Appendix 1

Extract from Consultation Document –Direct Tax Proposals

5. Proposals

It is apparent from the foregoing that many of the difficulties currently being encountered are linked to the inability of the lender/receiver to obtain all of the information needed to compute the various tax liabilities in the manner required by the existing legislation.

As noted previously, it is understood by Revenue that this information deficit may be less of an issue where a receiver is appointed to a company. However, there may be an issue in relation to the collection of corporation tax payable by a company where, for example, a receiver might retain the full proceeds of income earned during the receivership for the benefit of the debenture holder, leaving the company without funds to discharge the relevant tax liability.

5.1 Income Tax, Corporation Tax & Capital Gains Tax

Proposals 1 - 3 seek to remove, in the case of non-corporate receiverships, the uncertainty encountered in computing the tax liability from the income of property in receivership. In relation to the computation of income and capital gains, it is proposed that certainty and simplicity can best be achieved by computing taxable income and capital gains solely on the basis of the results of the receivership period. This would mean creating a clear tax charge on the receiver for the period over which he/she has control of the property. Proposal 4 deals with the collection of corporation tax while a company is in receivership.

Under the following alternative proposals 1-3, the receiver would be responsible for the taxes incurred in respect of those activities that he/she directs. Where, for example, the individual continues to trade or rent property in parallel with the receiver, that individual would separately account for any taxes arising on their own activities in the normal manner.

Proposal 1

- Tax legislation would provide that a receiver is the person primarily chargeable to, and liable for, income tax and capital gains tax on the income and capital gains from a property in receivership for the duration of that receivership (the receivership period). The lender should have a secondary liability. This rule would apply to all receivers (including court appointed receivers – section 1049 TCA 1997).

- The income of a receivership period would be computed separately for each property in receivership on the basis of the income (including deemed income, i.e. section 23 or balancing charge), losses, allowable deductions and capital allowances, including balancing allowances/charges of each such property in that period. The results of activities, outside of the receivership (e.g. other income or losses of the borrower) or matters relevant to periods prior to the commencement of the receivership period (e.g. unused capital allowances, unused losses, etc.) would not be taken into account for this purpose.

- However, it is envisaged that unused losses and capital allowances of a receivership period could, in certain circumstances, be offset against the income of another property in receivership where the same lender has appointed a receiver over other assets of the same borrower.

- Personal tax credits, other reliefs and the high earners restriction would not apply in computing the tax liability of the income of the receivership period.

- The income of the receivership period (including balancing charges and section 23 clawbacks) would be subject to a flat rate of tax, which would be lower than the current 41% rate. This seeks to reflect the fact that no personal tax credits or other reliefs will be available while at the same time not seeking to tax receivers at the marginal rate of income tax that might have applied to the owner.

- USC would not apply, but a USC element would be incorporated into the flat rate tax rate.

- Capital gains accruing on the sale of an asset by a lender or receiver would be computed solely by reference to the asset in question. Capital gains or losses arising on assets not in receivership, prior year losses, exemptions and reliefs applicable to the borrower would not be taken into account by the lender/receiver. However, losses incurred by a lender/receiver on a sale could be available for offset against gains on the sale of other assets by a lender/receiver where the same lender and borrower are parties to both sales. Capital gains tax will be charged at the rates currently provided for in legislation.

- Where necessary, special provisions for the making of income returns and tax payments in respect of income arising in the receivership period would be developed and legislated for along side these changes.

The implications of this approach include the following:

- The computation of the income and capital gains of the receivership period will be easier and certain as there should be no 'information gap' difficulties.

- The computation of tax liabilities should also be easier as the liabilities will be computed on the basis of the income of the receivership period and, where necessary, be independent of the borrower’s circumstances, e.g. other income, tax credits, rate bands etc.

- The persons required to submit tax returns and pay tax will be clearly identified in law and put beyond doubt, as will the due dates for the submission of returns and payments.

- Tax liabilities that might not have arisen had a receiver not been appointed would now arise. For example, a borrower may have unused rental or capital losses from an earlier period which would be used, under normal circumstances, to reduce later liability. Under this proposal, a receiver will not have the use of such losses. This approach will result in a reduction in the amount passing back to the lender (and the borrower).

- Setting an appropriate rate of tax is problematic, as each borrower’s “effective rate” of tax differs, dependent as it is on so many variables, e.g.

types of income, tax credits, reliefs etc. In addition, individuals also have to pay USC and PRSI. A set rate of tax may result in a higher or lower liability than would be the case if the liability was computed in the normal manner.

Proposal 2

An alternative to Proposal 1 is to dispense with balancing events and clawbacks completely in receivership cases (and allowing no relief to a new purchaser). This would mean no additional liability in the hands of the receiver and the allowances and deductions already granted to the individual would be left in place.

This approach might be perceived as a form of debt forgiveness. However, if the purchase price reflected the absence of allowances, the cost of the clawback not collected by the State would effectively be borne by the lender and the vendor rather than the new purchaser. While the forgiveness of balancing charges is likely to be welcomed, the same cannot be said if balancing allowances were also to be abolished in similar circumstances. It is difficult to see how an approach of dispensing with balancing charges but not with balancing allowancing could be justified.

This proposal is a variation on Proposal 1. It includes all of the features of that proposal other than it envisages that balancing charges and allowances and section 23/50 clawbacks would not apply where property is sold by a receiver or a lender in circumstances where a balancing charge etc. would occur. The implications of this approach would include the following:

- The receiver or lender would not be required to account for tax on "deemed income" arising on the sale of a property nor would they be entitled to a balancing allowance. This would
  1. remove the uncertainty faced by vendors/receivers contemplating the sale of such property,
  2. result in a reduced or greater tax liability (depending on whether the sale gave rise to a charge/clawback or an allowance), and
  3. impact (positively or negatively) on the amount of the sale proceeds the receiver can pay over to the lender.

- The allowances and deductions already granted to the borrower would be left in place.

- The purchaser of the property would not be entitled to any capital allowances or "section 23" relief in respect of that property. If the sale price reflected the absence of allowances, the cost of the clawback not collected by the State would, to some extent, effectively be borne by the lender and the vendor rather than the new purchaser.

Proposal 3

Under this proposal tax arising on the income or chargeable gains of property in receivership would be charged on the borrower rather than the receiver/lender.

The receiver/lender would be required to provide a borrower with all relevant information needed for the completion of annual tax returns which would enable the borrower prepare an accurate computation of the tax liability.

The receipts from a property in receivership, whether ongoing receipts, e.g. rents or the proceeds of sale would be subject to a withholding tax which would be

available as a credit against the borrower's tax liability on the property in question.

The implications of this approach would include the following:

- The difficulties associated with the "information deficit" would be removed.

- Balancing events and section 23 clawbacks would attach to the borrower (who benefited from the original allowances).

- The borrower would not be able to draw on the funds from the receivership activity (including the proceeds of the sale of the property) to meet the tax liabilities from the property in receivership and might not have access to other funds.

- The proceeds from the sale of the property would flow untaxed to the lender.

- Further tax costs could arise if the new owner was entitled to draw down capital allowances where the tax life of the building had not expired, which would mean that the amount of capital allowances awarded would be far in excess of the original capital expenditure incurred and the State would have to pursue the borrower for large amounts of outstanding tax with little or no prospect of ever collecting that liability. This is likely to eventually lead to large-scale write off of tax liabilities.

- If the withholding tax rate was set too high, the funds available to the lender would be reduced and it would be difficult to get excess tax back from the borrower. If too low, the State would have to pursue the borrower for the balance of the tax due.

- If the borrower is bankrupt or in liquidation, the State is likely to recover little or no tax.

- Even if the borrower is not bankrupt or in liquidation there may be a lack of incentive to file returns and/or an inability to pay any tax.

<u>Proposal 4</u>

As noted at the beginning of this Part, there may be an issue in relation to the collection of corporation tax payable by a company in receivership in certain circumstances. A possible solution to this difficulty would be to make the receiver an accountable person for any corporation tax due by the company while in receivership.