THE TAX IMPLICATIONS OF APPOINTING A RECEIVER

RESPONSE TO 2012 CONSULTATION

And further consultation on new proposals

Department of Finance and Office of the Revenue Commissioners

July 2013

Fiscal Division

Department of Finance

Government Buildings, Dublin 2

Ireland

Email to: ***receiverconsult2012@finance.gov.ie***

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1. Introduction

This document is a response to the joint Department of Finance and Revenue Commissioners public consultation on the "Tax Implications of Appointing Receivers" initiated by the Minister for Finance, Mr Michael Noonan T.D. in July 2012.

In essence, the document sets out a possible way forward in relation to the direct tax aspects of receiverships, having regard to the feedback received from respondents to the original consultation. The Department and the Revenue Commissioners are both of the view that, before proceeding with the proposals set out in the document, opinion needs to be tested further to ensure that they are robust and fit for purpose.

Interested parties are, therefore, asked to provide their views on the merits of the proposed approach outlined in this document, on the accompanying draft of the legislation underpinning the approach prepared in-house by Revenue and on the further set of consultation questions.

The aim is to legislate for the final proposals in Finance (No.2) Bill 2013.

VAT related aspects of the original consultation were legislated for in Finance Act 2013 (No.8 of 2013).

2. Responding

Response Period

The period for response will run for six weeks commencing on 8 July and ending on 16 August 2013. Responses received after this period cannot be considered.

How to Respond

The preferred means of response is by email to:
receiverconsult2012@finance.gov.ie

Alternatively, you may respond by post to:

Receivership Tax Consultation,
Fiscal Division,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

When responding, please indicate if you are a business, business professional, adviser, representative body or member of the public.

Freedom of Information
Responders should be aware that all material provided can be subject to the provisions of the Freedom of Information Acts 1997 and 2003. Parties should also note that responses may be published on the Department of Finance's website.

Should you wish any confidential information supplied to the Department of Finance not to be disclosed, because of its commercial sensitivity, you should, when supplying such information, identify same and specify the reasons for its sensitivity.

The Department of Finance will consult with relevant parties about such sensitive information before making a decision regarding release of such information under the Freedom of Information Acts 1997 and 2003. However, the Department of Finance will give no undertaking or assurance that such information will not be released under the provisions of the Freedom of Information Acts 1997 and 2003 and the final decision on whether or not to release such information rests with the Department of Finance or as set out in the Freedom of Information Acts 1997 and 2003.

Meetings with Consultation Team

The joint Department of Finance/Revenue Commissioners consultation team may invite respondents to meet with them in light of responses made.

3. Background

3.1. Following the dramatic recent increase in the number of corporate and other receiverships, difficulties have emerged for receivers in complying with their tax obligations. The difficulties are linked to:

- the inability of the lender/receiver to obtain all of the information necessary to compute the various tax liabilities in the manner required by the existing legislation,

- uncertainties surrounding the interpretation of that legislation, and

- administrative/procedural problems in filing and accounting for tax liabilities arising.

In that regard, it is recognised that the existing law is inadequate in certain respects and that there is a need for greater clarity.

3.2. In response to requests for clarification and certainty as to the tax obligations arising where a lender appoints a receiver or obtains possession of a property, the Minister for Finance approved a joint Department of Finance and Revenue Commissioners public consultation on the tax aspects of receiverships on 4 July 2012. The consultation ran for a two-month period to 4 September 2012. The consultation document set out Revenue's interpretation of the existing legislation and gave interested parties the opportunity to comment on a number of options to amend the legislation (TCA 1997 and VATCA 2010) with a view to dealing with the tax-related difficulties being experienced. The thrust of the various options was to remove as far as possible the uncertainty encountered in computing taxable income and capital gains in respect of property in receivership and to protect VAT in receivership situations. For ease of reference, the direct tax proposals contained in the consultation document are set out in ***Appendix 1***.

3.3. In light of the consultation feedback the VAT aspects of receiverships were separately legislated for in Finance Act 2013 (No.8 of 2013).

4. Responses to the Consultation

4.1. In all, there were 11 written responses to the consultation. These came from tax and insolvency representative bodies, a number of the larger accountancy firms, the Irish Banking Federation and NAMA. (A full list of the respondents is at ***Appendix 2***). In addition, during and after the consultation period, meetings took place between the consultation team and a number of the respondents and, in certain cases, their advisers. Feedback from these meetings has also been considered as part of the consultation exercise.

5. Outcome of Consultation

5.1. While respondents welcomed the consultation and recognised that it sought to address tax uncertainties facing secured lenders/receivers and the tax information

gaps, little in the way of consensus emerged in respect of the proposed direct tax solutions put forward in the consultation paper. To the extent that support was given to any of the proposals, it was unenthusiastic and limited in nature. A number of respondents favoured the principle of Consultation proposal 3 (withholding tax approach) but with serious reservations about applying a withholding tax to gross rental receipts and to sale proceeds. Variations on Consultation proposal 2 (which ignored section 23 claw-backs and balancing charges) was also favoured by certain respondents but as an option to be "elected" for by the receiver where there was insufficient information available to compute the tax liability under the current rules.

5.2. In general, respondents felt that the objective of achieving clear and workable legislative rules was not achieved by the proposals as published. Rather, almost all respondents expressed similar misgivings and concerns regarding the potential impact of the proposals on the tax and security position of the lender, receiver and borrower as well as various non-taxation issues such as the potential to create distortions and to encourage dysfunctional behaviour on the part of certain borrowers. There was particular concern expressed about making the receiver the chargeable person (i.e. the person primarily liable) for tax on income and gains arising in a receivership. It was also a strongly held view among respondents that the proposed changes entailed a very significant departure from generally accepted tax principles which was not warranted given, what they considered to be, the minimal tax exposure arising in most receiverships. In general, however, there was recognition that there was no "silver bullet" approach that would solve all of the issues that can arise in receiverships.

5.3. A summary of the major concerns raised by respondents is set out in ***Appendix 3.***

6. A Possible Way Forward

6.1 In considering a way forward it is clear that the following competing interests have to be recognised and reconciled:

- the receiver is seeking certainty as to procedures and ease of administration,
- the lender is seeking to maximise the proceeds from its security,
- the borrower's interest lies in ensuring that no more tax is paid under a receivership than would be paid outside of a receivership,
- the Exchequer's interest lies in ensuring, as far as possible that, where a tax liability arises for the borrower in receivership, the person who controls the asset and who is in receipt of the income pays the tax due.

6.2. In light of the above, and on further consideration and analysis of the issues involved and having regard to the consultation responses, it is clear that in proposing a way forward what is required is an approach that can best deal with the various issues arising while at the same time balancing as far as possible the competing interests referred to.

6.3 The basic objectives of such an approach must be:

- to give certainty to all parties concerned as regard tax computations and filing obligations,
- to avoid as far as possible distortions in commercial decision making and in borrower behaviour,

- to assist tax collection on income arising during receiverships, and
- to keep compliance/administration costs reasonable.

6.4 The approach outlined below is put forward as a means of achieving these objectives. It also reflects suggestions from some respondents that certain aspects of the current legislation as it relates to CGT remain generally fit for purpose and that the operation of the legislative requirements could be enhanced if certain information known to Revenue could be shared with the receiver/lender. In that regard, it has been pointed out that an information sharing precedent already exists in the context of VAT.

7. Proposed Approach

7.1 The main features of the proposed approach are set out below. A standard approach is being advocated to apply irrespective of the income type or the type of borrower. Draft legislation reflecting the approach and explanatory notes are contained in ***Appendices 4*** and ***5*** respectively.

A. Income arising to a Receiver (whether rents, trading or non-trading)

- Ring-fence the receivership period and compute the "net income" of the receivership period[1] solely on the basis of the cash receipts and cash outgoings, of that period, received or expended by the receiver, without regard to:
    - the borrower's capital allowances and losses (either for current or earlier years or accounting periods),
    - section 23 claw-backs or balancing events,
    - the borrower's other income, tax credits or other deductions etc.

- The receiver to deduct an amount representing tax from the "net income" of the receivership period at a flat rate of:
    - 20% where the receivership relates to borrowers who are non-corporates, and
    - 10% in the case of corporate receiverships

  and account to Revenue for that tax as a "payment on account" of the borrower's income tax, USC or corporation tax liability, as appropriate. As the tax payable by the receiver is a 'payment on account' in respect of "net income" of the receivership period that does not take account of losses, allowances and other deductions available to the borrower, the rates of tax proposed are lower than those at which the borrower may be chargeable (41% marginal rate income tax plus USC for individuals and 12.5% or 25% in the case of companies, depending on whether the income is trading or non-trading).

- Statements to be filed and tax to be paid by the receiver to the Collector-General within specified time limits.

[1] Net income will be computed for each chargeable period or part of a chargeable period falling within the receivership period

- The receiver to have an option, subject to conditions, not to deduct and remit tax to the Collector General where the receiver is satisfied based on evidence available that no tax would be due.

- The receiver to make all relevant information in relation to the receivership period available to the borrower in good time to allow the borrower to meet tax filing and payment obligations.

- The borrower to continue to be assessable on income arising in a year of assessment or an accounting period in the normal way, including that arising during the receivership period. This "income" to include section 23 claw-backs and balancing events where property is sold by the receiver within the holding period or tax life. The borrower to be liable for the resulting tax in the normal manner on the rental (and other) income of the receivership period.

- Any tax deducted by the receiver to be available as a credit to the borrower in computing the income tax or corporation tax liability referable to the property in receivership for the relevant year of assessment or accounting period in question.

- Provision to be made for a refund of overpaid "flat-rate" tax to be made to the receiver in certain circumstances.

B. Capital Gains arising to a Receiver

B.1 As mentioned above, some respondents were of the view that the existing CGT provisions affecting receivers (section 571 TCA 1997) remain generally fit for purpose and that what is required from an operational perspective is administrative support to ensure that the provisions are workable in practice.

B.2 Under section 571, CGT (or where appropriate corporation tax) on chargeable gains is computed in the normal way having regard to losses/reliefs etc as appropriate. Any capital gains tax arising is recoverable by assessment to income tax on the receiver under Case IV of Schedule D for the year of assessment in which the disposal occurs. The section also makes provision for the refund of tax to the receiver ("the accountable person") in the event of tax being overpaid.

B.3 Respondents have indicated that the major difficulties receivers experience at present with CGT reflect gaps in the historical information, particularly where the borrower is not co-operating. Particular areas of difficulty mentioned include the following:

- Base cost of property, particularly where construction costs were incurred by the borrower.
- details of enhancement & incidental costs
- available reliefs, including losses.

B.4 A case has been made that it should be possible for a receiver to either get confirmation from Revenue as to whether CGT is due without Revenue breaching the requirements of taxpayer confidentiality or to receive the necessary taxpayer information to allow the CGT calculation to be made. In that regard, it has been

pointed out that an information sharing precedent already exists in the context of VAT. Some respondents recommended that section 851A TCA 1997, which sets out the circumstances where Revenue may disclose taxpayer information to third parties, should be expanded to allow receivers obtain the information required to calculate CGT due on a disposal.

B.5 In relation to this latter point, section 851A(8) provides that a Revenue officer may disclose taxpayer information in certain specified circumstances including-

"(h) *taxpayer information which may reasonably be regarded as necessary for the purposes of determining any tax, interest, penalty or other amount that is or may become payable by another person or any refund or tax credit to which the other person is or may become entitled, may be disclosed to that other person*,"

Having considered the wording of subsection (8)(h), Revenue is of the view that, where a receiver requests taxpayer information for the purposes of determining any tax, interest, penalty or other amount that is or may become payable by the receiver, or any refund or tax credit to which the receiver is or may become entitled, by reference to the circumstances of the particular taxpayer, Revenue may share that information with receivers for those specific purposes without the need for further legislative change.

B.6 On the general question of access to Revenue held information, Revenue would caution against any expectation that the information it possesses will provide the solution to all of the receiver-related CGT information gaps. The information Revenue holds is largely dependent on tax returns submitted under the self-assessment system and certain other sources and may not be held in a form or to a level of disaggregation that is necessarily useful for the particular purpose envisaged. Nonetheless, Revenue is prepared to share what information it has for the sole purpose of assisting in the determination of a CGT liability, where the information cannot otherwise be accessed by the receiver from the borrower or from other sources.

B.7 Revenue is also prepared to accept that, where complete information is not available, a receiver who uses their "best endeavours" to calculate the tax due will be deemed to have met their obligations under section 571.

8. Factors Influencing Proposed approach

8.1 Some of the factors considered in arriving at the proposed approach outlined above can be summarised as follows:

- The approach would go a considerable way towards substantially reducing the existing information deficit while not totally eliminating it - for example, in some circumstances, the receiver/lender may not know definitively if loan interest is deductible.

- There are a number of tax (and other) difficulties associated with attaching balancing events and section 23 claw-backs to the receiver/lender. These include:
    - the likelihood that receivers will not be able to access sufficient information to compute the amounts involved where the borrower is not co-operating,

- the likelihood that lenders/receivers will simply hold property until the holding period or tax life has expired, thus avoiding potential tax charges on disposals but also delaying commercial decisions as to whether to dispose of property or not,
- the fact that the borrower has had the benefit of some or all of the reliefs in question,
- the fact that the amount of a claw-back or balancing charge will not be matched by equivalent cash receipts in the hands of the receiver/lender,
- the impact on the lender's security – which is viewed as a major issue by financial institutions, and
- the possibility, as alluded to by several respondents, that borrowers might "opt-in" to a receivership so as to avoid potential tax charges relating to claw-backs and balancing charges.

8.2 Freeing lenders/receivers from the responsibility of accounting for tax on section 23 claw-backs etc (which, based on Revenue's current (but disputed) interpretation lies with the lender) in situations where it is highly unlikely that the borrower will be in a position to discharge the tax (due to the fact that the borrower will not have access to the sale proceeds and is almost certainly in very difficult financial circumstances overall), might be viewed as depriving the Exchequer of a potential source of tax revenues and of generating long term tax debt problems for Revenue. However, respondents to the consultation stressed the point that at present, due to Revenue's existing interpretation of the legislation, lenders are generally not disposing of property in receivership until after the holding period has elapsed with the result that no claw-back arises in any event.

8.3 It is argued that imposing the claw-back on lenders/receivers under any new proposal would simply see that practice continue. In any event, it would appear to be the case that, regardless of whether a borrower sells a property directly outside of receivership or it is sold by a receiver on behalf of a lender, the first call on the proceeds of sale will go directly to the financial institution to the extent of the value of the security. So the likelihood is that, in the current depressed property market, there will be little if any proceeds of sale available to discharge tax liabilities irrespective of the circumstances under which property is sold. The proposed approach, gives, at a minimum, some prospect through the "payment on account" aspect that an amount of tax will be secured in cases where a borrower is neither cooperating with a receiver nor with Revenue.

9. Summary

9.1 It is considered that the above approach takes on board the primary concerns expressed by respondents to the consultation. It also has the following potential benefits:

- It will simplify the information and tax computation requirements in receiverships generally and provide greater certainty in relation to the tax obligations of receivers.

- It will help ensure that lenders' decisions to enforce their security through the receivership route will be based on commercial considerations and not be

influenced by potential exposure to tax liabilities arising from claw-backs or balancing charges.

- It will mitigate the risk (under some of the original consultation proposals) of potential dysfunctional behaviour on the part of borrowers e.g. a borrower "forcing" the issue to bring about a receivership on the basis that the lender/receiver would be responsible for tax arising on claw-backs in the event of the sale of a property.

- It will maintain equality of tax treatment for borrowers who sell section 23 property or other tax relieved property inside or outside of a receivership – in both situations the responsibility for discharging tax arising on claw-backs or balancing allowances will rest with the borrower.

- It provides some prospect of tax being secured for the Exchequer in receiverships.

10. Further Work

10.1 Subject to consideration of the responses to this further consultation, it is intended that final legislation will be included in Finance (No.2) Bill 2013. In addition, further work will be required in developing, in conjunction with interested parties, guidelines and administrative and operational procedures to underpin the above proposals.

11. Questions

In responding to this document you are invited to:

A) Comment generally on the merits or otherwise of the proposed course of action outlined,

B) Comment and where possible offer suggestions on the draft legislation, and

C) Give your views on the specific questions set out below.

Your views are important as they may help influence the final outcome of the consultation.

Question 1 Will the proposed approach provide the certainty sought by receivers and lenders as to their tax and filing obligations in receiverships?

Question 2 Will the proposed approach deal satisfactorily with lenders' concerns about enforcing their security through the receivership route and avoiding distortions in commercial decision-making?

Question 3 Will the proposed approach assuage concerns about and mitigate the risk of dysfunctional behaviour on the part of borrowers in the context of receiverships?

Question 4 Does the proposed approach achieve the objective of keeping compliance and administrative costs reasonable?

Question 5 Is the "one-size-fits-all" receipts/payments based approach proposed, irrespective of whether the borrower is a corporate or non-corporate, a logical approach?

Question 6 Is the refund provision sufficient to address concerns regarding the possible over-deduction of flat rate tax by a receiver – if not, what further refinements would you consider necessary?

Question 7 Are there aspects of the approach that you feel will not work?

Question 8 Are there issues of importance that you feel have been overlooked and, if so, how would you propose they be dealt with?

Question 9 Is the approach of maintaining section 571 TCA 1997 intact and enhancing its operation through information sharing a good one?