Tax Strategy Group
International Financial Services

1. Introduction

1.1. The Programme for Government pledges to support the future development of the International Financial Services industry "as a source of future employment growth, subject to appropriate regulation".

Strategy for the International Financial Services Industry in Ireland 2011-2016

1.2. The Clearing House Group (CHG), which operates under the aegis of Department of An Taoiseach and comprises high-level representatives from the public sector and industry, produced a new five-year strategy for the further development of the sector which was launched by An Taoiseach on 14th July this year.

1.3. The strategy sets out the key drivers to support the achievement of the overall objective of 10,000 net new jobs over the period in question. The foundations are a tax framework which is competitive and internationally respected and a regulatory regime which supports responsible business operations and ensures effective oversight and control.

1.4. The Department of Finance and the Revenue Commissioners actively engaged in the formulation of the new strategy through the CHG process. The document highlights that Ireland's reputation as a responsible on-shore tax jurisdiction is essential to our future success and that the credibility of our tax regime is a key selling point and will be protected.

1.5. In relation to specific tax issues, the strategy document highlights the negative impact of high personal tax rates on the ability to attract and retain highly skilled, mobile personnel and identifies this as the primary tax issue of concern to the international financial services industry.

1.6. The strategy also highlights the importance for the industry of a broad and high quality Double Tax Treaty network as treaties reduce tax impediments that might otherwise deter the development of bilateral trading and investment activities. The recent signing of a Double Taxation Agreement (DTA) with Saudi Arabia brings to 64 the number of comprehensive DTAs which Ireland has signed. The rapid expansion of Ireland's tax treaty network by more than 50% over the last number of years has been lauded as a significant competitive advantage for the industry.

Contribution of the IFSC to the Irish Economy

1.7. The international financial services (IFS) sector continues to make a significant contribution to the Irish economy in terms of employment and corporation tax yield. Employment in the sector increased in 2010 for the first time in 3 years, with 24,761 people directly employed in the sector at end-2010[1]. When certain related services are taken into account, the overall figure rises to almost 33,000[2] - the breakdown of employment by sector is illustrated below.

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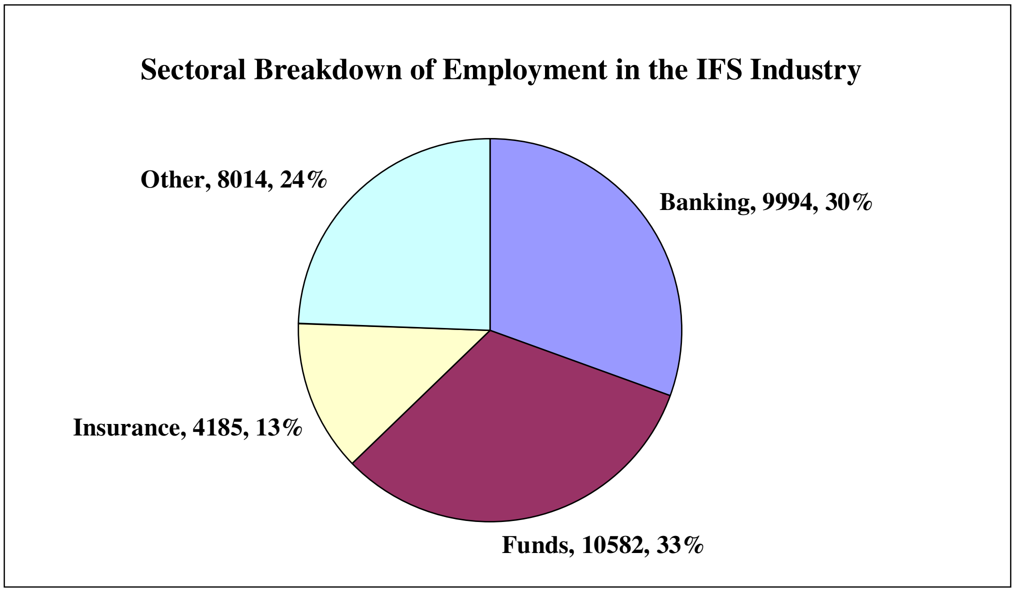
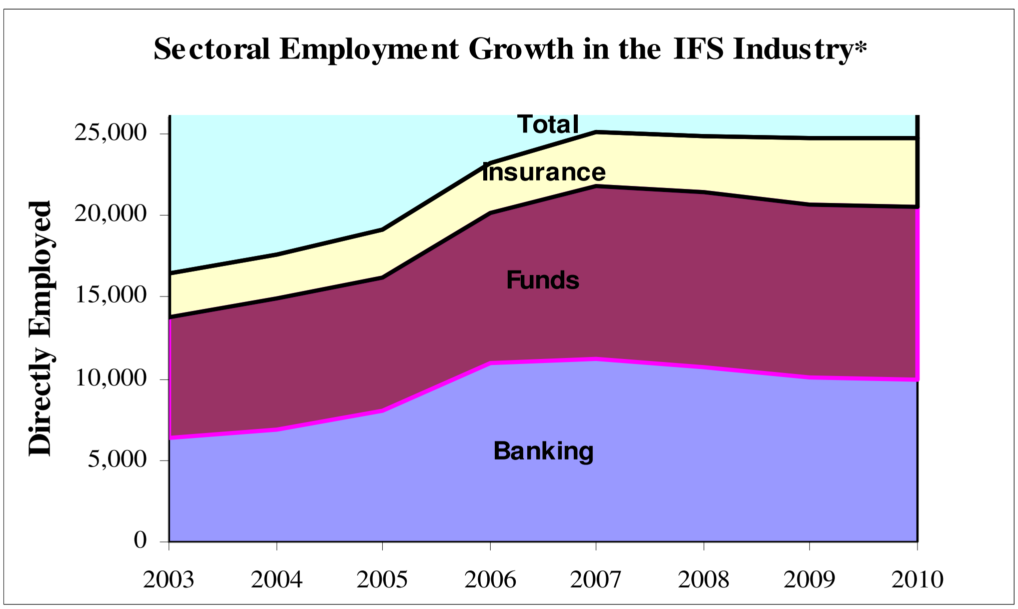
[1] Source - Finance Dublin Employment Survey – December 2010.

[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.

1.8. When one considers that direct employment grew by 8,300 in the period between 2003 and 2007 and has been maintained in spite of the very negative economic environment, the strategy aim of 10,000 jobs over the next 5 years looks ambitious but not unattainable if the right supporting conditions are in place.



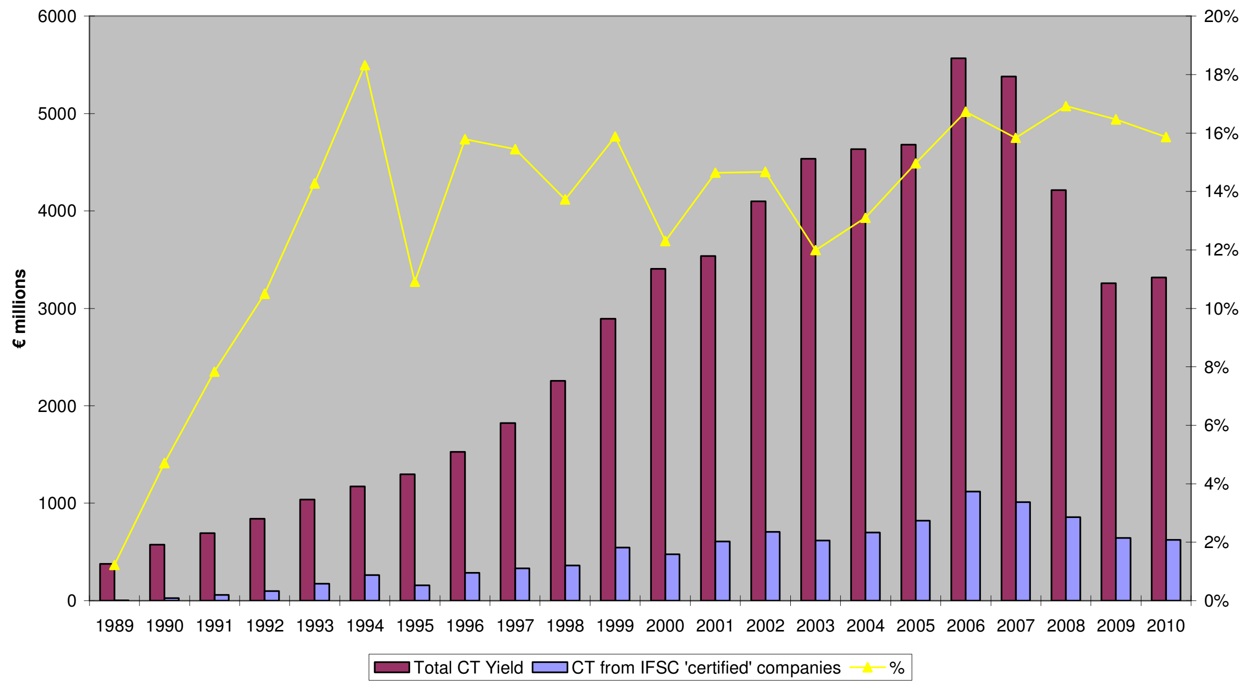


*Source: *Finance Dublin Employment Surveys* – 2004 – 2011

Growth in Direct Employment since 2003								
Year	2003	2004	2005	2006	2007	2008	2009	2010
Total	16459	17610	19095	23156	25058	24906	24692	24761

1.9. The Revenue Commissioners estimate corporation tax paid in 2010 by the international financial services industry to be in the region of €626 million – 16% of total yield. This figure only includes corporation tax yield from companies who were previously certified under the 10% IFSC regime and is therefore an underestimate to the extent that it excludes companies established since end-2002.

'IFSC' Contribution to Corporation Tax Yield 1989-2010



1.10. While the sector has so far weathered the economic conditions quite well, the downgrading of Ireland's sovereign debt rating presents challenges in terms of attracting new, and maintaining existing, business.

EU Commission Proposals for a Financial Transaction Tax (FTT)

1.11. As the Tax Strategy Group will be aware, the European Commission published a proposal on Sept 28th last for a Directive on a common system of financial transaction tax. The stated goal is to ensure that financial institutions make a fair contribution to covering the costs of the recent crisis, and to ensure even taxation of the sector vis-à-vis other sectors.

1.12. It is proposed that the tax would apply to financial institutions established in the EU in respect of certain financial transactions entered into by them. The definition of financial transaction is very broad but loans, deposits and certain foreign exchange transactions as well as mortgage-lending, consumer credit, etc. are excluded. Transactions with central banks are also excluded.

1.13. The introduction of the FTT would mean that Ireland would have to abolish Stamp Duty on share transactions. The Department of Finance has established an internal working group to examine the Commission's proposals and is consulting with industry to explore the potentially significant impact of the proposals on the international financial services sector in Ireland. The Department hosted a Roundtable discussion with IFS representatives on 14 October and has established a contact group to share information and views as the proposals evolve.

1.14. The Minister for Finance has made clear that Ireland's position is that if a tax such as this was introduced it should be on a wide international basis to include the major financial centres to prevent relocation of activities. He has also made clear that it would have to apply on an EU-wide basis to prevent distortion of activity within the European Union.

2. Budget & Finance Bill 2012 Submissions focussing on this sector

2.1 In the context of Budget and Finance Bill 2012, we are considering submissions from;

- *CHG Banking and Treasury Working Group Tax Sub-Group*
- *CHG Banking and Treasury Working Group International Asset Finance Sub-Group*
- *CHG Insurance Working Group Fiscal and Accounting Sub-Group*
- *CHG Funds Working Group Tax Sub-Group*
- *Irish Banking Federation*

2.2 As mentioned in the introduction, it is worth noting that enhancement of the remittance-based employment scheme (section 825B TCA 1997), targeted at attracting key international talent, is highlighted in every submission as the priority issue for the IFS sector in the context of Finance Bill 2012. That issue is being considered separately as part of broader income tax policy.

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:

- Alternative Investment Company
- Cash-Pooling
- Technical Liability to Tax on Irish Source Interest
- Group Relief for Losses – Definition for International Groups
- Capital Gains Tax on Foreign Denominated Bank Accounts
- Unilateral Credit Relief for Lease Rental Payments

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

- Islamic Finance
- Stamp Duty Issues
- UCITS IV
- Exchange Traded Funds
- Non-Resident Declarations

3. Alternative Investment Company ("AIC")

3.1 Based on 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.

3.2 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.

3.3 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. They believe that such a vehicle is necessary to allow funds hold a wider class of assets.

3.4 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.

3.5 The key issues to be considered include:

- whether the provision of a special tax regime for AICs which are wholly owned by a fund would constitute a "state aid" to the funds industry,
- implementation of the measure would add another layer of complexity into the tax regime, and
- how an AIC would be viewed internationally.

4 Cash-Pooling

4.1 In its most basic form, 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 overdraft costs and maximise investment returns. Difficulties arise where members of a company group are located in 'non-treaty countries' (countries 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.

4.2 The banking and treasury industry have highlighted over the last number of years that cash-pooling is a growth area and that opportunities exist for Ireland in terms of increased profits from this business and in terms of employment. They point out that this issue inhibits multinationals from servicing all group companies from Ireland and that, as a result, Ireland's attractiveness as a centre for such operations is accordingly diminished. They also make the argument that the strategic importance of in-house treasury operations that are located here strengthens the case for parent companies to locate or retain other jobs and operations, e.g.- manufacturing or support services, in Ireland.

4.3 Interest deductibility is prohibited in the case of such payments to non-resident group companies. We have previously refused to provide for deductibility for such interest payments because of concerns that such a measure could be used to facilitate the routing of income flows through Ireland, thereby eroding the tax base of other countries, and that such payments could also be used to erode the domestic tax base. However, in maintaining that position, we were always aware that legitimate payments made to non-treaty jurisdictions that do impose tax on income (as opposed to tax havens) can end up being doubly-taxed.

4.4 Following extensive discussions between the Department, Revenue and industry to explore possible options to address such concerns, Revenue have proposed a solution which would allow a deduction, in the case of treasury companies, for these interest payments but only to the extent that the income is subject to tax upon receipt in the non-treaty jurisdiction. This would ensure that the measure could not be used to facilitate 'no country taxation' as it will only be effective where tax is paid in the recipient country and will not provide an effective outlet for domestic base erosion.

5. Technical Liability to Tax on Irish Source Interest Payments

5.1 In general, tax is chargeable on income 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.

5.2 In general, but subject to significant exceptions, under existing legislation (section 198 TCA 1997), 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 non-treaty countries do, however, 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.

5.3 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.

5.4 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. They highlight that the UK has addressed this issue by introducing a broad exclusion from tax for UK source income earned by non-residents.

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6. Capital Gains Tax on Foreign Denominated Bank Accounts

6.1 Ireland introduced a holding company regime in 2004 to encourage holding companies to locate in Ireland. It is often the case that the functional currency chosen for an Irish holding company is the functional currency of the ultimate parent, e.g. US Dollar, Sterling, Canadian Dollar etc. Repatriation of dividends overseas or funding of subsidiaries, with funds received from the ultimate parent or dividends received from subsidiaries, from a non-Euro bank account can result in a capital gains tax event for Irish tax purposes.

6.2 This is because foreign currency constitutes an asset for capital gains tax purposes. The Euro-value of the functional currency must be established at the point it is received and lodged by the holding company and again at the point at which it is 'disposed of' – i.e. withdrawn and sent to parent or subsidiary company. If the Euro has appreciated in value vis-à-vis the functional currency in the interim – the company has a CGT liability (or a corresponding loss if the Euro value has fallen).

6.3 In the case of holding companies, capital contributions and dividends received and distributed can be many millions and, therefore, minor foreign exchange fluctuations can give rise to significant unexpected Irish CGT liabilities even though, on an accounting basis, no such gains (or losses) arise in the functional foreign currency financial statements.

6.4 The international insurance/reinsurance industry advises that this uncertainty creates real difficulties for holding companies and they are seeking that the exposure to CGT in such circumstances be removed.

6.5 We are engaged with the industry in exploring possible solutions to this issue.

7. Group Relief for Losses – Definition for International Groups

7.1 Broadly, Irish tax legislation currently provides for the surrender of losses and transfer of assets between Irish companies/branches where both companies are held within a 75% EU/EEA[3] group. However, to the extent that an Irish group company/branch is held by a non-EU/EEA parent, it is currently not possible for such a company to surrender or claim group losses from other Irish group companies.

7.2 This issue has been highlighted by the international insurance/reinsurance industry as a negative factor when non-EU/EEA companies and multi-national groups are exploring the possibility of setting up Irish insurance/reinsurance operations. The issue is not specific to that sector and has also been raised by other industries.

7.3 We are currently exploring the scope for revising the group relief rules as to the residence of the parent of Irish companies without opening avoidance opportunities or imposing a significant cost on the Exchequer.

8. Unilateral Credit Relief ("UCR") for Lease Rental Payments

8.1 In general, three main types of income suffer foreign withholding taxes: dividends, interest and royalties. These foreign taxes are typically relieved under tax treaty arrangements. Where Ireland does not have a tax treaty in place, relief is given unilaterally under Irish law. This involves giving credit for tax suffered in the source country against Irish tax on the income concerned.

8.2 Prior to Finance Act 2010, unilateral credit relief for royalty payments was only available to companies availing of the 10% manufacturing regime which expired at end-2010. UCR was then extended (in FA 2010) to all trading companies in order to ease the transition of "10% companies" to the 12.5% rate and to help maintain the competitiveness of the software industry where foreign taxes on royalty payments most commonly arise.

[3] Iceland, Liechtenstein and Norway are EEA members.

8.3 Some jurisdictions take the view that equipment lease rental payments are a form of royalty payment and so they impose a withholding tax. Such payments do not fall into the definition of ‘royalties’ for UCR purposes in Ireland, and as a result, unilateral credit relief is not available in respect of foreign withholding taxes on lease rental payments.

8.4 The aircraft leasing industry is requesting that UCR be granted in respect of foreign withholding taxes on lease rental payments in the same manner as for royalty payments and we are engaging with the industry to consider the proposal.

9. Other Issues Under Consideration

9.1 *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. Further technical amendments to the legislation are being considered in the context of Finance Bill 2012.

9.2 *Stamp Duty Issues*

The Stamp Duty Consolidation Act 1999 contains a number of exemptions for the transfer of financial instruments. The Funds Industry and the Banking and Treasury Industry have each identified a number of technical stamp duty issues which they are seeking to have addressed. Some of the issues relate to uncertainty about the applicability of current stamp duty exemptions to a number of transactions. The list of industry proposals are set out below;

- Extension of stamp duty exemption to transfer of units in an exempt unit trust – s.88 SDCA
- Extension of stamp duty exemption to cover cross-border mergers of investment funds – s.88B
- Extension of stamp duty exemption to cover in specie transfer of pension and charity scheme assets between unit trusts – s.82 SDCA
- Clarification of stamp duty exemption for foreign land – s.98 SDCA
- Extension of the stamp duty exemption for shares/securities of foreign companies to cover a wider range of foreign legal entities – s.88 SDCA
- Extension of associated companies relief to cover a wider range of foreign legal entities – s.79 SDCA
- Clarification in legislation that options over Irish shares are subject to the same level of duty that applies to share transfers.
- Clarification as to whether s.113 SDCA encompasses a Special Purpose Company (SPC) whose assets consists wholly / mainly of aircraft / ships.
- Clarification as to whether s.90 (2)(g)(ii) SDCA covers the assignment of an interest in a lease (e.g. the right to receive future lease rentals).

We are engaged in discussions with both sectors with a view to resolving as many of these issues as possible.

9.3 *UCITS IV*

In relation to cross-border mergers of investment funds under UCITS IV, a number of changes may be necessary to avoid discrimination between the tax treatment of domestic mergers and cross-border mergers of investment funds. For instance, in the case of a merger between two domestic funds there is no charge to tax on the Irish-resident investors. However, where a resident investor in an Irish UCITS exchanges his/her units for units in a non-Irish UCITS there is a charge to tax. Similarly, there is a charge to tax where a resident investor in a non-Irish UCITS exchanges his/her units for units in an Irish UCITS.

9.4 Exchange Traded Funds

Section 739G(2)(h) TCA 1997 provides an exemption in respect of non-resident investors in Irish funds when units in a fund are redeemed. The funds industry has advised that Ireland is the leading jurisdiction in which to domicile exchange traded funds (ETFs). By their nature, units in ETFs are sold on exchanges by investors (rather than redeemed) and are, therefore, technically not covered by the existing exemption. We are considering extending the exemption to cover the sale of units in an ETF.

9.5 Non Resident Declarations

In Finance Act 2010 the requirement for overseas investors in domestic investment funds to submit written non-resident declarations was removed and was replaced by a procedure under which the investment funds would make appropriate declarations to Revenue as to the non-residence of investors. It is now necessary to extend this procedure (which was introduced for individual investors) to cover the situation where investments would be held by intermediaries on behalf of investors.

Additionally, in the case of investment funds migrating to Ireland from other jurisdictions, a similar declaration procedure is required to mirror the effect of the legislative change mentioned above in relation to the removal of the requirement for non resident declarations.

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