Irish Tax Institute

Leaders in Tax

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Response to 2013 consultation on the tax implications of appointing a receiver

Dear Sir / Madam

We welcome the opportunity to take part in this further consultation on the direct tax implications of appointing a receiver. Given the complexity of this area, we think it has been worthwhile to take the requisite time to consider the issues that were raised during last year's consultation process so as to devise a workable regime for the longer term. This is a very complex area of tax law involving a number of parties, often with different priorities – the receiver, the lender and the debtor/borrower. It is important to try and balance the needs of these parties with legislation that is as fair and equitable as possible for all involved.

The focus in our response to the consultation paper is on the practical application of what is proposed. In our comments we have identified aspects that are not fully clear so far from the proposals and put forward suggestions with a view to making the new regime more certain, efficient and workable for all sides. Insofar as there are further detailed and practical issues relating to the administration of the tax, it would be useful to explore these under the auspices of the Tax Administration Liaison Committee (TALC).

Please note that in this submission for ease of reference our use of the term "receiver" is intended to include reference to mortgagees-in-possession.

(a) General comments on the proposals

It is practical to say that the person who controls the asset and receives the rent or sales proceeds should be in a position to collect and remit the tax to Revenue. A receiver can

only do this to the extent that they have actual "cash" income in hand during the receivership period. This has been recognised in the legislative proposals put forward in the paper. Where a receiver does not have full information on the debtor's tax affairs, applying a flat rate of tax seems reasonable. We note that under the proposed regime the debtor will be filing their tax return based on accounts prepared under the accruals basis, while the return made by the receiver will be on a cash basis. Therefore, care will be needed to deal with possible mismatches in the timing and taxation of income that may arise, to avoid errors in refunds or assessments.

We have made a number of specific observations on the draft legislation in section (b) below, where we consider it may be unclear or incomplete.

We appreciate Revenue's positive response to our proposal that historical capital gains tax (CGT) information on Revenue's files be shared with a receiver where available. This will assist receivers in calculating any liabilities due under section 571 TCA 1997. We also welcome that, in the absence of full information to determine a CGT liability, Revenue will recognise a receiver's "best endeavours" in calculating the tax due. We have made some observations on this in our response to question 9 below. We would welcome extension of this information-sharing provision to other taxes, as indicated below.

(b) Comments and suggestions on the draft legislation

In reviewing the draft legislation we have sought to establish whether a receiver can be clear about what is required of them and whether the legislation is workable in practice. We have considered 4 key issues in reviewing the legislation:

- Is there **clarity** as to how the base is calculated (on which the relevant tax is to be applied)?
- Will the receiver be in a position to obtain the **information** necessary to discharge his/her duties in operating relevant tax?
- Are the obligations in relation to provision of **information to the debtor** clear and workable?
- How will the mechanics of the **offset/refund** operate?

Our observations are as follows:

Subsection 1: Definitions

It would appear that in calculating the "net receipts" for a specified period, receipts and outgoings are to be computed on a "cash basis".

"Receipts"

If it is the case that only cash receipts will be taken into account, this will mean, for example, that accrued rental income will not be treated as "receipts" until actually

received. However, an issue may arise where accrued rental income has been taxed in the hands of the debtor in the period prior to the receivership period (on the accruals basis) and is subject to tax again in the hands of the receiver when it is actually received (on the cash basis). In these circumstances, it seems that the receiver may avail of the option in subsection 2(b) and opt not to deduct relevant tax from this income, but only where comfortable the tax is refundable in full.

The draft legislation specifically excludes balancing charges and deemed receipts under Section 372AP(7) from the definition of "receipts". We believe the legislation should also explicitly exclude the deemed income arising on the release of a "specified debt" under section 87B TCA 1997 from the definition of receipts.

"Outgoings"

a) Receivers' expenses

   We would welcome clarification that the definition of "outgoings" would include receivers' expenses incurred in collecting the income.

b) Interest

   We note that in order for an expense to meet the definition of "outgoings", it must be allowable as a deduction, be expended by the receiver in the specified period and relate to or arise from the property. This definition could be interpreted as excluding interest paid on a loan in relation to the property because, in the main, the interest is not paid by the receiver but is debited by the financial institution to the borrower's account - receipts from the property are then offset against the interest and capital due.

   As interest is a cost associated with generating the rental income from a property it should rightly be deductible as part of the property's outgoings. Otherwise, substantial tax liabilities could be paid over to Revenue on account by the receiver in cases where no tax is in ultimately due by the debtor. This could result in an increase in the number of refund cases arising.

   The legislation should support the position that interest on a loan for a property in receivership is deemed to be expended by the receiver, for the purposes of calculating outgoings.

c) Trading stock

   It would seem that the definitions in subsection 1 are aimed at dealing with calculation of tax arising on **rental income**. Where receipts arise on the disposal of assets which are held as trading stock a deduction should be available for the carrying value of the stock in calculating the tax due. It is not clear from the definition of "outgoings" in subsection 1 that this is the case.

In the absence of a specific provision to include trading stock in the definition of outgoings it will be necessary to calculate the tax liability which would arise on the debtor in the "normal" way. In our comments on subsection 2 below we recommend that the receiver should be able to avail of the option to calculate and pay the tax under normal principles, if it can be correctly computed.

d) Criteria for deductibility

The receiver is obliged to determine whether each expense related to a rental property meets the criteria for deductibility set out in section 97 TCA 1997. This may not be a straightforward task in every case (for example, where numerous properties are involved) and a measure of judgment will be required to be exercised. We would welcome clarification in guidance that Revenue will take a practical approach to this issue.

Timing issues may also arise where, for example, a receiver does not know whether the debtor has taken a deduction (on the accruals basis) for a particular expense in the period prior to the receivership period. We note in response to subsection 14 below that this timing difference could also impact on the calculation of the refund.

The consultation paper cites the information-sharing powers contained in section 851A TCA 1997 as an appropriate avenue for dealing with information deficits relating to CGT. We propose that this approach be extended to circumstances where the receiver requires additional information in calculating tax due, for example in determining whether an expense meets the definition of "outgoings".

Subsection 2: Option not to deduct relevant tax

The principle of applying a flat rate in receivership situations where information is limited has merit. However situations do sometimes arise where there is sufficient information for the receiver to calculate the actual tax due. In these situations it should be possible for the receiver to calculate the tax liability based on the actual tax position of the debtor, with the option to follow the debtor's accounting period for filing purposes. We note that section 571 TCA 1997 allows the receiver to "step into the shoes" of the borrower for the purposes of calculating and remitting capital gains tax due.

Without an option to calculate the tax based on the actual figures where these are available, the receiver may be forced to pay over more relevant tax than they know should be due. This can arise in situations where there are losses etc available.

Under the legislation as currently drafted, the receiver may opt not to deduct relevant tax where they are satisfied that the tax **would be repayable in full** (following the filing of the debtor's tax return). However, it may be the case that the tax paid over by the receiver will ultimately not be repayable **in full** to the receiver, but the receiver has sufficient information on the debtor's overall tax position to know that there is likely to

be a partial refund e.g. due to the availability of losses etc to the debtor. This could lead to overpayments of relevant tax and again is a reason why the option to calculate tax based on the debtor's position is important.

The receiver is obliged under this subsection to keep and preserve records in support of their availing of the option not to deduct relevant tax. Revenue guidance on the type and extent of records that would be considered adequate in these circumstances would be welcome.

Subsection 3: The return

"Return date" is defined in subsection 1 as the date that falls 3 months after the end of the specified period. This is a very short timeframe within which to comply. From a practical perspective, receivers may be dealing with multiple debtors who have multiple property holdings both in their own capacity and through other arrangements, for example in partnership with others. It would be very difficult in these circumstances for a receiver to collate, prepare and submit the returns within a 3-month window. This deadline is also 6 months in advance of the corporation tax filing deadline and almost 8 months before the income tax filing deadline. While we understand that the relevant tax paid over is intended to be a payment on account of the debtor's tax liability, the work required to comply within this timeframe is extensive.

We think it would be reasonable to seek submission of the return one month in advance of the tax return filing deadline for the debtor. This would allow sufficient time for the debtor to enter a credit on his/her return for the tax payment made by the receiver, identified on the statement provided to the debtor.

Subsection 3 is quite clear on the details that must be included on the return. However, it is not clear whose tax number should be used to file the return, i.e. whether it is the receiver's or the debtor's tax number. This is important in terms of contacting Revenue subsequently on any return submitted.

From a Revenue systems perspective it would probably be sensible for filings to be made under the tax number of the debtor, given the related tax payment is a "payment on account" for the debtor.

It would be useful to discuss at an early stage how filings could be facilitated to minimise the administrative burden, e.g. to resolve questions as to whether a return will be required for each debtor or for each property, whether the receiver will be required to register for relevant tax in relation to each appointment/charge, whether ROS returns can be made etc. We believe that this discussion could be facilitated through TALC and we would be happy to engage in this process.

Subsection 5: Provision of statement to the debtor

Subsection 5 requires the receiver to provide a statement to the debtor at the time the

receiver files their return. This statement is required to set out details of what has been submitted to Revenue and what relevant tax the receiver has paid. Where the debtor's address is not known at the time the receiver files his return, the legislation requires that the statement must be provided to the debtor within 4 weeks of obtaining the debtor's address.

It is often the case that the relationship between the receiver and the debtor is strained. A receiver will often not be aware of the debtor's current address. In some cases, a debtor may have left the jurisdiction and is unlikely to contact the receiver or financial institution on their return. In its current form, subsection 5 would appear to provide for an open-ended period for provision of the statement to the debtor, which may even extend beyond the date when the receiver is discharged.

We believe that there should be some parameters around how long this obligation should last for and it should not be open-ended. If the taxpayer's current address is unknown to the receiver, by the time the final return for the receivership is filed by the receiver, then the obligation to provide the statement to the debtor should cease.

If either the debtor or Revenue require any additional information from the receiver relating to any transactions undertaken by them, it should be open to them to request same, subject to the time limits on the obligation to retain records.

Where the receiver has provided a statement to a debtor the legislation is unclear as to how, in the event of a dispute, an assertion that the information has been provided could be supported. This is important due to the provision in subsection 7 that the receiver can be liable to a penalty of €1,000 for failure to meet this obligation. It is equally unclear as to whether there is an obligation on the receiver to actively trace the debtor where his/her whereabouts are unknown. We would welcome clarification on these two points.

Subsection 8, 9 and 10: An assessment

These sections allow Revenue to raise assessments or make adjustments where they are of the view that tax has been underpaid or where items are incorrectly included as relevant income. It may be the case that, when the assessment is raised, a receiver may no longer be in place and will no longer have access to the funds to deal with any underpayments.

If it is not possible to address this in the legislation, clear Revenue guidance will be needed on dealing with the practicalities that could arise.

Subsection 14: Offsettable tax and refunds of overpaid relevant tax

Subsection 14 sets out how "offsettable tax" will be calculated where a debtor files a tax return with Revenue, after the receiver has paid over the relevant tax. It also provides that the receiver will receive a refund of the excess of tax deducted and remitted to Revenue over this offsettable tax. There are a number of aspects to this that are unclear

in the legislation:

(a) We assume from reading the legislation that Revenue will automatically review the position to determine whether a refund is due to the receiver when the debtor's return is filed and will notify the receiver of the amount due. This is important as the receiver will not be in a position to know that a refund is due, or even, indeed, that the debtor has filed a return.
(b) As highlighted above, a mismatch may arise between the period the payment on account has been made by the receiver on a cash basis, and the period when the income is returned to Revenue by the borrower on an accruals basis. Where mismatches arise it should be possible to carry the credit for the payment made on account to earlier or later periods.
(c) It is not clear if the 4-year time limit under section 865 TCA 1997 applies in these circumstances.
(d) Presumably, where a receiver has paid over the relevant tax, and a refund arises, the receiver will receive the refund even if they have been subsequently discharged.
(e) Where it is the case that the debtor discharges their loans so no amounts are owing to the financial institution, there is no provision in the legislation for the debtor to receive the refund.
(f) It is not clear how a refund will be allocated in a case where multiple receivers have been appointed.
(g) Due to the operation of the formula a refund may not be available to the receiver where tax has been overpaid on the stream of income they received.

In relation to (d) and (e) above, from a logical point of view it should be the case that the person who made the tax payment receives the refund. We would suggest that the legislation in subsection 14(c) be amended to reflect that the excess shall be repaid to the specified person who made the payment. It will then be up to that person to allocate the refund to the party to whom it is due.

(c) Institute views on the specific questions raised

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

The proposals provide for greater certainty than is currently the case, which is welcome. We have commented in section (b) above on aspects of the legislation where greater clarity is required to facilitate correct and timely return of the relevant tax due.

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?

We believe that the proposed approach would address the concerns raised on behalf of lenders during the initial consultation that tax policy could inappropriately influence a

commercial decision.

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

In the previous consultation we raised concerns that transferring the primary tax liability on income from the debtor to the receiver/lender may result in a perception of more favourable treatment for those in the receivership process than those outside it. Under the current proposals, the primary liability would rest with the debtor; we think this addresses this concern.

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

There will be significant compliance costs for receivers in administering this regime. There will be an obligation on them to:

- determine whether expenses qualify as deductible "outgoings",
- determine whether they should avail of the option not to deduct relevant tax,
- calculate any relevant tax due,
- prepare the returns and remit the relevant tax,
- provide statements to debtors, and
- properly allocate any refunds they receive to the relevant party.

To reduce the compliance burden as far as is possible consideration will need to be given to ways to streamline the filing process. For example, having a shorter return form for receivers, allowing filings to be uploaded via ROS, clear Revenue guidance etc. These types of issues could be explored in more depth at TALC.

The proposed penalties are also quite substantial if the provisions are not followed correctly. To alleviate the administrative burden to some extent, it will be important, as outlined above, to make provision for the receiver to be able to access as much information relating to the debtors circumstances as is necessary for him/her to fulfil his/her obligations.

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

While it is logical to treat both individual and corporates in a similar manner when dealing with for example rental income, it is also appropriate that different rates of withholding tax would apply (i.e. the 10% withholding rate for corporates and the 20% rate for individual debtors, provided in the draft legislation).

It can happen that a receiver has more information available to them in certain cases which would enable them to calculate the correct tax liability due. As highlighted above we think it is important to have the option to calculate tax based on the actual position of

the debtor, where sufficient information is available.

As pointed out above, the definition in subsection 1 does not seem to cover situations where the proceeds on disposal of assets as trading stock are assessed as trading receipts. It would therefore be necessary to include trading stock in the definition of "outgoings" and/or to allow calculation of the tax liability based on the actual position of the debtor.

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?

Refunds will have to be initiated by Revenue on a timely basis when the debtor files their return, as the receiver will not be in a position to know that the return has been filed and that a refund is owing.

The refund provision also appears to propose that a refund can only arise where the tax paid over by the receiver relates to the same period for which a return is filed by the borrower. As a result of the timing difference between the accruals and cash receipts basis, a mismatch may occur. It should be possible that payments on account be matched to earlier or later periods where necessary.

As noted in subsection 2, an option to calculate and pay the actual tax due where this is feasible would prevent the over deduction of relevant tax by a receiver in the first instance.

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

As noted in our comments on subsection 1 the current definitions do not seem to address the tax position where assets are sold as trading stock i.e. the definition of "outgoings" does not cover a deduction for the carrying value of trading stock.

We have pointed out aspects of the refund provision where further clarity is needed.

As pointed out in section (b) above, the requirement for the receiver to provide a statement to the debtor is likely to prove problematic in practice in situations where debtors have left the jurisdiction or cannot otherwise be located.

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

The repeal of Section 96(3) will mean that an individual debtor will now clearly have primary liability for income tax and USC (as well as PRSI) on rental income and on balancing events. In a receivership situation the debtor will not be in receipt of the rental income or in control of the property once a receiver has been appointed. Difficulties may arise for the debtor in paying any balance of tax due, over and above the tax withheld and paid over by the receiver.

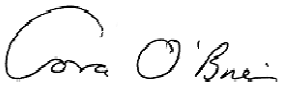
Question 9: Is the approach of maintaining Section 571 TCA 1997 intact and enhancing its operation through information sharing a good one?

As noted in section (a) above, we believe that this is a useful development. We would ask that where information is incomplete and a receiver has completed and returned CGT based on their "best endeavours", that some comfort be made available to the receiver that he/she has met his/her obligation and that the matter is closed.

We would welcome clarification on the appropriate procedure that must be used in submitting a return of the CGT liability e.g. whether it is the case that a Form 11 must be submitted, on the basis that it is an income tax assessment, or on a Form CG1. Currently it is not clear which is required, or which filing and payment dates apply. These aspects could be further discussed in due course.

We are available to discuss further any of the matters raised in this submission.

Yours truly



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