

This technical query paper was submitted to Revenue via the TALC Direct/Capital Taxes sub-committee in advance of the June 2022 TALC Direct/Capital Taxes sub-committee meeting. There was a further discussion on the matter at the February 2023 TALC Direct/Capital Taxes sub-committee meeting and the discussion will be reflected in the Minutes.



Request for clarification on the application of the term “*similar in all material respects*” in section 747B(2A) to investments including Exchange Traded Funds (ETFs) / Exchange Traded Commodities (ETCs)

20 June 2022

Introduction

Revenue previously accepted that the tax treatment of ETFs and ETCs domiciled in the US, EEA and OECD countries follows the treatment of share investments and therefore such investments were subject to CGT treatment on disposals. However, effective 1 January 2022, Revenue have withdrawn this blanket statement.

In practical terms this does not change the analysis, rather each individual investment (whether an ETF, ETC or other) needs to be examined to determine the appropriate tax treatment. Revenue’s TDM still refers to an offshore investment being regarded as a fund if the investment is “equivalent” to an Irish authorised unit trust. The reason Revenue previously agreed that ETFs issued by US or Canadian issuers under a unit trust arrangement were not considered funds we understand is because it was accepted such investments are not considered to be “equivalent” to Irish unit trust schemes.

At the TALC Direct / Capital Taxes sub-committee meeting on 28 April 2022, the Institute sought confirmation from Revenue concerning the criteria to be considered when determining if a fund, investment company or unit trust is “similar in all material respects” to an investment limited partnership, an authorised investment company or authorised unit trust scheme.

Revenue requested examples from members of characteristics to be determined in considering if an investment is similar in all material respects to an Irish regulated fund (as this will assist in determining if an investment is liable to CGT on sale under first principles or whether it is a fund).

We have provided detail and examples below to seek clarity on:

- (i) the term “similar in all material respects” as used widely in legislation on funds and in 747B (2A) and
- (ii) the application of that term to ETFs/ETCs and similar investments as used widely by investors.

Legislation

The definition of a “fund” is much narrower in the context of investments within the EU/EEA/OECD countries with which Ireland has a DTA. In those cases, the investment must fall within certain clearly defined parameters in order to be considered a fund for tax purposes.

The specific legislation is at section 747B TCA 1997, which lists the legal structures that are to be considered a fund for tax purposes in section 747B (2A) TCA 1997.

Section 747B (2A) TCA 1997 provides:

“This Chapter does not apply to an offshore fund other than an offshore fund which –

(a)

- (i) is an undertaking for collective investment formed under the law of an offshore state,*
- (ii) is similar in all material respects to an investment limited partnership (within the meaning of the Investment Limited Partnership Act 1994), and*
- (iii) holds a certificate authorising it to act as such an undertaking, being a certificate issued by the authorities of that state under laws providing for the proper and orderly regulation of such undertakings,*

(b) is authorised by or under any measures duly taken by a Member State for the purposes of giving effect to:

- (i) Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), or*
- (ii) any amendment to that Directive,*

(c)

- (i) is a company formed under the law of an offshore state,*
- (ii) is similar in all material respects to an authorised investment company (within the meaning of [Part 24 of the Companies Act 2014],*
- (iii) holds an authorisation issued by the authorities of that state under laws providing for the proper and orderly regulation of such companies and that authorisation has not ceased to have effect, and*
- (iv) is an investment company –*
 - (I) which raises capital by promoting the sale of its shares to the public, or*
 - (II) each of the shareholders of which is an investor which, if the company were an authorised investment company within the meaning of [Part 24 of the Companies Act 2014] would be a collective investor within the meaning of section 739B, or*

(d)

- (i) is a unit trust scheme, the trustees of which are not resident in the State,*
- (ii) is similar in all material respects to an authorised unit trust scheme (within the meaning of the Unit Trusts Act 1990),*
- (iii) holds an authorisation issued by the authorities of that offshore state under laws providing for the proper and orderly regulation of such schemes and that authorisation has not ceased to have effect, and*
- (iv) provides facilities for the participation by the public, as beneficiaries under the trust, in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatsoever.”*

Background on Exchange Traded Products

Exchange traded funds (ETFs) and Exchange Traded Commodities (ETCs) are types of investments within a broader category of financial products called exchange-traded products (ETPs). ETPs constitute a diverse class of financial products that seek to provide investors with exposure to financial instruments, financial benchmarks, or investment strategies across a wide range of asset classes. ETP trading occurs on national securities exchanges and other secondary markets, making ETPs widely available to market participants including individual investors.

ETC's

Exchange-traded commodity funds are structured as trusts or partnerships that physically hold a precious metal or that hold a portfolio of futures or other derivatives contracts on certain commodities or currencies. ETC's are typically structured as debt securities. In our view an ETC is a debt instrument and is therefore not a material interest in an offshore fund within the meaning of section 743 TCA 1997.

ETF's

ETFs are pooled investment vehicles holding an underlying basket of securities, whether it be equities, bonds, commodities, currencies or hybrids. ETF shares are traded intraday on an exchange and at market prices that may or may not be the same as the net asset value (“NAV”) of the shares. The price is generally based on market demand typically driven by the underlying securities' prices.

US domiciled ETFs

US domiciled ETFs have various legal structures, which can impact on the appropriate tax treatment.

In the US, certain types of ETFs must register with the Securities and Exchange Commission (“SEC”) under the Investment Company Act of 1940. The legal structure of ETFs that are registered with the SEC are open-end investment companies or unit investment trusts.

In the US ETFs are regulated by the Federal Reserve System and are subject to applicable federal and state banking laws and to supervision by the Federal Reserve.

Features of ETFs

Unlike with mutual fund shares, retail investors can only purchase and sell ETF shares in market transactions. That is, unlike mutual funds, ETFs do not sell individual shares directly to, or redeem their individual shares directly from, retail investors. Instead, ETF sponsors enter into contractual relationships with one or more financial institutions known as “Authorized Participants.” Authorized Participants typically are large broker-dealers. Only Authorized Participants are permitted to purchase and redeem shares directly from the ETF, and they can do so only in large aggregations or blocks (e.g., 50,000 ETF shares) commonly called “Creation Units.”

To purchase shares from an ETF, an Authorized Participant assembles and deposits a designated basket of securities and cash with the fund in exchange for which it receives ETF shares. Once the Authorized Participant receives the ETF shares, the Authorized Participant is free to sell the ETF shares in the secondary market to individual investors, institutions, or market makers in the ETF.

The redemption process is the reverse of the creation process. An Authorized Participant buys a large block of ETF shares on the open market and delivers those shares to the fund. In return, the Authorized Participant receives a pre-defined basket of individual securities, or the cash equivalent.

Irish tax analysis - offshore funds within the EU/EEA/OECD DTA countries

As outlined above there are four categories of fund under section 747B (2A) TCA 1997 and we have provided comments on the typical hallmarks/characteristics within those categories (but mainly related to company and unit trust scheme investments) that members would deal with in practice.

1. Authorised collective investment undertakings

Certain authorised collective investment undertakings that are similar in all material respects to an Irish Investment Limited Partnership. This structure is rare in the context of ETFs/ETCs so we have not included any further detail on this.

2. An investment fund authorised by the EU as a UCITS

An investment that is authorised under measures taken by a Member State to give effect to the UCITS directive. Generally, the prospectus for any investment will state if it is a UCITS investment. If it is, then no further analysis is required as it is considered a fund for tax purposes. If it is authorised/regulated by some authority but is not UCITS authorised, then more analysis is required.

3. An authorised investment company

An authorised investment company that is similar in all material respects to an authorised investment company (within the meaning of Part 24 of the Companies Act 2014), and which raises capital for promoting the sale of its shares to the public.

If any of the following tests are not met, then the authorised investment company is not a fund:

- (i) The investment must be authorised by the authorities of the state in which it is formed, under laws providing for the proper and orderly regulation of such companies
- (ii) The investment must be similar in all material respects to an authorised investment company (within the meaning of Part 24 of the Companies Act 2014)
- (iii) The fund must raise capital by promoting the sale of its shares to the public **or** each of the shareholders of the fund would be considered a collective investor (within the meaning of section 739B)

On a practical level it is difficult to decide whether “foreign laws” provide for the proper and orderly regulation of the company. Therefore, it can be more practical to focus instead on the other two conditions, both of which can generally be ascertained from a review of the prospectus for the particular investment.

Raising capital

In order to be a fund, if the investment is structured as a company, it must “*raise capital by promoting the sale of its shares to the public*”. An investment company which raises capital in some other form as opposed to promoting the sale of its shares to the public, is not considered a fund for tax purposes.

Since 2018, we understand most private individual investors in the EEA cannot invest in US ETFs. This is because rules came into force in 2018 requiring providers of investment products to supply retail investors with a ‘key information document’ (KID) to help them better understand the product they are buying. US ETFs do not provide such a document. Therefore, since 2018 US ETF’s are only marketed to Professional Investors in the EEA. Arguably this does not come within the remit of “*promoting the sale of its shares to the public*”.

Similar in all material respects

The other condition that needs to be met in the case of a company is that it is “similar in all material respects” to an Authorised Investment Company within the meaning of Part 24 of the Companies Act 2014. Two features in particular are relevant:

The memorandum and articles of association of an Irish authorised investment company must provide either:

- (i) that the shares of the company are at the request of the shareholders purchased by the company directly or indirectly out of the company's assets or
- (ii) the company takes steps to ensure that its shares will trade within a specified percentage of NAV, the percentage to be no more than 5%.

With regard to condition (i), as outlined above US domiciled ETF investments structured as corporates are often structured with “creation units” issued to institutional investors, with no facility for individual shareholders to redeem their units directly with the company. This would appear to be a key difference with an Irish Part 24 authorised investment company. The following is an extract from a sample iShares Prospectus:

“Shares of the Fund are held in book-entry form, which means that no stock certificates are issued. The Depository Trust Company (“DTC”) or its nominee is the record owner of, and holds legal title to, all outstanding shares of the Fund. Investors owning shares of the Fund are beneficial owners as shown on the records of DTC or its participants. DTC serves as the securities depository for shares of the Fund. DTC participants include securities brokers and dealers, banks, trust companies, clearing corporations and other institutions that directly or indirectly maintain a custodial relationship with DTC. As a beneficial owner of shares, you are not entitled to receive physical delivery of stock certificates or to have shares registered in your name, and you are not considered a registered owner of shares. Therefore, to exercise any right as an owner of shares, you must rely upon the procedures of DTC and its participants.”

In this case the ETF raises capital by promoting the sale of certificates in bearer form. Certificates are not considered shares when generally interpreting tax legislation, so arguably this investment is not a fund.

For condition (ii), there is no requirement for US ETF's to trade within a certain percentage of NAV. The following is an example from the Prospectus of a US domiciled ETF structured as open-end investment company:

“The Fund could lose money over short periods due to short term market movements and over longer periods during more prolonged market downturns. Local, regional or global events such as war, acts of terrorism, the spread of infectious illness or other public health issues, recessions, or other events could have a significant impact on the Fund and its investments and could result in increased premiums or discounts to the Fund's NAV.”

In our view if the investment company has any of the following characteristics it is not similar in all material respects to an Authorised Investment Company within the meaning of Part 24 Companies Act 2014:

- (a) The investment company does not facilitate the redemption of investor units directly.
- (b) The investment company allows the fund to trade at a premium or discount and does not actively take any steps to ensure the fund trades within a certain percentage of NAV.
- (c) The fund is directly marketed and sold to authorised participants such as large investment brokers rather than members of the general public.

4. An authorised unit trust scheme

The final category is an authorised unit trust scheme, which (to be considered a fund) must be similar in all material respects to an Authorised Unit Trust Scheme within the meaning of the Unit Trusts Act 1990.

If the investment is a unit trust scheme, it must *“provide facilities for the participation by the public, as beneficiaries under the trust, in profits or income arising from the acquisition, holding, management, or disposal of securities or any other property whatsoever.”*

A unit trust scheme is not a fund unless the public participate “as beneficiaries under the trust” in profits or income from the investments. Depending on the structure of the investment in question, it could be said there is no trustee/beneficiary relationship.

There are some key features under the Unit Trusts Act 1990 that need to be met for an investment to be considered an Authorised Unit Trust Scheme. Therefore, if those key features are not present, it is our view that the investment is not *“similar in all material respects”* to its Irish equivalent.

In the case of a unit trust, a key feature of an Irish regulated unit trust is that it must provide facilities to investors to redeem their units directly with the trustees.

Many US ETFs that are structured as unit trusts do not provide this facility and the only way that an investor can realise value for his or her units is by selling them on the open market. This is because the units in the investment consist of block-size creation units (usually c.50,000) and can only be redeemed in creation units. As a result, only large institutional investors can redeem units directly with the trust and therefore it is not possible for individual investors to purchase or redeem units directly with the Trust. Individual investors can only trade shares on a secondary market on a Stock Exchange.

It should be possible to see from the prospectus for the investment that this is how the investment operates.

Another characteristic to note with many ETF investments is that they are not actively managed. In most cases the portfolio of stocks in the investment is fixed (i.e. it is decided at the outset exactly what mix of securities the investment will hold). The almost total absence of change in the investment’s portfolio eliminates the need for the trust to

contract with an investment adviser for management services. By contrast the Irish equivalent of this investment must have both a management company and a trustee in place.

These key differences indicate in our view that a unit trust structured in this way, which is not a UCITS investment, is not a fund investment.

The following is an extract from a sample unit trust investment prospectus:

“Individual Units of the Trust may be purchased and sold on NYSE Arca, Inc. (the “Exchange”), under the market symbol “SPY”, through your broker-dealer at market prices. Units trade at market prices that may be greater than NAV (premium) or less than NAV (discount). Units are also listed and traded on the Singapore Exchange Securities Trading Limited (stock code S27), the Tokyo Stock Exchange (code 1557) and the Australian Securities Exchange.....Only certain institutional investors (typically market makers or other broker-dealers) are permitted to purchase or redeem Units directly with the Trust, and they may do so only in large blocks of 50,000 Units known as “Creation Units.” Creation Unit transactions are conducted in exchange for the deposit or delivery of in-kind securities and/or cash constituting a substantial replication of the securities included in the Index.”

The prospectus also confirms that the ETF it is not actively managed:

“The Trust is not actively managed. Rather, the Trust attempts to track the performance of an unmanaged index of securities. This differs from an actively managed fund, which typically seeks to outperform a benchmark index.”

In our view if the unit trust investment has any of the following characteristics it would not be treated as similar in all material respects to an Authorised Unit Trust Scheme within the meaning of the Unit Trusts Act 1990:

- (a) There is no beneficiary/trustee relationship between the trustees of the unit trust and individual investors.
- (b) The fund is directly marketed and sold to broker-dealers rather than members of the general public.
- (c) The unit trust does not facilitate the redemption of investor units directly.
- (d) There is no management company in place and the fund is not actively managed.

Revenue may have additional comments on characteristics they would consider relevant in determining if an investment is “similar in all material respects” and we would welcome Revenue clarity on the matter to assist members advising clients and ensuring taxpayers obligations are met correctly.