Irish Tax Institute

Response to Department of Finance Consultation on the Tax Treatment of Receiverships

4 September 2012

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The Irish Tax Institute

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A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of our members, we play an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

Executive Summary

There is no solution to the current challenges facing the tax treatment of receiverships that is either simple or straightforward. However, we have been guided in our response to this consultation paper by a number of fundamental principles:

- There are clearly urgent economic and market issues facing receiverships at the moment. However, any examination of the tax regime must balance these current needs with the requirement to set in place a robust system for the longer term.
- Whatever is finally agreed must be as commercially viable as possible for all the parties involved.
- The costs of government administration and taxpayer compliance must be reasonable.
- The regime must provide certainty so that each party understands their obligations.

A number of the paper's proposals would appear to transfer the primary liability for certain taxes from the borrower to another party – be it the receiver or the lender. We understand the attractiveness of collecting tax from the receiver or lender, in cases where it might otherwise be very difficult to collect it from the borrower. However, this could create distortions where the borrower may have enjoyed a benefit in the past from holding the asset and the lender now becomes ultimately liable for any future tax which arises from holding or selling the asset. Any shift of this nature would be a significant departure from generally accepted tax principles and the full ramifications would need to be carefully thought through.

Even if such a step could be warranted, it should only be considered if there is evidence of significant tax at risk to the Exchequer. However, our members' experience of dealing with receiverships suggests that there is minimal tax exposure in most receivership cases at present, due to a range of variables including current market conditions, loss relief carried forward and interest costs.

We believe that a full economic impact assessment should be conducted on the proposals in this Consultation Paper which meet with the most positive feedback from the parties who respond. Any decisions on tax policy could have much wider implications for lender and borrower behaviour and could impact on the market and on lenders' loan impairment positions. All such aspects should be considered in the assessment as well as the net tax yield that might result from any change.

Suggested Ways to Improve the Current Regime

At section 6 of our response, we considered ways in which the current regime for collecting and remitting tax due could be improved.

This is an alternative approach to actually changing the primary liability of the parties involved. We would welcome the opportunity to discuss these suggestions further.

1. Introduction

Before we consider the issues and proposals set out in the consultation paper, it is important to review the realities of the current environment for receiverships. We also highlight the wider implications of changing the tax regime which must be taken into account.

The Current Environment

It is clear that receivership activity has increased hugely over the last number of years. In 2007 11 receiverships took place. In contrast, 249 took place in 2012, an increase of over 2,000%[1]. The bulk of receiverships have involved the appointment of receivers to specific properties held by borrowers i.e. fixed charge receivers.

The downturn in the property market has had the following effects on properties in receivership:

- The realisable sales value has declined dramatically. In many cases properties may now be sold for less than they cost to purchase, if they can be sold at all.
- Properties are taking longer to sell.
- Rental profit has declined due to a fall-off in economic activity combined with increased interest charges on borrowing.
- Premiums are no longer paid to the same extent for tax-based properties, as a result of the pending guillotine on many property reliefs in 2014 and the restriction on relief claims due to the High Earners Restriction.

In light of all these factors, it is very unusual to realise taxable profits on properties in receivership, which clearly impacts the tax at risk for the Exchequer. Therefore, in considering what type of tax regime change is required, we believe that the focus should be on developing a fair, straightforward and solid regime that can actually work in practice for borrowers, lenders, receivers and the Exchequer.

The Wider Economic Implications of Regime Change

On an issue such as receiverships, we are particularly conscious that tax policy does not operate in isolation. There will clearly be wider economic implications to any change in the tax treatment of receiverships. As we see it, there are 3 key questions that need to be addressed in considering these implications:

- What impact (if any) the proposal will have on borrower behaviour?
- What impact (if any) the proposal will have on lender/receiver behaviour?
- The possible implications for the property market?

[1] Insolvency Journal publication, Receivership Stats 2012 and 2007

In forming our views on the proposals in the consultation document we have used our best endeavours to consider the above questions. However a much more structured and detailed review of the issues could be achieved through an economic impact assessment (as suggested in the Executive Summary). We believe that this should be completed before any final decision is made.

Consideration also needs to be given to the interaction of the proposals with company law regarding priority of debt in receiverships and with the Personal Insolvency Bill 2012.

2. The Structure of this Submission

In this submission we:

- Review the background to the current position and its complexities.
- Consider the interpretation of current direct tax legislation.
- Highlight issues to consider in evaluating the consultation paper's proposals for direct taxes (1-4) and our conclusions.
- Suggest improvements to the current collection mechanisms.
- Highlight issues to consider on VAT proposals (A-E).
- Respond to the specific questions set out in the consultation paper.

3. Background and Current Complexities

The current complexities have been brought to light because of the surge in receivership activity over the last few years, at a time when there have not been concurrent developments in tax legislation and administration. As noted in the consultation paper, difficulties and uncertainties currently arise in a number of areas:

- There is often difficulty for the receiver/lender in accessing information from the borrower to compute a direct tax liability.
- There is uncertainty in many cases, as to who is chargeable to tax on the liabilities arising.
- There can also be uncertainty as to who is accountable for the tax due.
- As regards VAT, the treatment of transactions which are supplies of goods appears to be quite clear. However, the same cannot be said for supplies of services.
- Further difficulties and uncertainties arise in relation to taxes not covered in the consultation paper, in particular Relevant Contracts Tax (RCT). In addition, there are a number of administrative difficulties arising across a range of taxes, at present. We have provided further details on the various issues in Appendix 1.
- The paper makes no reference to cross-border situations where, for example, properties are not located in the State or a borrower has become non-resident.

Feedback from members indicates that the problems connected with accessing information, relate mainly (but not exclusively) to fixed charge receiverships involving individuals rather than corporate receiverships.

The calculation of tax due for an individual borrower can also be very challenging, as the lender/receiver often does not have access to information on income or expenses of the borrower generated by assets/employments not under the control of the receiver, e.g. the borrower's PAYE income, pension reliefs, tax credits etc.

The current system is complex because the borrower remains the taxpayer with primary liability for tax due i.e. the chargeable person. However, the legislation provides for a collection regime which imposes obligations on the receiver and lender. While the primary liability for tax due should rightfully rest with the borrower, the specific arrangements for collecting the tax in receiverships need to be adjusted. .

As with any change in law, consideration must be given to the practicalities of its introduction and particularly the effective date from which a change applies. These matters need to be worked through to ensure any uncertainties in tax treatment or administration are addressed.

4. Interpretation of Current Direct Tax Legislation

In the table below, we have summarised the interpretation set out in the consultation paper of who is the chargeable person for payment of the direct tax liabilities, under current law.

Who is currently" chargeable" to tax – position per the Consultation Paper?

	Asset/business owner	**Lender**	**Receiver**
Rental income		X(note 1)	
Balancing event (on rented properties)		X (note 2)	
Section 23 type relief clawback (on rented properties)		X (note 2)	
Non-rental income individual/corporate	X (company receivership – company obligation)		X (where receiver over sole trader) (note 3)
Capital gains			X
Corporation tax	X		

However, there are a number of differing views on aspects of the above interpretation:

1. Differing legal views exist as to whether Revenue can impose an obligation on the lender for the tax on rental income under Section 96(3) TCA 1997.
2. The consultation paper states Revenue's view that liabilities arising on balancing events and clawbacks on rented property can be imposed on the lender, not the

borrower, where a receiver has been appointed. This is not the view of our members, based on their interpretation of the legislation and we have not had sight of any detailed analysis of Revenue's technical position on the matter.

3. Receivers account for tax on non-rental income under Section 52 TCA 1997 in the case of sole trader and individuals/partnerships. There is some practice of accounting for tax on such income in the case of corporates. However, this has developed as a practice rather than as a reflection of the legislative position.

5. Consultation Paper Proposals on Direct Taxes and our Views

Below, we deal with each proposal in the consultation paper, in terms of:

- The amendments to the tax treatment being suggested.
- The possible administrative impact of the changes.
- Other implications of the changes.

5.1 Proposal 1

5.1.1 Summary of Chargeable Persons under Proposal 1

	Asset/business owner	**Lender**	**Receiver**
Rental income			X
Balancing event			X
Section 23 type relief			X
Non-rental income individual/corporate	X (company receivership – company obligation)		X (where receiver over sole trader)
Capital gains			X

Under Proposal 1, the receiver would be primarily liable for tax on the income and gains (including balancing allowances/charges and Section 50/23 clawbacks) arising in a particular receivership at a flat rate of tax. The rate of the tax is not specified in the proposal. In calculating the receiver's liability, no regard would be had to the borrower's losses/allowances forward nor to any tax exemption that may apply to the borrower (such as the CGT Principal Private Residence Relief). The lender would have secondary liability for the tax due.

5.1.2 Administrative issues to consider

From an administrative perspective, a number of matters need to be considered in evaluating this proposal:

- The receiver is unlikely to have sufficient historical information to accurately calculate any clawbacks/allowances arising on a balancing event. Nor will they be able to obtain this information from Revenue due to taxpayer confidentiality provisions.

- If the receiver does have the information to calculate a claw-back, he may be faced with a liability that cannot be funded because the claw back is deemed/notional income rather than cash, e.g. the claw-back exceeds the actual cash realised on the sale of the relevant property.
- Without historical data on the assets qualifying for capital allowances, such as their tax life, the date of purchase and the tax written down value, the receiver would have great difficulty in calculating the current year claim.
- The exclusion of the borrower's losses and capital allowances brought forward could result in tax paid by the receiver at the flat rate being significantly overstated as compared with the tax that would arise on the borrower under general principles. Where it transpires that the tax paid by the receiver exceeds the actual tax due, the borrower would be entitled to a refund on filing of their tax return or this refund could be allocated by Revenue against other tax liabilities of the borrower if his/her tax affairs were not up-to-date. The proposal makes no reference to an adjustment mechanism for the receiver/lender. Even if a refund were available, it is difficult to see how the receiver/lender could be compensated for tax overpaid when the refund is finally settled. Section 571 TCA 1997 currently provides for a refund to be made to a receiver where CGT is overpaid.
- The interaction with the borrower's income tax return is unclear. Would the borrower still be required to file a tax return including all their income and gains or would income and gains on which the receiver is primarily liable be excluded from the borrower's return?
- If the income and gains on which the receiver is chargeable are carved out without reference to losses and capital allowances, this would imply that the borrower is free to use these losses and allowances against their other income or carry them forward.
- The process and timing for the receiver to pay the tax and make the return to Revenue is unclear.
- The incorporation of the USC in the flat rate suggests that this proposal relates purely to individual borrowers in receivership. If this proposal is to apply to corporate borrowers a separate means of establishing an appropriate rate would need to be considered.
- Multiple receivers may be appointed to deal with the assets of a single borrower and it is not clear how this situation would be dealt with, for example if we take into account the proposal's references to limited offset of losses and allowances during the receivership period.

5.1.3 Other implications

Proposal 1 notably transfers the borrower's tax liability to the receiver, while restricting a receiver's right to allowances and reliefs etc. This could have the following implications:

- If it is likely that where a receiver is appointed the tax due will be much higher than the tax that would be due if no receiver were appointed, this may result in delays in appointment of receivers by a lender.
- The way in which the tax is calculated could lead to substantial overpayments of tax or the creation of artificial tax liabilities where none exist. This could create legal risks for the receiver.
- Although the document is silent on this issue, it would seem that the borrower retains the benefit of losses and allowances carried forward. This could create situations where it is preferable for a borrower to allow a property go into receivership rather than engage with the bank and Revenue in relation to their debts.
- The fact that the borrower retains the benefit of losses and allowances carried forward in a receivership scenario could result in inequitable treatment when compared with borrowers not in receivership.

Conclusion:

In our view, Proposal 1 involves shifting the primary liability to tax from the borrower to the receiver/lender. This is a very significant departure from general tax principles. Such a departure should only be considered where it significantly simplifies the tax treatment or addresses significant tax loss to the Exchequer. We have seen no evidence to date, to suggest this is the case.

5.2 Proposal 2

5.2.1 Summary of Chargeable Persons under Proposal 2

	Asset/business owner	**Lender/mortgagee**	**Receiver**
Rental income			X
Non-rental income individual/corporate	X(company receivership – company obligation)		X (where receiver over sole trader)
Capital gains			X

As can be seen from the table above, the key distinction from Proposal 1 is the treatment of balancing events/Section 23 clawbacks. Proposal 2 suggests that balancing events on the sale of property in receivership are disregarded by the receiver when calculating the tax liability.

Conversely, the purchaser of the property would not be able to avail of any allowances carried forward.

5.2.2 Administrative issues to consider

From an administrative perspective, the calculation of the tax due by the receiver will be simpler because balancing events and clawbacks are disregarded. However the issues identified in Proposal 1 will still arise:

- The potential for overpayment of tax due because losses/allowances brought forward by the borrower are not available to be included in the calculation of tax by the receiver.
- The interaction with the borrower's income tax return is unclear
- There is no refund mechanism in place if overpayments arise.
- If it is decided to eliminate balancing events or clawbacks the logical choice would be to base the purchaser's relief on the remaining tax written down value /unclaimed relief on the property. This is the approach already adopted by tax legislation in certain intra-group transfers or company reconstruction situations.

5.2.3 Other implications

1. Borrowers with properties in receivership could arguably be treated much more favourably than those not in receivership, if balancing events are disregarded once a property is in receivership, while the borrower retains the benefit of allowances claimed to date. The borrower also retains losses carried forward.

   In contrast, where a receiver has not been appointed the borrower would be responsible for balancing charges and clawbacks if they dispose of property in their own right. This could impact on a borrower's behaviour when dealing with the lender.
2. While tax-based properties may not enjoy the same premium prices as heretofore, disallowing relief to the purchaser could act to reduce the market value of an asset further and impact on the commercial decision to appoint a receiver.

Conclusion:

This proposal involves a transfer of the primary liability from the borrower. Proposal 2 could also result in more favourable treatment for borrowers in receivership than those who are not. This could be counterproductive in encouraging early engagement by

5.3 Proposal 3

5.3.1 Summary of Chargeable Persons for Tax under Proposal 3

	Asset/business owner	Lender/mortgagee	Receiver
Rental income	X		X (withholds tax)
Balancing event	X		
Section 23 type relief	X		
Non-rental income individual/corporate	X		
Capital gains	X		X (withholds tax)

In this proposal the borrower is the chargeable person for income tax and capital gains tax and the receiver applies (an unspecified) withholding tax rate on rents and proceeds on disposals. This withholding tax would be available as a credit against the borrower's liability.

5.3.2 Administrative issues to consider

While the simplicity of a withholding tax mechanism is attractive, the following points need to be considered

- If the withholding tax is applied to the gross sales proceeds or rent, tax could be paid over that would not be due, had the normal tax deductions been taken into account. Indeed, in the current market it is likely that very little if any tax is properly due in a large number of cases, so that any withholding tax on gross proceeds would be excessive.
- In this case, there is no mechanism to refund excessive tax withheld by the receiver/lender, when the borrower files their income tax return it would appear from the consultation paper that this payment would be credited against the borrower's tax liability. As stated above, it is difficult to envisage how, in practice, lenders would be able to ensure that they benefitted from such refunds to the borrower.
- The lines of communication between borrowers and receivers are not always clear and open. Borrowers could seek to delay making returns to Revenue should disagreements arise with the receiver on the information provided by the receiver to the borrower. At times it can be impossible for a receiver to even locate the borrower to pass on information.

5.3.3 Other implications

A withholding tax obligation based on a gross top line measure could be somewhat arbitrary and could have implications for the lender and for the way in which receiverships are conducted:

- If the withholding rate is too high, the net return to the lender from the receivership process is lower than it should be. This could further impair lenders' loan books.
- It could also impact on a borrower's willingness to engage with the bank if tax is being withheld in any event, regardless of whether they co-operate.
- In the longer term it could impact on loan security sought by lenders i.e. in order to be more prudent, loan collateral sought could be grossed-up to take account of the withholding rate to compensate the lender, in the event of any default.
- There may be company law implications in seeking to prioritise Revenue debt over lender debt where withholding tax is applied at source.

Conclusion:

While Proposal 3 does not transfer the primary liability to tax from the borrower, there is a significant risk that tax may be paid to Revenue which is not otherwise due. It is not clear how this tax would be refunded in such circumstances. This proposal may also have company law implications.

5.4 Proposal 4

The main feature of Proposal 4, it that the receiver would stand accountable for any corporation tax due by a company while in receivership. Little detail has been provided in the paper as to how this would work in practice, so we are limited to considering the issue in principle only.

Under existing Irish tax law (as confirmed by a decision of the High Court in *Wayte (Holdings) Limited (in receivership) Alex Burns v Edward N Hearne*), a receiver/lender is not liable for corporation tax on income, other than in respect of Irish source rental income.

The consultation paper implies that a receiver will be in control of the company that owns the assets which are the subject of the receivership. This will often not be the case as the majority of receiverships tend to involve the appointment of a fixed charge receiver who will only control certain of the company's assets. Therefore ascertaining and paying the tax would prove difficult for the receiver. In the case of floating charge receiverships a receiver should have access to the books and records, but records may not always be fully up-to-date. Also, there may not be full co-operation from the borrower which would impact on the receiver's access to the necessary information to compute a corporation tax liability accurately.

Where multiple receivers have been appointed to a company's assets by different banks, it is unclear which receiver would be liable for the corporation tax due. The interaction between group companies would also need to be considered if this proposal were to be further explored e.g. how would group loss relief claims be made?

The proposal lacks sufficient information to come to a firm conclusion. We would need more detail to consider it properly.

6. Suggested Improvements to the Current Regime

There is no one ideal approach that will address all the unique complexities that arise in receivership situations. We think that rather than moving the primary liability from the borrower and as such departing from accepted tax principles, focus should be given to addressing difficulties in collecting tax due. Receivers or lenders should only be accountable for collecting tax for Revenue on income or gains to the extent they receive and control that income. They should not be primarily liable for tax due by the borrower. We have set out below some suggestions to make collection of tax due under the current legislation less difficult.

6.1 Capital Gains Tax

We believe that Section 571 TCA 1997 which deals with chargeable gains on disposal of assets by a receiver or liquidator is workable in practice subject to some administrative supports. Under this legislation, CGT is computed in the normal manner i.e. taking account of losses, reliefs etc. where appropriate. The tax due is assessable on the receiver under Case IV as income in the year the disposal occurs. Section 571(8) provides for a refund of tax to the "accountable person" where it transpires that tax has been overpaid.

The current difficulties in calculating CGT arise from gaps in historical data, for example establishing the base cost of an asset, losses forward etc. There are ways in which this gap can be addressed:

1. Revenue hold historical data on taxpayer's assets from their returns e.g. historic cost, enhancement expenditure, reliefs claimed, losses used/forward etc. It should be possible for a receiver to be able to get confirmation from Revenue as to whether CGT is due, without Revenue breaching the requirement for taxpayer confidentiality. Section 851A TCA 1997 provides for circumstances where Revenue is permitted to disclose taxpayer information for example, where disclosure is made to the taxpayer's agent.

   We think this section should be expanded to allow receivers obtain the necessary information to calculate CGT due. This would put the right to access such information on a statutory footing.

2. In the absence of full and complete information on an asset, the receiver should be deemed to have computed the tax to Revenue's satisfaction once

they use their “best endeavours” in calculating the tax due. Revenue recognise “best endeavours” as an appropriate approach in certain circumstances already, in particular in the Code of Practice for Revenue Audit, in valuing an asset.

To ease the administration burden for both receivers and Revenue in processing such CGT payments, we suggest that the receiver/lender be allowed to make all filings for each receivership under a single registration number. Under the current regime, payments may be filed under the borrower number or the receiver/lender number or a combination of either.

6.2 Rental Income

It is practical to say that the person who controls the asset in a receivership and receives the rent, should be in a position to remit the related tax to Revenue. Section 96 TCA 1997 already allows for this by making the lender an assessable person on the rent arising.

The current difficulties with Section 96 arise because it is impossible for a receiver to have full information on the taxpayer’s position so as to be able to accurately calculate the tax due on the rent. It would be impractical for the receiver to seek to obtain this information from Revenue due to the range of complexities involved in calculating income tax where numerous variables will determine to what extent and at what rate tax is due. We think Section 96 could be simplified in the following way:

- Allow the receiver to collect tax on the rental income, net of expenses and interest, for the receivership period, based on a flat rate. As the receiver controls the asset, they should have full information on the expenses in relation to that rental property to enable them to do this calculation.
- As the liability is deemed to be that of the mortgagee/lender, this tax could be paid over to Revenue by reference to the lender’s corporation tax filing date, as part of their corporation tax liability.

The borrower would remain the chargeable person for tax on his/her income and pay and file their tax liability in the normal manner. The tax paid on the rental income would be treated as a “payment on account”.

6.3 Clawbacks and Balancing Events

The liability for clawbacks on tax-based properties should rest with the borrower. It is the borrower who has availed of the relief and obtained the benefit of those allowances to date. To transfer the liability arising on a clawback of relief to a receiver/lender would create a fundamental difference between the tax treatment of borrowers with assets in receivership and those where no receiver has been appointed.

From a policy perspective, transferring the liability from the borrower is also likely to further delay property sales, as the lender will want to ensure the tax life of the property has ended before the sale is made.

6.4 Other income

The receiver should only be accountable for tax on other income to the extent it arises to them during the receivership period.

6.5 Corporation tax

For the reasons identified in relation to Proposal 4 we believe that liability for corporation tax should rest with the company, which is best placed to compute the tax due.

6.6 Our Suggestions for who is Accountable for Tax Due

Our view is that the borrower should remain primarily liable for tax due, but the receiver/lender would be accountable for collecting and remitting tax in respect of certain income as identified above. This is illustrated in the table below:

Accountable person	Asset/business owner	Lender	Receiver
Net rental income		X	
Balancing event	X		
Section 23 type relief	X		
Non-rental income individual/corporate	X(company receivership – company obligation)		X (where receiver over sole trader and receives income)
Capital gains			X
Corporation tax	X		

7. VAT on Receiverships

As highlighted above as regards VAT, the treatment of transactions which are sales of goods appears to be quite clear. The consultation paper suggests in 4.2 that the receiver/lender is currently accountable for VAT where they make taxable supplies. We would point out that this is not the current legislative position.

We have considered proposals A – E set out in the paper from the perspective of:

- Whether the proposal would be workable in practice
- Whether the proposal may be contrary to Ireland’s obligations under EU law.

Proposal A

Where taxable services/lettings are supplied by a receiver/lender in the course of carrying on the business of the borrower, or using the assets of the borrower, those services/lettings would be deemed as supplied by the borrower - the receiver would be obliged to make the returns and remit the tax arising. "Taxable lettings" includes those subject to a waiver by the borrower and those he/she has opted to tax.

The above legislative proposal is similar to the current treatment of supplies of goods by the receiver in the receivership period. Feedback from our members suggests that this works well in practice in relation to the supply of goods and would be workable in relation to the supply of services once introduced from a specific date and not applied retrospectively.

Proposal B

Under this proposal, where a borrower was making an exempt letting and a receiver/lender opts to tax a letting of that property, the borrower is deemed to be an accountable person in respect of that letting but the receiver is obliged to make the return and remit the tax arising on the supplies.

This would appear to be a workable option.

Proposal C

For the period of the receivership, the receiver/lender is responsible for the obligations of the borrower under the capital goods scheme (CGS), including payment of any amount due as a result of an adjustment under the scheme. Under this proposal the borrower will remain the capital goods owner, and where an adjustment under the CGS gives rise to an increase in deductibility, the entitlement to the deductibility will remain with the borrower.

The aim of the CGS is to ensure that the VAT deductibility for a property reflects the use to which the property is put over the VAT-life. Where it is used fully for taxable supplies, all the VAT incurred in acquiring or developing the property can be reclaimed. If it is not used in full for the making of taxable supplies the borrower is penalised through a clawback of a portion of the VAT input he/she claimed.

Proposal C seeks to makes the receiver liable to pay the VAT clawed back, even though it is the borrower who has benefitted from the initial VAT claimed. This is inherently inequitable, in particular in those cases where the restriction on the ability of the receiver to apply an option to tax (see E below) gives rise to the CGS adjustment.

Where a receiver rents the property on a short-term letting to generate funds or sells the property in circumstances that there is no option to tax, the legislation could result in a significant amount of a VAT adjustment due. This CGS adjustment could easily equal or exceed the rent or sales proceeds on offer. Therefore, the receiver could be left with a liability they cannot fund. The only sensible stance to take in that situation may be not to proceed with the transaction.

Ireland is required to implement a system of VAT which is in keeping with the provisions of EU VAT Directives. Under Article 205 of Directive 2006/112, Member States may provide that persons other that the person liable for payment of VAT is made jointly and severally liable. This Article would appear to be the basis for the provisions of Irish VAT law whereby receivers are made liable for output VAT on supplies of goods (and - under proposals A/B above – on services). However, we note that both the existing Irish legislation in relation to goods and the proposal under A/B above for services, do not seek to impose "joint and several" liability on the receiver, but instead make the receiver solely liable.

It is also clear that the right of a Member State to impose joint and several liability is limited to VAT which arises under Articles 193 to 200 and Articles 202, 203 and 204. These Articles in each case relate to Output Tax (i.e. VAT arising on a taxable supply of goods or services).

On the other hand, adjustments to Input Tax arising under the CGS are dealt with in Chapter 5 (in particular Articles 187 to 189) of Directive 2006/112.

Article 205 does not authorise Member States to impose joint and several liability on another person for adjustments to Input Tax arising under any of the Articles of Chapter 5. Furthermore, the right of a Member State under Article 189(d) to "*permit administrative simplifications"* in relation to the CGS, cannot be used to impose secondary or substitute liability on another person.

Equally, the general right of Member States under Article 273 to "*impose other obligations when they deem necessary to ensure the correct collection of VAT"* cannot be used to impose liabilities on other persons further than that permitted by the relevant provisions of the Directive (e.g. Art 205). This was confirmed by the ECJ in the case of *Federation of Technological Industries* [C-384/04].

We therefore request that consideration be given to Ireland's obligations under the VAT Directives and in particular the obligation not to extend the rules on joint and several liability beyond those specifically authorised by the those Directives.

Proposal D

This proposes to make a specific provision to ensure the receiver/lender is responsible for payment of any amount due by the borrower as a result of a waiver cancellation adjustment during the receivership period.

It is important to reflect on the way a waiver of exemption operates. Up to 1 July 2008 short leases were exempt from VAT but a landlord could waive this exemption. Where the exemption was waived, the landlord was entitled to deduct the VAT incurred on the acquisition/development of the let property. The waiver of exemption applied to all properties let by the landlord under short leases or lettings. The landlord was required to charge VAT on all rents payable to her/him under short leases or lettings.

Where the waiver is subsequently cancelled, which can occur automatically when the last property in a portfolio to which the waiver applied is sold, a repayment must be made to Revenue of the excess of input VAT recovered over the VAT paid on all the lettings which had been subject to the waiver.

This would have several implications. If we take, for example, a fairly common scenario where a borrower has a large portfolio of properties mortgaged with different banks with different receivers appointed to them.

a. Those banks that act early and dispose of the property they hold will suffer no VAT cost from the proceeds they may achieve. However, the bank left holding the last property unsold will have to absorb the full cost of the cancellation adjustment for the entire portfolio on sale of that final property.
b. This "last bank" may not even be aware that they hold the last unsold property and from any practical perspective has little or no chance to establish what VAT adjustment is actually due as the adjustment has to take account of the full portfolio.
c. The sensible position for that the bank to take in such circumstances may be not to sell the property at all.
d. It is also possible that a borrower cancels the waiver unknown to the receiver(s) and the receiver unknowingly becomes liable to a VAT clawback on the borrower's full portfolio.

As it is demonstrated above this proposal would prove difficult to apply in practice. Similar to Proposal C, it seeks to move the tax liability to the receiver/lender even though it is the borrower who has obtained the benefit of the input VAT. We would also note that in correspondence with the Institute in May of this year regarding such a scenario Revenue acknowledged that "where a receiver sells the last property covered by a waiver any tax payable in respect of the cancellation of the waiver remains the responsibility of the borrower who has the waiver".

Also, the same issue of compatibility with EU VAT Directives (identified at C above) applies here.

Article 137 of Directive 2006/112 authorises a Member State to allow an option for taxation (we understand that this is the basis in EU VAT law for the original "waiver of exemption" legislation under Irish VAT law).

Article 137 does not explicitly give Member States the right to apply a claw-back of input VAT where the waiver no longer applies. However Article 137(2) states that Member

States shall lay down "detailed rules" governing the exercise of that option. The Irish clawback rule on cancellation of a waiver would therefore appear to derive is basis from this Article 137(2).

However, whether or not the Irish rules on waiver cancellation adjustment derive authority from Art 137 or otherwise, it is clear that the waiver cancellation amount is a clawback of Input Tax originally taken by the borrower.

As pointed out at C above, Article 205 of Directive 2006/112 does not allow Member States to apply joint and several liability to adjustments of Input VAT.

We would also point out that the requirement (in Article 137(2)), to lay down "detailed rules", does not allow a Member State complete autonomy to impose any rules it chooses (e.g. to impose secondary or substitution liability on Input Tax adjustments when no other provision of the Directive authorises such an imposition). To apply Article 137(2) in this way would be contrary to the principles of fiscal neutrality and proportionality. The ECJ has continually stressed the requirement on Member States to apply discretionary provisions of the Directive in a manner consistent with those principles.

Proposal E

This notes that a receiver cannot opt to tax a sale to a person connected to the owner (borrower) or vendor (receiver) unless it can be demonstrated that the provision is operating in a manner not envisaged when this anti-avoidance measure was introduced.

The receiver's role is to realise the maximum price on disposal of the borrower's assets. It can be the case that the best price arises in a sale to a connected party. However, under the legislation a receiver cannot opt to tax the sale even if full market value is being paid and the sale is to a taxable purchaser. This can mean that a receiver is forced to sell a property to a lower bidder in order to avoid incurring a VAT clawback.

It is not clear why this measure is in place. If for anti-avoidance or anti-evasion purposes, it would appear to breach the principle of proportionality as it applies to all connected sales regardless of whether there is avoidance or evasion. It is difficult to understand Revenue's concern in maintaining this provision as if a sale is opted, Revenue's interest is protected as the property is brought back into the VAT net and subject to the Capital Goods Scheme for 20 years.

We believe that the provision to restrict the option to tax in connected party sales in receiverships should be revoked.

8. The Consultation Questions

Question 1

Is it generally the case that a receiver/manager carrying on a company's trade would have access to the information needed to enable him/her compute the taxable results of the receivership period (i.e. before capital allowances, unused losses etc.)? If not –

a) What type of information would the receiver have difficulty in obtaining, and why?
b) Is this a common difficulty for receivers?

Answer

The bulk of receiverships are fixed charge receiverships. In these cases the receiver will only control certain assets of the company and will not have control over the books and records of the trade of a company or individual/partnership.

Even where a floating charge receiver is appointed to carry out the trade, difficulties can arise in accessing historical information where the company records may not be up-to-date or the company does not provide full co-operation with the receiver.

Question 2

Would a fixed charge receiver appointed to rental property have sufficient information relating to rents receivable and expense incurred (as specified in Section 97(2) TCA 1997) to be able to compute the profit rents (before, for example capital allowances and losses forward) of that property? If not what difficulties are receivers encountering?

Answer

In general, a fixed charge receiver would have access to a substantial amount of the information relating to rents receivable and expenses incurred since the commencement of the receivership period. However, they may not have access to information on expenses incurred in the period from the commencement of the tax year, if tax must be computed on an annual basis.

Question 3

Would a receiver or lender generally have sufficient information to accurately compute a capital gain or loss arising on a sale of property i.e. before unused losses and personal exemption are taken into account? If not, what difficulties are receivers encountering?

Answer

It can be difficult to ascertain some historical details on assets, for example the base cost and enhancement expenditure. As noted in our proposals for improving the current regime, we believe a statutory provision should be in place to allow Revenue assist in dealing with gaps in historical data so that the correct tax liability can be ascertained. Revenue provide assistance in relation to VAT on a concessionary basis, as set out in eBrief No. 16/2012.

Question 4

What issues, if any, arise from making –

a) *the receiver primarily chargeable to and liable for income tax and capital gains tax arising on property in receivership?*
b) *the receiver the accountable person for corporation tax liabilities incurred during the receivership period in the case of a company in receivership?*
c) *the lender secondarily chargeable to and liable for income tax, corporation tax and capital gains tax arising on property in receivership?*

Answer

a) As stated above, we have fundamental concerns about the transfer of primary liability from the borrower to another taxpayer. This would represent a significant shift in the generally accepted principle that the taxpayer is the chargeable person in relation to their own tax liabilities.

The gaps in information needed to compute the tax liabilities correctly would make it difficult for the receiver or lender to comply with their obligations. There is also no mechanism for refunds of tax overpaid to be provided to a party other than the taxpayer.

An increased burden of responsibility arises on the receiver/lender to calculate and account for tax due where they do not have full information and may not receive co-operation from the borrower.

b) In most cases, a receiver is unlikely to have access to the company's full books and records where they are appointed as a receiver to specific company assets. In the case of floating charge receiver they may also not have full information to correctly account for tax due to deficits in the information they receive.

c) As noted in our Executive Summary, we do not think that it is appropriate to transfer liability from the borrower to another party**.**

Question 5

Does ring fencing the receivership period as provided in Proposal 1 for income and capital gains purposes overcome the information deficit faced by receivers/lenders? If not, please set out the reasons why you consider this approach might not work and suggest alternative solutions where possible.

Answer

As noted in our response to Proposal 1, ring fencing may address some of the difficulties arising from the information deficit. However it does not deal with problems around calculating current year capital allowance claims or tax due on balancing events.

Question 6

In Revenue's view balancing events and clawbacks arising on the sale of property would be chargeable on the receiver/lender rather than the borrower.

- *a) What issues, if any, does this give rise to for receivers/lenders and borrowers?*
- *b) Is Revenue's view that borrowers in these situations do not, and are probably unlikely ever to, have the necessary funds to pay tax on balancing charge or Section 23 clawbacks generally correct?*
- *c) If you do not agree with the Revenue approach, would you have any suggestions as to how this issue could be addressed in a manner which would minimise the exposure of the State in foregoing tax due otherwise?*

Answer

In relation to the questions raised above, under current legislation it is far from clear that balancing events and clawbacks fall on the receiver or the lender. We appreciate that there may be some cases where borrowers may not have funds readily available to pay tax due in such circumstances. However, this should not be grounds for shifting the liability that is deemed to arise, from the borrower to the receiver or lender. It is the borrower who has benefitted from the allowances claimed. Such an approach would be of great concern and could have wider ramifications.

Question 7

Does the non-availability of capital or section 23 relief for purchasers in proposal 2 have implications for receivers/lenders in attempting to sell property in such circumstances? If so, please provided details and possible solutions to any difficulties.

Answer

While tax-based properties do not attract the same premiums as heretofore, disallowing relief to purchasers would act to reduce the market value of the asset and could impact on the commercial decision to appoint a receiver i.e. if the lender feels that the sale of the property should be delayed until the market improves.

Question 8

Do receivers/lenders envisage any difficulties with the requirement under Proposal 3 that they provide a borrower with all relevant information for completion of returns etc? If so, please provide details.

Answer

The communication channels between borrowers and receivers may not always be clear and open. If borrowers do not make themselves available to receive the information provided, difficulties could arise.

VAT

Question 9

A receiver/lender is obliged to remit the VAT on services supplied/rents received in the course of carrying on the businesses or from the assets of the borrower. What difficulties are receivers/lenders having in complying currently? Do you foresee difficulties with the proposed legislation change?

Answer

In practice, this does not appear to cause difficulty. Legislative change would provide welcome certainty.

Question 10

What difficulties, if any, are foreseen with the provision to make receivers/lenders responsible for the obligations of the capital goods owner for the period of receivership?

Answer

As highlighted above, this could result in large VAT liability arising which the receiver is unable to fund from the proceeds of disposal of the property. We would also question as to whether imposing such a requirement on receivers is permissible under Article 205 of Directive 2006/112.

Question 11

What difficulties, if any, are forseen with the provision to make receivers/lenders responsible for the obligations of the borrower in relation to waiver cancellation adjustments?

Answer

We have noted above the reasons why this provision would be problematic in practice. Again, we do not believe it is permissible under Article 205 of Directive 2006/112.

Question 12

What difficulties, if any, arise with the anti-avoidance measure that prohibits the receiver from opting to tax a sale to a person connected with the borrower?

Answer

The current restriction on the option to tax for sales to connected parties is impacting on the choice of purchaser and resulting in the receiver being unable to maximise the profit on disposal of an asset. It also delays sales as a receiver must sell to a buyer in circumstances where they can opt to tax in order to avoid a VAT clawback.

Appendix 1

Current Administrative Difficulties when Dealing with Receiverships (direct taxes)

Computational Issues

- How to factor into the computations, group relief and/or loss claims that could reduce the income or profits of a mortgagor.
- How the receiver can ensure that any group relief (if available), is claimed/surrendered where they have no control over the filing of the corporation tax returns of either the company in receivership or any loss making group companies which are not in receivership.
- If the mortgagee-in-possession (MIP) pays tax, how does this interact with the mortgagor's income tax liability? In particular, whether the tax is credited to the mortgagor and what happens if the tax becomes refundable?
- How should an MIP deal with rental deductions such as interest and capital allowances?

    Would they be entitled to deduct the receivership costs as a rental expense?
    Would they be in a position to calculate a Case V liability, if any, given all the required elements of that calculation?

- The computation of income tax attributable to the rental income will be complicated by the possible application of the high earner's restriction, multiple sources of income, joint assessment and the inability to access the information necessary to compute any tax liability. Situations have also arisen where multiple receivers have been appointed to different rental properties owned by the same individual.
- How to deal with part-disposals where there are no records on previous sales price or base cost.
- How does the receiver know the motive of the borrower for land sales i.e. to determine whether they are liable to CGT or income tax for "trading in land",
- How the carrying value of land can be ascertained when the borrower is trading in land.
- Whether PPR relief is available to the lender/receiver?

Filing Issues

- Whether a receiver is required to apply for a separate PPS number in respect of all receiverships or does the Receiver use the PPS number of the individual over whose assets the Receiver is appointed?

- What, if any, forms are to be returned by the MIP in respect of the income?
- What is the due date for filing of returns?
- Will a separate return have to be made for each MIP or one return for all MIPs in a given tax year?
- Whether the MIP (financial institution)
  - needs to register for income tax in order to account for the tax liability arising,
  - must pay and file as an income tax payer,
  - must account for the USC (individuals)
  - can avail of any relief that may be claimable by the mortgagor and the mechanics of making such a claim?
- In relation to completion of Form 8-2 -Return of Third Party Information by Persons in receipt of Income of Others

   a. In some cases, on appointment as receiver over specified assets of a borrower, the Receiver will apply for a new tax reference number. In such cases this will be the reference number that will be included on the Form 8-2. However the receiver does not always apply for a separate PPSN. In these cases how is the Form 8-2 to be completed?

   b. Form 8-2 requests details of the income of others received by a third person (e.g. the receiver); however the form does not request details of the expenditure incurred by that person (the receiver) in connection with that income. Is the Receiver required to include details of the expenditure associated with that income as an appendix/attachment to Form 8-2?

- In cases where the Receiver has applied for new tax reference numbers on appointment as receiver, they have received pay and file reminder notices in respect of that number. This can cause confusion about what is required to be filed and when.
- What obligations if any does the financial institutions have in respect of preliminary income tax e.g. where rental income will be received over a period of years?