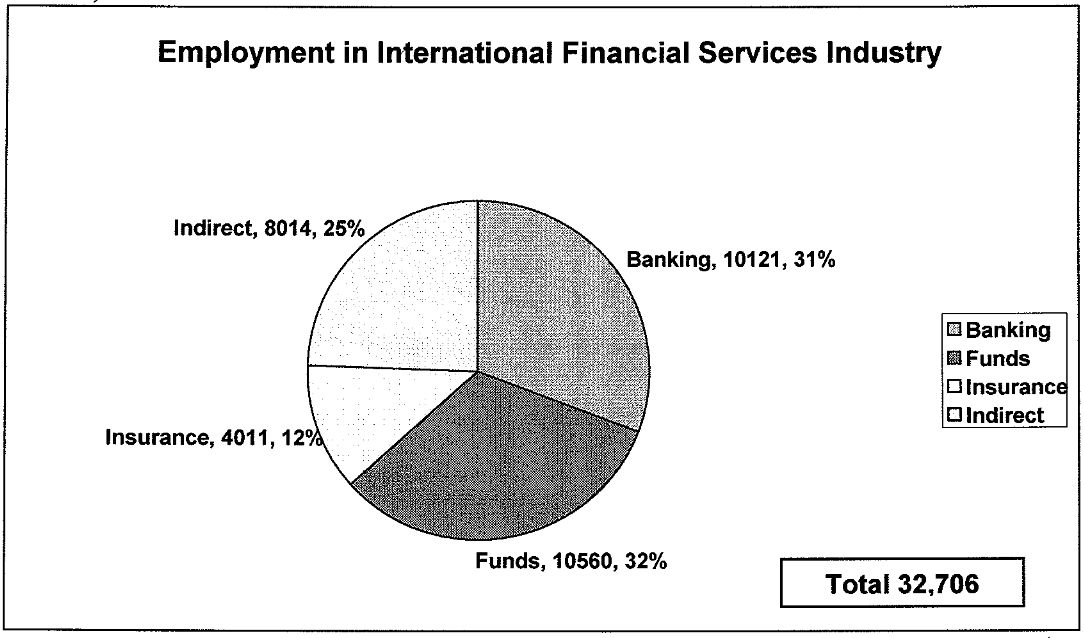
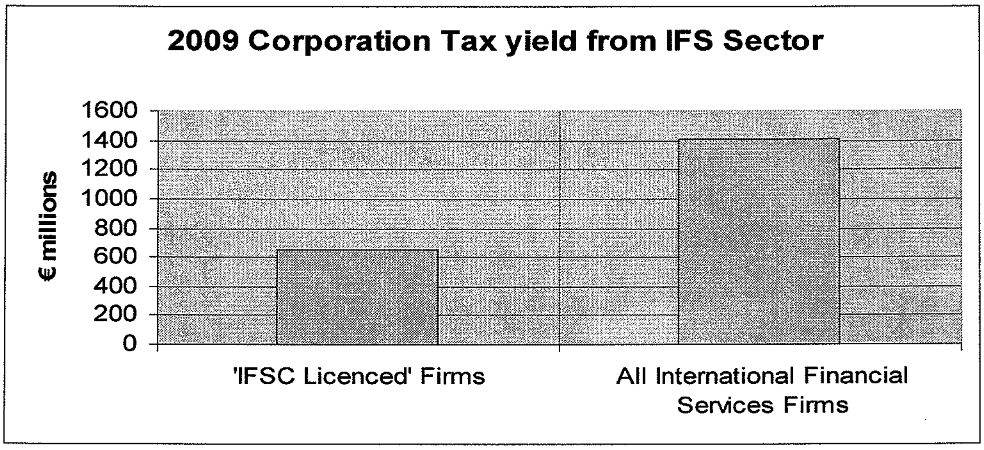
Tax Strategy Group
International Financial Services

1. Introduction

1.1. The international financial services (IFS) sector continues to make a significant contribution to the Irish economy in terms of employment and corporation tax yield. There are approximately 25,000 people directly employed in the sector[1] - the breakdown of employment by sector is illustrated below. When certain support services are taken into account, the overall figure rises to almost 33,000[2].



1.2. The Revenue Commissioners estimate that the corporation tax yield from companies licensed under the old 10% IFSC regime was €642m in 2009. According to the FSI / Accenture Report, when firms established since expiry of the IFSC tax regime are included, the total corporation tax yield from all IFS firms in 2009 was €1.4bn (36% of total 2009 CT yield).

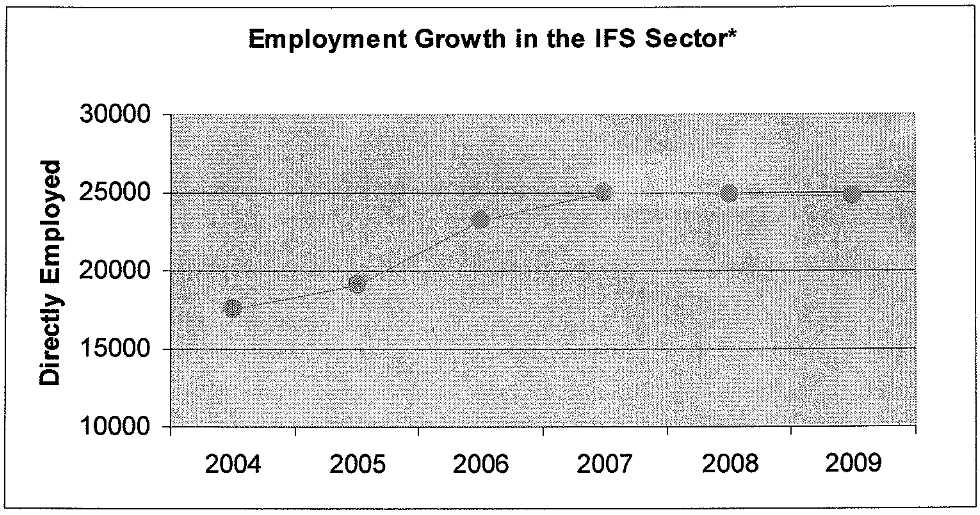


[1] Source - Finance Dublin Yearbook 2010. Figures relate to 2009 Employment Survey.
[2] A joint Financial Services Ireland / Accenture Report –*The IFSC in Ireland*, 2010 estimates 8,014 people employed in certain support services and niche industries such as professional services, IT and outsourcing, payments and corporate treasury.

1.3. The international financial services sector 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.

1.4. Government support and strategy for the sector is articulated in the 2006 policy document *Building on Success.* The Clearing House Group is currently devising a new strategy for the IFSC.

1.5. The Government identifies the international financial services industry, in its *Smart Economy* strategy paper, as having the potential over the medium term to contribute significantly to the growth of output and employment in the Irish economy. In this regard, it is encouraging to note that employment in the sector has held up remarkably well remaining steady around 2007 levels with a small drop in the numbers employed in banking being offset by an increase in the numbers employed in the international insurance sector.



*Source: *Finance Dublin Yearbooks* – 2004 - 2010

1.6. In response to recommendations, from both the Dublin Castle workshop and the Global Irish Economic Forum which was held at Farmleigh in September last year, former Taoiseach John Bruton has recently been appointed chairman of 'IFSC Ireland', with responsibility for promoting Ireland's international financial services industry. The post is funded by industry representative bodies with administrative support provided by the IDA. Building upon the measures introduced in Finance Act 2010 to facilitate Islamic Finance in Ireland, John Bruton will take part in an EI / IDA trade mission to the Gulf region in December. Representatives from the Central Bank and the Department of Finance will also take part in this mission.

1.7. The recent signing of a Double Taxation Agreement with Singapore, brings to 61 the number of comprehensive double taxation agreements which Ireland has signed. Double taxation agreements are key instruments for developing and strengthening economic and trade relations between countries. They reduce tax impediments that might otherwise deter the development of bilateral trading and investment activities. The rapid expansion of Ireland's tax treaty network reflects the priority that the Government has afforded to international business operators over the last number of years.

2. Budget & Finance Bill 2010 Submissions focussing on this sector

2.1 In the context of Budget and Finance Bill 2010, we are considering submissions from;

- *Department of Enterprise, Trade and Innovation*
- *CHG Banking and Treasury Working Group Tax Sub-Group*
- *CHG Banking and Treasury Working Group International Asset Finance Sub-Group*
- *CHG Banking and Treasury Working 'Green IFSC' Sub-Group*
- *CHG Insurance Working Group Fiscal and Accounting Sub-Group*
- *CHG Funds Working Group Tax Sub-Group*
- *Irish Securitisation Forum*
- *Irish Taxation Institute*
- *Irish Business and Employers Confederation*

2.2 It is worth noting that enhancement of the remittance employment scheme introduced in Finance (No. 2) Act 2008 is highlighted in every submission as the priority issue for the international financial services sector in the context of Finance Bill 2011.

2.3 It is intended to focus only on substantial individual issues raised in the submissions rather than technical points or points of clarification.

2.4 The key issues being considered are:

- Remittance
- Section 110 of the Taxes Consolidation Act 1997
- Alternative Investment Company
- Green IFSC
- Interest payments to non–residents (Cash-Pooling and Technical liability to tax on Irish source income)
- Foreign Branch Exemption

2.5 A number of other, more technical, issues are also being considered:

- Capital Gains Tax on Foreign Denominated Bank Accounts
- Islamic Finance
- Stamp Duty Issues
- UCITS IV
- Section 247 TCA 1997 – Anti-avoidance measure

3 Remittance

3.1 In recent years, international investment has become increasingly mobile, particularly in a number of areas of economic activity such as internationally traded services which is considered to constitute a key potential driver of future economic and employment growth. This development has been mirrored by an increased mobility of highly-skilled workers in those areas of economic activity who can generally command high salaries and associated benefits.

3.2 As a result, a number of jurisdictions have put measures in place to ensure that they can continue to attract investment either to maintain or increase existing levels of economic activity and employment. Increasingly, these efforts have focussed on attracting highly skilled workers. For example, favourable tax schemes have been used to attract highly skilled migrants in the

Netherlands, Belgium, Denmark, Finland, Norway and Sweden. OECD research shows that the level of personal taxation affects the location choices of highly skilled workers. [3]

3.3 As the Tax Strategy Group will be aware, a limited form of the remittance regime was reintroduced in Finance (No. 2) Act 2008 to ensure that Ireland would continue to be able to compete internationally to attract skilled workers in the context of the increasingly scarce and mobile international investment in key areas of economic activity. The scheme provides, subject to numerous restrictions, that where an individual comes to Ireland to carry out the duties of a foreign employment, the Income Tax on the income from that employment is reduced to the tax due on the greater of (a) the amount of the income from that employment remitted to the State, or (b) €100,000 plus 50% of the income from the employment above that amount. The scheme operates by way of refund in order to ensure that it is not open to the same abuse that led to the abolition of the previous remittance scheme in 2006.

3.4 The measure was intended as a strong signal of the Government's commitment to strengthening the skill base of the economy while at the same time addressing some of the legitimate concerns raised about such arrangements over the years.

3.5 Further limited changes were made in Finance Act 2010 – the restriction of the scheme to non-EEA nationals was removed and the requirement for a beneficiary to remain in Ireland for a minimum of three years was reduced to one year.

3.6 However, it is understood from industry representations that the scheme has still had very little take-up and has been unsuccessful in its objective of attracting highly-skilled mobile executives to work in Ireland. This lack of success somewhat undermines Ireland's attempts to position itself as a leading centre for innovation (e.g. the work of the Innovation Task Force) and its efforts to maintain its competitive position vis-à-vis international competitors for Foreign Direct Investment. The Report of the Commission on Taxation also reflected this view; it called for the termination of the current measure and its replacement by a far more enhanced scheme.

3.7 The principal request from industry is that the value of share awards be allowed to qualify for the remittance scheme. Increasingly, top executives in the financial services area are being paid a large proportion of their salary in shares. In light of the financial crisis, there is a move to long-term rewards related to shares rather than cash bonuses. The remittance scheme currently only provides relief for emoluments that are subject to PAYE. Share awards are currently not taxable under the PAYE system and are taxed under self assessment. Therefore remuneration in the form of share awards does not currently qualify under the remittance scheme.

3.8 Industry is also seeking the removal of a number of restrictions from the current scheme which considerably limit eligibility. A few examples of these restrictions are:

- The scheme only applies to individuals who, on or after 1 January 2010, become tax resident here and work in Ireland for the first time
- The claimant, prior to becoming resident in the State for tax purposes, must have –

[3] OECD (2005), *Taxation, Ethnic Ties and the Location Choice of Highly Skilled Immigrants*, OECD working paper by Liebig and Sousa-Poza.

a. been a resident of, and resident in, a country or jurisdiction with which Ireland has a double taxation agreement;

b. been employed in that country or jurisdiction by the same relevant employer that he or she is employed by in the State (for this purpose it is sufficient for the claimant to be employed in the State by an associated company of the foreign employer); and

c. exercised the greater part of his or her employment in that country or jurisdiction.

3.9 While the development of initiatives to attract internationally mobile talent into Ireland through an enhancement of the current scheme is primarily a personal tax matter, and falls to be considered primarily in that context, it is nonetheless important to highlight that it is the primary tax issue of concern to the international financial services industry in the context of Budget/Finance Bill 2011.

4 Section 110 of the Taxes Consolidation Act (TCA) 1997

4.1 As the Tax Strategy Group will be aware, Section 110, TCA 1997 governs the taxation of securitisation transactions. While the profits of a Section 110 (S110) company are taxed at 25% rather than 12.5%, designation as a S110 company confers significant other tax benefits on a company.

4.2 Securitisation has been provided for in the IFSC since 1991. Significant changes to the tax treatment of securitisation were introduced in Finance Act 2003 to facilitate the growth of the industry in Ireland and there have been a number of further enhancements to the securitisation tax regime since that time.

4.3 Before the onset of the difficulties experienced by the international financial services industry since 2007, securitisation was one of the fastest growing areas of the international financial services sector in Ireland.

4.4 Given the changed international securitisation environment and the differing emphases in submissions that we have received from individual international financial services sectors over the last few years in relation to Section 110, a "stock-take" of the use of the provisions was begun in May of this year as a joint initiative between the Department, Revenue and industry (represented by Financial Services Ireland).

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4.7 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. In addition, we remain committed to considering enhancements to other aspects of Section 110 to address competitiveness concerns of industry in respect of legitimate business.

4.8 Among other things, industry is seeking the widening of the definition of "qualifying assets" that can currently be held by a S110 company to include tangible assets including aircraft and commodities such as precious metals (the current provisions allow a S110 company to hold financial assets only). The latter change would facilitate the use of Irish securitisation vehicles in Islamic financial transactions because Shariah law requirements commonly dictate that there is an underlying tangible commodity.

5 Alternative Investment Company

5.1 According to representations from the international funds industry, significant opportunities currently exist for Ireland, as a leading regulated fund domicile, to become a centre of excellence for green investment, infrastructure investment, private equity and other types of alternative investment funds.

5.2 The industry has made proposals for the introduction of a new investment vehicle – the 'Alternative Investment Company' (AIC) which they believe is necessary to enable them to develop competitive product offerings in these markets. The industry propose that the AIC would give rise to income which would be deemed 'trading' in all cases and so chargeable to corporation tax at the 12.5% per cent rate. In addition, they are seeking that a capital gains tax exemption would apply to any gains arising.

5.3 The proposals from industry are complex and require detailed consideration and consultation. We are not yet in a position to form a conclusion on the merits of the proposal but are committed to working with industry to further explore all of the issues.

6 Green IFSC

6.1 In December last year, the Department of Enterprise, Trade & Innovation's High Level Group on Green Enterprise launched a report - 'Developing the Green Economy in Ireland'. The report endorsed the development of a 'Green IFSC' initiative under the auspices of the Clearing House Group's Banking and Treasury Working Group with the support of Department of the Taoiseach.

6.2 It is intended that a Memorandum on the subject will be submitted to Government over the next few weeks seeking, among other things, Government support for "appropriate fiscal and regulatory measures".

6.3 While the 'Green IFSC' proposal is not primarily a "tax-driven" initiative, an industry submission on 'tax enablers' which would facilitate the development of such an initiative is currently being considered. Two of the proposals would require legislative amendment but it may be possible to address the majority of the issues highlighted in the submission administratively.

6.4 Industry has highlighted difficulties that arise for large projects, such as wind turbines, in relation to the Business Expansion Scheme (BES). Such large-scale projects often have an extended development phase before commencing to trade. BES relief is only available to companies carrying on a trade and so is not available during these costly early stages. In addition, industry has expressed the view that the current lifetime limit of €2 million per group does not recognise the significant capital requirements of many 'green' companies, particularly those in the energy sector. An increase in the limit to €10 million is being sought.

6.5 Section 110 was amended in Finance Act 2008 to include greenhouse gas emission allowances in the definition of financial assets that can be held by a S110 company. Industry has requested that this be further amended to ensure that acquisition of a 'right to acquire' a greenhouse gas emission allowance is also regarded as a financial asset. In addition, industry has requested that the scope of the definition be expanded to include all carbon emissions and not just those approved by Governments.

6.6 In addition to the legislative changes sought, industry has expressed the view that published guidance from the Revenue Commissioners outlining the current tax treatment that applies to certain transactions common to 'green' enterprises would be very valuable. In particular, they are to make a detailed submission to the Department / Revenue with a view to seeking published clarification on the following issues:

- *Tax treatment of carbon credit transactions*
- *Eligibility for capital allowances for certain types of "Green" expenditure*

7 Interest payments to non-residents

7.1 This year, as in the past number of years, the international financial services sector has requested that a number of issues relating to the treatment of payments of interest to non-residents be addressed in the 2011 Finance Bill. The issues are:

- Whether Irish companies paying non-yearly or 'short' interest (interest on a loan which is not capable of lasting longer than 12 months) to a non-resident parent should be entitled to a tax deduction for the payment, and
- Whether non-residents should have an Irish tax liability in respect of an interest payment from Ireland.

7.2 *Cash Pooling*

The first issue is of particular importance to companies in the corporate treasury sector engaged in 'cash-pooling'. Cash-pooling is a treasury management function where a multinational company seeks to centralise all its deposits and overdrafts on a daily basis in order to minimise costs and maximise returns. Difficulties arise where members of a company group are located in jurisdictions with which Ireland does not have a tax treaty as deductibility of 'short' / non-yearly interest payments is disallowed when interest payments are made to such jurisdictions. The banking and treasury industry insist that cash-pooling is a growth area and opportunities exist for Ireland in terms of increased profits from this business and in terms of employment. It is worth noting that the FSI / Accenture study estimates that 200 people are currently employed in the corporate treasury sector and corporation tax receipts amount to €163 million in 2009.

7.3 We have so far been reluctant to accede to this request because of concerns that such changes could leave Ireland open to facilitate the routing of income flows through Ireland to evade a tax that may well be due in other EU Member States or Treaty partners.

7.4 However, we have been working with industry to explore possible options to address such concerns. Industry have suggested that a deduction would only be allowed for 'short' interest payments in situations where the interest payment would be subject to tax in the recipient's jurisdiction. This issue requires further detailed consideration.

7.5 *Technical Exposure to Irish Income Tax*
Under the tax code, tax is chargeable from any property in the State, whether or not the owner is a citizen or is resident in the State. The effect of this is to include non-residents in receipt of interest payments from an Irish debtor, as the debt would be considered property in the state.

7.6 In general, but subject to significant exceptions, under existing legislation (section 198), interest payments to non-residents are not liable to Irish tax where the recipient is resident in an EU or other country with which we have a double taxation agreement. Interest payments to residents of other countries do have a tax liability in respect of the payments received and strictly speaking, the non-resident should account for the tax due under the self assessment system.

7.7 Generally, the collection mechanism employed is a withholding tax. However, exemption from withholding tax is available in the case of Quoted Eurobonds. The exemption was introduced in order to improve the competitiveness of the Irish debt market and is available where the issued debt is listed on a recognised stock exchange. However, the technical liability to Irish tax on source interest still remains where the recipient is not in a treaty jurisdiction.

7.8 Industry has been making representations on this issue for many years arguing that there is an inconsistency between the technical charge to tax and the effective collection mechanism for such tax. Industry argues that the exemption of Quoted Eurobonds from withholding tax arrangements precludes effective collection in those jurisdictions outside the EU and the countries where we have double taxation agreements. They highlight that the UK has addressed this issue by introducing a broad exclusion from tax for UK source income earned by non-residents.

7.9 We have heretofore been opposed to removing the liability to Irish tax on Quoted Eurobonds on the grounds of reputation concerns. However, due to the recent introduction of new US GAAP accounting rules, known as FIN 48, which lay out strict criteria requiring disclosure of tax positions in an entity's financial statements, this issue is becoming increasingly problematic for industry and is impacting on the ability to effectively market Irish debt. We are, therefore, prepared to give the matter renewed consideration.

8 Foreign Branch Exemption

8.1 The CHG Insurance Working Group is seeking the introduction of a foreign branch exemption regime to increase Ireland's attractiveness as a headquarters location for insurance and reinsurance companies.

8.2 Irish companies are generally subject to tax on their worldwide income with credit available for foreign tax paid in certain defined circumstances. Foreign branches of Irish companies are subject to tax in Ireland but credit is given for foreign tax paid on the profits of the branch. It is, therefore, unlikely - given our relatively low rate of corporation tax - that there is a significant taxation yield from such foreign branches.

8.3 For a number of years, the broader IFS industry has been seeking the introduction of a participation exemption regime for dividends from foreign subsidiaries. As in the case of branches above, Ireland currently operates a credit system for tax on foreign dividends. Where foreign branch profits are taxed in a foreign jurisdiction, generally there is no residual liability to tax in Ireland. This amounts to an effective exemption from Irish tax. Industry argues that the credit system is administratively burdensome but our view is that it satisfies the need for transparency around the flow of funds through Ireland and addresses potential reputation concerns in the absence of specific anti-abuse "Controlled Foreign Company" legislation.

8.4 The issues arising in relation to taxation of foreign branches would not be dissimilar to those relating to taxation of foreign subsidiaries and we need to ensure that we are consistent in the principles that we apply to the two issues. Having said that, they are discrete issues and we have agreed to explore further industry's proposals for a foreign branch exemption in light of the following recent developments;

- Branches are increasingly important in the financial services sector for regulatory reasons – in particular, the EU Solvency II requirements, which will shape the insurance and reinsurance sector in the EU over the next decade, make branch structures more favourable than subsidiaries, and

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8.5 It may be that the concerns we have around introduction of full participation exemption would equally apply to a foreign branch exemption. In addition, a number of complex issues need to be considered, including;

- How branch profits should be quantified.

- The possibility of artificial diversion of profits to exempt branches arises. Ireland does not currently have "Controlled Foreign Companiy" (CFC) legislation which is the principal protection employed by other jurisdictions against the artificial diversion of profits to foreign related companies.

- The treatment of losses needs detailed consideration. The introduction of an exemption for foreign branch profits would prevent any relief being given for losses incurred by the foreign branch. This would impact on certain companies, for example companies breaking into new jurisdictions or markets. Industry advocate the introduction of an election for the exemption not to apply – this proposal is modelled on the current French system. This would mean that such companies could continue to benefit by remaining under Ireland's current rules for the taxation of foreign branches.

8.6 We intend to work with industry to explore all of these issues before coming to any conclusions on the merits of the proposals.

9. Other issues under consideration

9.1 *Capital Gains Tax on Foreign Denominated Bank Accounts*

In the majority of cases, the functional currency chosen for an Irish holding company is invariably the functional currency of the ultimate parent, e.g. US Dollar, Sterling, Canadian Dollar etc. Given that capital contributions and dividends received and distributed can be many millions, minor foreign exchange fluctuations can give rise to significant unexpected Irish CGT liabilities. The fluctuations can also give rise to losses which can be offset, to the benefit of the company, against other gains.

Industry advise that this uncertainty creates real difficulties for holding companies and they are seeking that the capital gains tax treatment of such foreign currency should follow the accounting treatment - no such gains (or losses) arise in the functional foreign currency financial statements.

9.2 *Islamic Finance*

As the Tax Strategy Group will be aware, a suite of measures were introduced in Finance Act 2010 to facilitate Islamic Finance in Ireland. In addition to the section 110 amendment mentioned at 4.9 above, further technical amendments to the legislation are being considered in the context of Finance Bill 2011.

9.3 *Stamp Duty Issues*

Industry has identified a number of technical stamp duty issues which they are seeking to have addressed. A number of the issues relate to uncertainty about the applicability of current stamp duty exemptions to a number of transactions. A few examples are outlined below;

- Section 113 of the Stamp Duties Consolidated Act, 1999 (SDCA) contains an exemption for the transfer of aircraft or ships and interests in, or shares in, an aircraft or ship. Industry is seeking clarification that this encompasses a Special Purpose Company (SPC) whose assets consists wholly / mainly of aircraft / ships.

- Section 90(2)(g)(ii) SDCA, 1999 exempts the transfer of leases in certain circumstances. Industry is seeking an amendment to clarify that the assignment of an interest in a lease (e.g. the right to receive future lease rentals) is covered.

9.4 *UCITS IV*

As the Tax Strategy Group will be aware, a number of measures were introduced in Finance Act 2010 to give the international funds industry in Ireland 'first mover advantage' in relation to the new European UCITS (Undertakings for Collective Investment in Transferable Securities) IV Directive which will come into force on 1 July 2011.

EFAMA (European Funds and Asset Management Association) published a report - *'Analysis of the Tax Implications of UCITS IV'* on September 15th 2010. The report identifies two additional areas where changes to our legislation may be required in order to ensure that there are no taxation barriers in Ireland to the cross-border merger of funds provided for under UCITS IV.

9.5 *Section 247, TCA 1997 – Anti-avoidance measure*

Section 247, TCA 1997 provides for relief to companies in respect of interest paid on loans applied in acquiring interests in certain other companies. The Revenue Commissioners have identified a number of cases where the provisions of this section are being misused given the purposes for which the section was enacted.

It is intended to make proposals to counter such misuse and to ensure that the relief is more closely focussed on businesses referred to in the section, i.e. trading, property rental, and the holding of shares in trading or property rental companies.

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