share capital value movement to be taken into account in matching corresponding amounts in a related loan

1.4 The international financial services industry is represented on a number of groups established under the auspices of the Department of the Taoiseach, and at a high level on the Clearing House Group (CHG). The Department of Finance and the Revenue Commissioners engage with the industry through participation in the CHG process.

1.5 Building on Success sets out a framework for the development of the international financial services sector in Ireland. That document reflects any concerns expressed by the Department in relation to the scope of fiscal and legislative changes recommended in it and the feasibility and desirability of such changes. It also restates concerns that Government has about artificial structures constructed with a view to tax avoidance. In relation to specific fiscal issues, the document refers to the ongoing consideration of a number of medium term issues that have been identified as requiring attention such as further developments for the Securitisation industry, as well as on-going policy response to new product development.

2. Budget & Finance Bill 2008 Submissions focussing on this sector

2.1 In the context of Budget and Finance Bill 2008, the following submissions have been made from:

- *CHG Banking and Treasury Working Group Tax Sub-Group*
- *CHG Insurance Working Group Fiscal and Accounting Sub-Group*
- *CHG Funds Working Group Tax Sub-Group*
- *CHG Banking and Treasury Working Group International Asset Finance Sub-Group*
- *The Irish Securitisation Forum*
- *Cross Border Leasing Group*

2.2 The Irish Tax Institute and the Irish Bankers Federation were involved in the preparation of a number of the sub-group submissions, principally that of the Banking and Treasury group.

2.3 There is some crossover between the various submissions, which in keeping with the established process, focuses on measures that would enhance the competitiveness of the financial services industry in Ireland and increase Ireland's attractiveness as a centre for international financial services operations. A number of changes have been sought and these are currently being examined mainly in the context of the Finance Bill. It is intended to focus only on substantial individual issues raised in the submissions rather than technical points or points of clarification. Issues which have been raised in more than one submission are considered only once.

The main issues identified by the various groups are:

- Participation exemption for dividends
- Equalisation Reserves
- 8 Year Deemed Disposal – Section 50 Finance Act 2006
- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
- Extend the definition of "qualifying assets" within the meaning of Section 110
- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
- Interest withholding tax*
- Tier 1 interest*
- Residual income tax liability*
- Remittance basis of income tax*

2.4 It is intended to focus this paper on key items. Those items flagged with an asterisk above, have been raised before in the context of previous discussions and decisions have been made not to change current policy. Moreover, some of these same issues have been addressed in the discussions on *Building on Success* where no different conclusions were reached. The remaining issues are dealt with in the paragraphs below.

3. Participation Exemption for Dividends

3.1 The Group will recall that the Holding Company measure, introduced in Finance Act 2004, provides for a capital gains tax exemption on the disposal of a foreign subsidiary by an Irish holding company. Furthermore, capital duty on the subscription of new capital to a holding company was removed when CCD was abolished in Finance Act 2006.

3.2 Industry is asking that a similar exemption be introduced for dividends received by an Irish holding company from foreign subsidiaries. Under current tax law, dividends received by an Irish holding company from an Irish subsidiary are exempt from tax. Dividends from a foreign subsidiary however are subject to corporation tax at the passive income rate of 25%.

3.3 The tax charge is modified and reduced by offsetting as a credit any foreign withholding tax, and subject to certain limitations, any underlying corporation tax paid at the level of the subsidiary paying the dividend. Furthermore, there is an ability to mix tax credits to ensure that the maximum credit is offset against the Irish tax charge of 25%. i.e. in many real situations the 25% tax charge is fully offset by foreign tax credits. It is also possible that where such credits are not immediately available, a company can delay the payment of dividends until sufficient credits can be accumulated to cover any Irish tax charge. The problem in achieving this end result of no tax payable is the need for constant tracking and re-computation of credits on an ongoing basis. Since Industry accepts that the system of foreign tax credits provided for in the tax code is sufficient to obviate any disadvantage that may exist through lack of a tax exemption for dividends, it seems that administrative complexities or marketing issues are driving the case for the exemption.

3.4 Industry argues that the substantial restrictions placed on claiming interest relief under section 247 TCA 1997 in Finance Act 2006 in respect of the acquisition of subsidiaries are further justification for exempting dividend income from a charge to Irish tax. We would not take the view that these measures have had a negative impact on its business. The actions taken then were purely to prevent aggressive tax avoidance using artificial structures and were not designed to impact on legitimate business between group companies.

3.5 Industry also suggests that a holding company regime, without a clear exemption for dividends, will not find acceptance given the competing regimes in an international environment and that local organisations are having difficulties in persuading their organisation to locate here as a result of these difficulties. This is counter to our previous understanding based in information from the IDA and Industry itself that this was not actually seen as a significant impediment.

3.6 Nevertheless, the Group should note that the ECJ judgement in the case of *Test Claimants in the FII Group Litigation v [UK] Commissioners of Inland Revenue* has implications for the current tax treatment in Ireland of Irish sourced and foreign sourced dividends paid to Irish resident companies. The appropriate response to the judgement in the case is being considered carefully and issues such as the introduction of participation exemption will form part of that consideration process.

3.7 Any changes that may be proposed would have to have regard, for example, to the implications for the current 25% corporation tax rate on non-trading income, our international reputation, safeguards against the potential flight of investment offshore, tax avoidance issues and the broader impact on the current balance of the tax system. All of these issues require careful examination in determining what should be the appropriate response to the ECJ judgement in the FII case.

3.8 Furthermore, there are two particular factors which complicate any potential response. Many jurisdictions with participation exemptions include provisions in tax law to protect their Exchequer against the location in low tax jurisdictions of passive income in order to avoid tax in their jurisdiction. Notable amongst these is the Controlled Foreign Corporation (CFC) rules that exist in the UK even though the UK does not have a participation exemption regime for dividends. Ireland does not have such provisions and does not support them. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX In addition, a report of the EU Code of Conduct Group indicates that a majority of the group considers that a holding company regime that gives exemptions for dividends to be harmful if it does not include a condition that the profits out of which the dividends are paid are taxed at a minimum level. Ireland did not agree with that view and our disagreement is recorded in the Report of the Code of Conduct Group.

3.9 Notwithstanding these issues, the issue will be examined in light of Industry concerns.

4. Equalisation Reserves

4.1 In accordance with Regulation 24 of Statutory Instrument 380 (SI 380) of 2006, non-life re/insurance undertakings are required to establish an equalisation reserve when business written falls under a certain class. Under current legislation equalisation reserves are not allowable as a tax deduction.

4.2 Industry informs us that this situation leaves Ireland at a competitive disadvantage by comparison to certain other EU countries where it is understood the tax treatment of equalisation reserves is different in that it is an allowable deduction for tax purposes. Industry has requested therefore that equalisation reserves required by the Financial Regulator for prudential purposes are treated as an allowable deduction for tax purposes in Ireland.

4.3 The matter will be considered further in consultation with Industry.

5. Eight Year Deemed Disposal – Section 50 Finance Act 2006

5.1 Section 50 of Finance Act 2006 introduced a new chargeable event for investment undertakings, under which a tax charge would be triggered at the end of every 8-year period. The legislation was triggered by the need to counter a practice that had come to light in the domestic life policies sector, whereby exit tax could be avoided by the continual rolling over of the policy. Similar provisions were introduced for domestic and foreign life assurance policies and for offshore funds to provide a level playing field in the funds/life policies sectors.

5.2 The Funds industry have objected to the 8-year rule but only in the case of funds that had mostly non-resident investors and some Irish resident investors. The difficulty according to Industry is that the rule imposes such an administrative burden on the managers of such funds that it will make Ireland uncompetitive.

5.3 Funds can have:

- All Irish resident investors
- Mostly Irish resident investors
- All non-resident investors
- Mostly non-resident investors with some Irish resident investors

5.4 Discussions with Industry over the course of the past year have led to the agreement in principle of a proposed de minimis exemption for Irish funds provided that the level of investment by Irish investors did not exceed a certain threshold. This can be achieved by exempting funds from the provisions where the level of Irish investors does not exceed certain limits. We have not responded yet as to where any threshold should be set.

5.5 Furthermore, while Industry welcomes the de minimis exemption, it feels that its members would still be required to undertake significant investment in terms of developing systems for calculating whether a fund was exempt or not. They have made several alternative proposals for easing the administrative burden on their members. These proposals are now being examined and engagement with Industry will continue over the coming months.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXX.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXX

<u>7. Extend the definition of qualifying assets within the meaning of Section 110</u>

7.1 Part of the success of the 2003 changes to Section 110 was the relatively broad concept of qualifying assets, which relied on a definition of financial asset that contained a non-exhaustive list of examples of financial assets. Industry believes that to maintain Ireland's competitive edge, it is necessary to update the definitions of qualifying assets and financial assets.

7.2 Industry XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX requests that carbon credits/carbon permits and insurance policies and reinsurance policies should be included as qualifying assets. Regarding insurance and reinsurance policies being specifically included, this would bring legislative certainty to Revenue Commissioners practice of recognising securitisation transactions involving insurance and reinsurance policies as falling within the Section 110 regime even though they are not included in the non-exhaustive list of financial assets.

7.3 This matter is being examined but further discussions will be necessary with industry and, in the context of carbon credits, with the Department of Environment, Heritage and Local Government.

7.4 These issues are currently being considered with a view to identifying possible solutions in the context of this year's Bill. This process is ongoing and involves detailed technical consultations with various parties from the industry. The additions, if agreed to will broaden the activities covered in Section 110 and need to be considered fully as regards their implications

<u>XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX</u>

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXX.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXX.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

The Group may wish to consider the issues raised in this paper.